INSTEEL INDUSTRIES INC
Form 10-Q
February 08, 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 January 1, 2011

OR

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

For the Transition Period From ________ to ________

Commission File Number: 1-9929

Insteel Industries, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

Yes þ No o

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

Yes o No o

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

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 February 7, 2011 was 17,579,037.

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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	
	January 1, 2011	January 2, 2010
Net sales	$ 52,306	$ 41,201
Cost of sales	52,441	37,526
Inventory write-downs		1,933
Gross profit (loss)	(135)	1,742
Selling, general and administrative expense	4,168	3,742
Acquisition costs	2,750	
Restructuring charges	4,390	
Other income, net	(13)	(153)
Interest expense	151	148
Interest income	(13)	(12)
Loss from continuing operations before income taxes	(11,568)	(1,983)
Income taxes	(3,940)	(860)
Loss from continuing operations	(7,628)	(1,123)
Loss from discontinued operations net of income taxes of $ - and ($8)		(13)
Net loss	$ (7,628)	$ (1,136)
Per share amounts:		
Basic:		
Loss from continuing operations	$ (0.44)	$ (0.07)
Loss from discontinued operations		
Net loss	$ (0.44)	$ (0.07)
Diluted:		
Loss from continuing operations	$ (0.44)	$ (0.07)
Loss from discontinued operations		
Net loss	$ (0.44)	$ (0.07)
Cash dividends declared	$ 0.03	$ 0.03

Weighted average shares outstanding		
Basic	17,511	17,410
Diluted	17,511	17,410

See accompanying notes to consolidated financial statements.

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

	(Unaudited) January 1, 2011	October 2, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 2,787	$ 45,935
Accounts receivable, net	22,356	24,970
Inventories, net	61,062	43,919
Prepaid expenses and other	4,961	3,931
Total current assets	91,166	118,755
Property, plant and equipment, net	91,521	58,653
Other assets	7,583	5,097
Total assets	$ 190,270	$ 182,505
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 22,342	$ 20,689
Accrued expenses	8,316	5,929
Current portion of long-term debt	675	
Current liabilities of discontinued operations		210
Total current liabilities	31,333	26,828
Long-term debt	12,825	
Other liabilities	5,852	7,521
Long-term liabilities of discontinued operations		280
Commitments and contingencies		
Shareholders equity:		
Common stock	17,579	17,579
Additional paid-in capital	46,489	45,950
Retained earnings	78,501	86,656
Accumulated other comprehensive loss	(2,309)	(2,309)
Total shareholders equity	140,260	147,876
Total liabilities and shareholders equity	$ 190,270	$ 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)

	Three Months Ended	
	January 1, 2011	January 2, 2010
Cash Flows From Operating Activities:		
Net loss	$ (7,628)	$ (1,136)
Loss from discontinued operations		13
Loss from continuing operations	(7,628)	(1,123)
Adjustments to reconcile loss from continuing operations to net cash used for operating activities of continuing operations:		
Depreciation and amortization	2,054	1,715
Amortization of capitalized financing costs	20	125
Stock-based compensation expense	539	487
Asset impairment charges	2,868	
Inventory write-downs		1,933
Excess tax benefits from stock-based compensation		(11)
Loss on sale of property, plant and equipment		11
Deferred income taxes	(3,969)	(345)
Increase in cash surrender value of life insurance over premiums paid	(248)	
Net changes in assets and liabilities (net of assets and liabilities acquired):		
Accounts receivable, net	2,614	3,513
Inventories	3,442	(1,840)
Accounts payable and accrued expenses	(4,038)	(14,525)
Other changes	(745)	289
Total adjustments	2,537	(8,648)
Net cash used for operating activities continuing operations	(5,091)	(9,771)
Net cash used for operating activities discontinued operations		(29)
Net cash used for operating activities	(5,091)	(9,800)
Cash Flows From Investing Activities:		
Acquisition of business	(37,588)	
Capital expenditures	(506)	(327)
Increase in cash surrender value of life insurance policies		(111)
Net cash used for investing activities continuing operations	(38,094)	(438)
Net cash used for investing activities	(38,094)	(438)

Cash Flows From Financing Activities:		
Proceeds from long-term debt	109	52
Principal payments on long-term debt	(109)	(52)
Cash received from exercise of stock options		17
Excess tax benefits from stock-based compensation		11
Cash dividends paid		(526)
Other	37	(32)
Net cash provided by (used for) financing activities continuing operations	37	(530)
Net cash provided by (used for) financing activities	37	(530)
Net decrease in cash and cash equivalents	(43,148)	(10,768)
Cash and cash equivalents at beginning of period	45,935	35,102
Cash and cash equivalents at end of period	$ 2,787	$ 24,334
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 36	$ 24
Income taxes	709	
Non-cash investing and financing activities:		
Purchases of property, plant and equipment in accounts payable	73	92
Declaration of cash dividends to be paid	527	
Restricted stock surrendered for withholding taxes payable		7
Note payable issued as consideration for business acquired	13,500	

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 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				(7,628)		(7,628)
Comprehensive loss						(7,628)
Compensation expense associated with stock-based plans			539			539
Cash dividends declared				(527)		(527)
Balance at January 1, 2011	17,579	$ 17,579	$ 46,489	$ 78,501	$ (2,309)	$ 140,260

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

The accompanying unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that the Company considers necessary for a fair presentation of results for these interim periods. The results of operations for the three-month period ended January 1, 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 14 to the consolidated financial statements).

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

(2) Recent Accounting Pronouncements

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

(3) 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.

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As of January 1, 2011, the Company held financial assets that are required to be measured at fair value on a recurring basis. The financial assets held by the Company and the fair value hierarchy used to determine their fair values are as follows:

(In thousands)	**Total**	**Quoted Prices in Active Markets (Level 1)**	**Observable Inputs (Level 2)**
Current assets:			
Cash equivalents	$ 3,732	$ 3,732	$
Other assets:			
Cash surrender value of life insurance policies	4,736		4,736
Total	$ 8,468	$ 3,732	$ 4,736

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 January 1, 2011.

As of January 1, 2011, the Company had no nonfinancial assets that are required to be measured at fair value on a nonrecurring basis other than the assets and liabilities acquired from Ivy (see Note 14 to the consolidated financial statements) that were acquired at fair value. The carrying amounts of accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term maturities of these financial instruments. The Company believes that the carrying amount of the $13.5 million secured subordinated promissory note approximates fair value based on comparable debt with similar terms, conditions and proximity to the issue date, which would be considered a level 2 input.

(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 has liquidated the assets of the business. 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.

Liabilities of discontinued operations as of January 1, 2011 and October 2, 2010 are as follows:

(In thousands)	**January 1, 2011**	**October 2, 2010**
Liabilities:		
Current liabilities:		
Accrued expenses	$	$ 210
Total current liabilities		210
Other liabilities		280

Total liabilities	$	$ 490

(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 January 1, 2011, there were 409,000 shares available for future grants under the plans.

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***Stock option awards*.** Under the Company s equity incentive plans, employees and directors may be granted options to purchase shares of the Company s common stock at the fair market value on the date of the grant. Options granted under these plans generally vest over three years and expire ten years from the date of the grant. Compensation expense and excess tax benefits associated with stock options for the three-month periods ended January 1, 2011 and January 2, 2010 are as follows:

	Three Months Ended	
(in thousands)	**January 1, 2011**	**January 2, 2010**
Stock options:		
Compensation expense	$ 227	$ 213
Excess tax benefits		11

As of January 1, 2011, the remaining unamortized compensation cost related to unvested stock option awards was $654,000, which is expected to be recognized over a weighted average period of 1.24 years.

The fair value of each option grant is estimated on the date of grant using a Monte Carlo valuation model based upon assumptions that are evaluated and revised, as necessary, to reflect market conditions and actual historical experience. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The dividend yield is calculated based on the Company s annual dividend as of the option grant date. The expected volatility is derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on the Company s common stock. The expected term for options is based on the results of a Monte Carlo simulation model, using the model s estimated fair value as an input to the Black-Scholes-Merton model, and then solving for the expected term. There were no stock option grants during the three-month periods ended January 1, 2011 and January 2, 2010.

The following table summarizes stock option activity for the three-month period ended January 1, 2011:

	Options Outstanding *(in thousands)*	Exercise Price Per Share Range			Exercise Price Per Share Weighted Average	Contractual Term - Weighted Average	Aggregate Intrinsic Value *(in thousands)*
Outstanding at October 2, 2010	847	$ 0.18	-	$ 20.27	$ 10.63		
Granted			-				
Expired			-				
Exercised			-				
Outstanding at January 1, 2011	847	0.18	-	20.27	10.63	7.09 years	$ 2,797
Vested and anticipated to vest in the future at January 1, 2011	828				10.64	7.06 years	2,734
Exercisable at January 1, 2011	461				11.28	5.78 years	1,530

Restricted stock awards. Under the Company s equity incentive plans, employees and directors may be granted restricted stock awards (RSAs) which are valued based upon the fair market value on the date of the grant. Restricted stock granted under these plans generally vests one to three years from the date of the grant. There were no restricted stock grants during the three-month periods ended January 1, 2011 and January 2, 2010. Amortization expense for restricted stock for the three-month periods ended January 1, 2011 and January 2, 2010 is as follows:

	Three Months Ended	
(In thousands)	**January 1, 2011**	**January 2, 2010**
Amortization expense	$ 66	$ 130

As of January 1, 2011, the remaining unrecognized compensation cost related to unvested restricted stock awards was $100,000, which is expected to be recognized over a weighted average vesting period of 0.54 years.

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The following table summarizes restricted stock activity during the three-month period ended January 1, 2011:

(Share amounts in thousands)	**Restricted Stock Awards Outstanding**	**Weighted Average Grant Date Fair Value**
Balance, October 2, 2010	67	$ 13.37
Granted		
Released		
Balance, January 1, 2011	67	$ 13.37

Restricted stock units. On January 21, 2009, the Executive Compensation Committee of the Board of Directors approved a change in the equity compensation program such that awards of restricted stock units (RSUs) to employees and directors would be made in lieu of awards of restricted stock. RSUs granted under these plans are valued based upon the fair market value on the date of the grant and provide for a dividend equivalent payment which is included in compensation expense. The vesting period for RSUs is generally one to three years from the date of the grant. RSUs do not have voting rights. There were no RSU grants during the three-month periods ended January 1, 2011 and January 2, 2010. Amortization expense for RSUs for the three-month periods ended January 1, 2011 and January 2, 2010 is as follows:

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