INSTEEL INDUSTRIES INC
Form 10-Q
April 18, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 30, 2019

OR

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

For the transition period from ________ to ________

Commission File Number: 1-9929

Insteel Industries, Inc.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive offices)	(Zip Code)

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

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

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [X]
	Smaller reporting company [ ]
Non-accelerated filer [ ]	
	Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

Yes [ ] No [X]

The number of shares outstanding of the registrant's common stock as of April 17, 2019 was 19,251,607.

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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 per share amounts)
(Unaudited)

	Three Months Ended		**Six Months Ended**	
	March 30, 2019	**March 31, 2018**	**March 30, 2019**	**March 31, 2018**
Net sales	$111,948	$107,417	$216,058	$205,158
Cost of sales	104,927	92,001	198,061	178,081
Gross profit	7,021	15,416	17,997	27,077
Selling, general and administrative expense	6,556	7,475	13,090	13,238
Other expense (income), net	(971)	166	(1,800)	185
Interest expense	45	23	75	51
Interest income	(12)	(53)	(167)	(129)
Earnings before income taxes	1,403	7,805	6,799	13,732
Income taxes	354	1,926	1,624	(258)
Net earnings	$1,049	$5,879	$5,175	$13,990
Net earnings per share:				
Basic	$0.05	$0.31	$0.27	$0.73
Diluted	0.05	0.31	0.27	0.73
Weighted average shares outstanding:				
Basic	19,242	19,052	19,233	19,047
Diluted	19,340	19,258	19,338	19,241

Cash dividends declared per share	$0.03	$0.03	$0.06	$1.06
Comprehensive income	$1,049	$5,879	$5,175	$13,990

See accompanying notes to consolidated financial statements.

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

	(Unaudited) March 30, 2019	September 29, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 490	$ 43,941
Accounts receivable, net	50,574	51,484
Inventories	117,227	94,157
Other current assets	6,265	5,895
Total current assets	174,556	195,477
Property, plant and equipment, net	109,377	106,148
Intangibles, net	9,157	9,703
Goodwill	8,293	8,293
Other assets	10,188	9,913
Total assets	$ 311,571	$ 329,534
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 35,124	$ 60,059
Accrued expenses	5,991	11,929
Total current liabilities	41,115	71,988
Long-term debt	5,365	-
Other liabilities	18,561	15,881
Commitments and contingencies		
Shareholders' equity:		
Common stock	19,252	19,223
Additional paid-in capital	73,667	72,852
Retained earnings	155,105	151,084
Accumulated other comprehensive loss	(1,494)	(1,494)
Total shareholders' equity	246,530	241,665
Total liabilities and shareholders' equity	$ 311,571	$ 329,534

See accompanying notes to consolidated financial statements.

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

	Six Months Ended March 30, 2019			March 31, 2018		
Cash Flows From Operating Activities:						
Net earnings	$	5,175		$	13,990	
Adjustments to reconcile net earnings to net cash provided by (used for) operating activities:						
Depreciation and amortization		6,622			6,409	
Amortization of capitalized financing costs		32			32	
Stock-based compensation expense		1,019			1,073	
Deferred income taxes		2,136			(2,270	)
Loss (gain) on sale and disposition of property, plant and equipment		(1,758	)		221	
Increase in cash surrender value of life insurance policies over premiums paid		(62	)		(275	)
Net changes in assets and liabilities (net of assets and liabilities acquired):						
Accounts receivable, net		910			(10,171	)
Inventories		(23,070	)		18,697	
Accounts payable and accrued expenses		(30,357	)		(4,218	)

Other changes	(838)	1,005
Total adjustments	(45,366)	10,503
Net cash provided by (used for) operating activities	(40,191)	24,493
Cash Flows From Investing Activities:		
Capital expenditures	(8,107)	(9,316)
Acquisition of business	-	(3,300)
Proceeds from surrender of life insurance policies	18	121
Increase in cash surrender value of life insurance policies	(263)	(245)
Proceeds from property insurance	1,048	-
Proceeds from sale of property, plant and equipment	8	-
Net cash used for investing activities	(7,296)	(12,740)
Cash Flows From Financing Activities:		
Proceeds from long-term debt	17,626	169
Principal payments on long-term debt	(12,261)	(169)
Cash dividends paid	(1,154)	(20,184)
Payment of employee tax withholdings related to net share transactions	(175)	(210)
Net cash provided by (used for) financing activities	4,036	(20,394)
Net decrease in cash and cash equivalents	(43,451)	(8,641)
Cash and cash equivalents at beginning of period	43,941	32,105
Cash and cash equivalents at end of period	$ 490	$ 23,464

Supplemental Disclosures of Cash

Flow Information:				
Cash paid during the period for:				
Income taxes, net	$	1,387	$	1,060
Non-cash investing and financing activities:				
Purchases of property, plant and equipment in accounts payable		497		1,233
Restricted stock units and stock options surrendered for withholding taxes payable		175		210

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
For the six months ended March 30, 2019						
Balance at September 29, 2018	19,223	$19,223	$72,852	$151,084	$(1,494)	$241,665
Net earnings				4,126		4,126
Compensation expense associated with stock-based plans			174			174
Restricted stock units and stock options surrendered for withholding taxes payable			(7)			(7)
Cash dividends declared				(576)		(576)
Balance at December 29, 2018	19,223	19,223	73,019	154,634	(1,494)	245,382
Net earnings				1,049		1,049
Vesting of restricted stock units	29	29	(29)			-
Compensation expense associated with stock-based plans			845			845
Restricted stock units and stock options surrendered for withholding taxes payable			(168)			(168)
Cash dividends declared				(578)		(578)
Balance at March 30, 2019	19,252	$19,252	$73,667	$155,105	$(1,494)	$246,530
For the six months ended March 31, 2018						
Balance at September 30, 2017	19,041	$19,041	$69,817	$135,851	$(1,333)	$223,376
Net earnings				8,111		8,111
Compensation expense associated with stock-based plans			235			235
Cash dividends declared				(19,612)		(19,612)
Balance at December 30, 2017	19,041	19,041	70,052	124,350	(1,333)	212,110
Net earnings				5,879		5,879
Stock options exercised, net	2	2	(2)			-
Vesting of restricted stock units	20	20	(20)			-
			838			838

Compensation expense associated with stock-based plans						
Restricted stock units and stock options surrendered for withholding taxes payable			(210)			(210)
Cash dividends declared				(572)		(572)
Balance at March 31, 2018	19,063	$19,063	$70,658	$129,657	$(1,333)	$218,045

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 United States (“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 U.S. (“GAAP”) have been condensed or omitted pursuant to such rules and regulations, although we believe the disclosures made are adequate to make the information not misleading. The September 29, 2018 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 September 29, 2018 included in our Annual Report on Form 10-K filed with the SEC on October 26, 2018.

The accompanying unaudited interim consolidated financial statements reflect all adjustments of a normal recurring nature that we consider necessary for a fair presentation of results for these interim periods. The results of operations for the six-month period ended March 30, 2019 are not necessarily indicative of the results that may be expected for the fiscal year ending September 28, 2019 or future periods.

We have evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q and concluded 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

Current Adoptions

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15 "Statement of Cash Flows Topic 230: Classification of Certain Cash Receipts and Cash Payments." ASU No. 2016-15 addresses how certain cash receipts and cash payments are presented and classified in the statement of cash flows with the objective of reducing existing differences in the presentation of these items. The amendments in ASU No. 2016-15 became effective for us in the first quarter and were adopted retrospectively. The adoption of this update did not impact our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers," as subsequently amended, which supersedes 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. We adopted ASU 2014-09 during the first quarter using the modified retrospective method. The adoption of this update did not significantly change our policies for recognizing revenue nor materially impact our consolidated financial statements (see Note 3).

Future Adoptions

In May 2017, the FASB issued ASU No. 2017-09 "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting." ASU No. 2017-09 was issued to clarify and reduce both (i) diversity in practice and (ii) cost and complexity when applying its guidance to changes in the terms and conditions of a share-based payment award. ASU No. 2017-09 will become effective for us in the first quarter of fiscal 2020. We are evaluating the impact that the adoption of this update will have on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04 "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. ASU No. 2017-04 will become effective for us in the first quarter of fiscal 2021 and early adoption is permitted. We are evaluating the impact that the adoption of this update will have on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 “Leases,” which will replace the guidance in Accounting Standards Codification (“ASC”) Topic 840. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset. ASU No. 2016-02 will become effective for us in the first quarter of fiscal 2020. In July 2018, the FASB issued ASU No. 2018-11, “Leases (Topic 842): Targeted Improvements,” which provides an additional (and optional) transition method whereby the new lease standard is applied at the adoption date and recognized as an adjustment to retained earnings. The amendment has the same effective date and transition requirements as ASU No. 2016-02. We are evaluating the impact that the adoption of these updates will have on our consolidated financial statements.

(3) Revenue Recognition

We recognize revenues when obligations under the terms of a contract with our customers are satisfied, which generally occurs when products are shipped and control is transferred. We enter into contracts that pertain to products, which are accounted for as separate performance obligations and typically one year or less in duration. We do not exercise significant judgment in determining the timing for the satisfaction of performance obligations or the transaction price. Revenue is measured as the amount of consideration expected to be received in exchange for our products. We have elected to apply the practical expedient provided for in ASU No. 2014-09 and not disclose information regarding remaining performance obligations that have original expected durations of one year or less.

Variable consideration that may affect the total transaction price, including contractual discounts, rebates, returns and credits are included in net sales. Estimates for variable consideration are based on historical experience, anticipated performance and management's judgment and are updated as of each reporting date. Shipping and related expenses associated with outbound freight are accounted for as fulfillment costs and included in cost of sales. We do not have significant financing components.

The following table disaggregates our net sales by product line:

	Three Months Ended		**Six Months Ended**	
(In thousands)	**March 30, 2019**	**March 31, 2018**	**March 30, 2019**	**March 31, 2018**
Welded wire reinforcement	$68,941	$64,806	$135,219	$121,697
Prestressed concrete strand	43,007	42,611	80,839	83,461
Total	$111,948	$107,417	$216,058	$205,158

The following table disaggregates our net sales by geography based on the shipping addresses of our customers:

	Three Months Ended		**Six Months Ended**	
(In thousands)	**March 30, 2019**	**March 31, 2018**	**March 30, 2019**	**March 31, 2018**
United States	$111,620	$106,930	$215,241	$204,213
Foreign	328	487	817	945
Total	$111,948	$107,417	$216,058	$205,158

Contract assets primarily relate to our rights to consideration for products that are delivered but not billed as of the reporting date and are reclassified to receivables when the customer is invoiced. Contract liabilities primarily relate to performance obligations that are to be satisfied in the future and arise when we bill the customer in advance of shipments. Contract costs are not significant and are recognized as incurred. Contract assets and liabilities were not material as of March 30, 2019.

Accounts receivable includes amounts billed and currently due from customers stated at their net estimated realizable value. Customer payment terms are generally 30 days. We maintain an allowance for doubtful accounts to provide for the estimated amount of receivables that will not be collected, which is based upon our assessment of customer creditworthiness, historical payment experience and the age of outstanding receivables. Past-due trade receivable balances are written off when our collection efforts have been unsuccessful.

(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 March 30, 2019 and September 29, 2018, we held financial assets that are required to be measured at fair value on a recurring basis, which are summarized below:

(In thousands)	**Total**	**Quoted Prices in Active Markets (Level 1)**	**Observable Inputs (Level 2)**
As of March 30, 2019:			
Other assets:			
Cash surrender value of life insurance policies	$10,076	$ -	$ 10,076
Total	$10,076	$ -	$ 10,076

As of September 29, 2018:			
Current assets:			
Cash equivalents	$44,257	$44,257	$ -
Other assets:			
Cash surrender value of life insurance policies	9,769	-	9,769
Total	$54,026	$44,257	$ 9,769

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 our 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 we would receive upon surrender of these policies as of the reporting date.

As of March 30, 2019 and September 29, 2018, we had no nonfinancial assets that were required to be measured at fair value on a nonrecurring basis. 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 carrying amount of long-term debt outstanding under our revolving credit facility approximates its estimated fair value. The estimated fair value of long-term debt is primarily based upon quoted market prices as well as borrowing rates currently available to us for bank loans with similar terms and maturities.

(5) Intangible Assets

The primary components of our intangible assets and the related accumulated amortization are as follows:

(In thousands)	Gross Amount	Accumulated Amortization	Net Book Value
As of March 30, 2019:			
Customer relationships	$ 9,070	$ (1,902)	$ 7,168
Developed technology and know-how	1,800	(416)	1,384
Non-competition agreements	1,800	(1,286)	514
Trade name	140	(49)	91
	$ 12,810	$ (3,653)	$ 9,157
As of September 29, 2018:			
Customer relationships	$ 9,070	$ (1,598)	$ 7,472
Developed technology and know-how	1,800	(371)	1,429
Non-competition agreements	3,687	(2,994)	693
Trade name	140	(31)	109
	$ 14,697	$ (4,994)	$ 9,703

Amortization expense for intangibles was $273,000 and $359,000 for the three-month periods ended March 30, 2019 and March 31, 2018, respectively, and $546,000 and $688,000 for the six-month periods ended March 30, 2019 and March 31, 2018, respectively. We completed the acquisition of a business during the six-month period ended March 31, 2018, and the effects of the purchase price allocation for this transaction on the accompanying consolidated financial statements were not material.

(6) Stock-Based Compensation

Under our equity incentive plan, employees and directors may be granted stock options, restricted stock, restricted stock units and performance awards. Effective February 17, 2015, our shareholders approved the 2015 Equity Incentive Plan of Insteel Industries, Inc. (the “2015 Plan”), which authorizes up to 900,000 shares of our 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 March 30, 2019, there were 241,000 shares of our common stock available for future grants under the 2015 Plan, which is our only active equity incentive plan.

Stock option awards**.** Under our equity incentive plan, employees and directors may be granted options to purchase shares of common stock at the fair market value on the date of the grant. Options granted under these plans generally vest over three years and expire ten years from the date of the grant. Compensation expense associated with stock options was $383,000 and $381,000 for the three-month periods ended March 30, 2019 and March 31, 2018, respectively, and $438,000 and $471,000 for the six-month periods ended March 30, 2019 and March 31, 2018, respectively. As of March 30, 2019, there was $272,000 of unrecognized compensation cost related to unvested options which is expected to be recognized over a weighted average period of 1.66 years.

The fair value of each option award granted is estimated on the date of grant using a Monte Carlo valuation model. The estimated fair values of stock options granted during the three- and six-month periods ended March 30, 2019 and March 31, 2018 was $7.96 and $10.46 per share, respectively, based on the following assumptions:

	Six Months Ended	
	March 30, 2019	**March 31, 2018**
Risk-free interest rate	3.84 %	2.72 %
Dividend yield	0.50 %	0.40 %
Expected volatility	43.08 %	37.74 %
Expected term (in years)	4.56	4.89

The assumptions utilized in the Monte Carlo valuation model 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 was based on the U.S. Treasury yield curve in effect at the time of the grant. The dividend yield was calculated based on our annual dividend as of the option grant date. The expected volatility was derived using a term structure based on historical volatility and the volatility implied by exchange-traded options on our common stock. The expected term for options was based on the results of a Monte Carlo simulation model, using the model's estimated fair value as an input to the Black-Scholes-Merton model, and then solving for the expected term.

The following table summarizes stock option activity:

	Options Outstanding *(in thousands)*	Exercise Price Per Share Range			Weighted Average	Contractual Term - Weighted Average *(in years)*	Aggregate Intrinsic Value *(in thousands)*
Outstanding at September 29, 2018	264	$10.23	-	$41.85	$ 29.25		
Granted	58	21.57	-	21.57	21.57		
Exercised	(5)	18.05	-	26.75	23.95		$ 21
Outstanding at March 30, 2019	317	10.23	-	41.85	27.93	7.83	205
Vested and anticipated to vest in the future at March 30, 2019	313				27.91	7.81	205
Exercisable at March 30, 2019	145				26.05	6.38	205

Stock option exercises include “net exercises” for 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 our 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. Compensation expense associated with RSUs was $462,000 and $457,000 for the three-month periods ended March 30, 2019 and March 31,2018, respectively, and $581,000 and $602,000 for the six-month periods ended March 30, 2019 and March 31,2018, respectively. The market value of RSUs granted during the three- and six- month periods ended March 30, 2019 and March 31, 2018 was $763,000 and $712,000, respectively.

As of March 30, 2019, there was $611,000 of unrecognized compensation cost related to unvested RSUs which is expected to be recognized over a weighted average period of 1.62 years.

The following table summarizes RSU activity:

Weighted

(Unit amounts in thousands)	**Restricted Stock Units Outstanding**	**Average Grant Date Fair Value**
Balance, September 29, 2018	103	$ 30.40
Granted	35	21.57
Released	(36)	25.28
Balance, March 30, 2019	102	29.16

(7) Income Taxes

Effective income tax rate**.** Our effective income tax rate was 23.9% for the six-month period ended March 30, 2019 compared with (1.9%) for the six-month period ended March 31, 2018. 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. On December 22, 2017, the Tax Cuts and Jobs Act (the “Act”) was enacted, which, among other changes, reduced the federal statutory corporate tax rate from 35% to 21% effective January 1, 2018. Based on the provisions of the Act, we remeasured our deferred tax assets and liabilities and adjusted our estimated annual federal income tax rate to incorporate the lower corporate tax rate into our first quarter tax provision for the prior year which resulted in a $3.7 million reduction of income tax expense. Since our fiscal year ends on the Saturday closest to September 30 rather than the calendar year, we are subject to IRS rules relating to transitional income tax rates. As a result, our federal statutory rate is 21% for fiscal 2019 and beyond, but was 24.5% for fiscal 2018.

Deferred income taxes. As of March 30, 2019, we recorded a deferred tax liability (net of valuation allowance) of $7.5 million in other liabilities on our consolidated balance sheet. We have $2.1 million of state net operating loss carryforwards ("NOLs") that begin to expire in 2022, but principally expire between 2022 and 2031. We have also recorded gross deferred tax assets of $16,000 for various state tax credits that begin to expire in 2019, but principally expire between 2019 and 2020.

The realization of our deferred tax assets is entirely dependent upon our ability to generate future taxable income in applicable jurisdictions. GAAP requires that we periodically assess the need to establish a reserve against our deferred tax assets to the extent we no longer believe it is more likely than not that they will be fully realized. As of March 30, 2019 and September 29, 2018, we recorded a valuation allowance of $265,000 and $233,000, respectively, pertaining to various state NOLs and tax credits that were not expected to be utilized. The valuation allowance is subject to periodic review and adjustment based on changes in facts and circumstances and would be reduced should we 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 March 30, 2019, we had no material, known tax exposures that required the establishment of contingency reserves for uncertain tax positions.

We file U.S. federal, state and local income tax returns in various jurisdictions. Federal and various state tax returns filed subsequent to 2013 remain subject to examination.

(8) Employee Benefit Plans

Supplemental employee retirement plan. We have Retirement Security Agreements (each, a "SERP") with certain of our employees (each, a "Participant"). Under the SERPs, if the Participant remains in continuous service with us for a period of at least 30 years, we will pay 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 us, but has completed at least 10 years of continuous service, the amount of the Participant's supplemental retirement benefit will be reduced by 1/360th for each month short of 30 years that the Participant was employed by us.

Net periodic pension cost for the SERPs includes the following components:

	Three Months Ended		Six Months Ended	
(In thousands)	**March 30, 2019**	**March 31, 2018**	**March 30, 2019**	**March 31, 2018**
Interest cost	$96	$ 86	$192	$ 172
Service cost	74	62	148	139
Recognized net actuarial loss	35	38	70	76
Net periodic pension cost	$205	$ 186	$410	$ 387

(9) Long-Term Debt

Revolving Credit Facility. We have a $100.0 million revolving credit facility (the "Credit Facility") maturing May 13, 2020 that is used to supplement our operating cash flow and fund our working capital, capital expenditure, general corporate and growth requirements. 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 March 30, 2019, $5.4 million of borrowings were outstanding on the Credit Facility, $92.8 million of borrowing capacity was available and outstanding letters of credit totaled $1.8 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 our election, 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 our excess availability as of March 30, 2019, the applicable interest rate margins on the Credit Facility were 0.25% for index rate loans and 1.25% for LIBOR loans.

Our 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 we are unable to make certain representations and warranties provided for under the terms of the Credit Facility. We are 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 our 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 our stock subject to certain minimum borrowing availability requirements; incur or assume indebtedness; issue securities; enter into certain transactions with our affiliates; or permit liens to encumber our property and assets. The terms of the Credit Facility also provide that an event of default will occur 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 us or any of our 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; certain entries of judgment against us or any of our subsidiaries, which are not covered by insurance; or a change of control. As of March 30, 2019, we were 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 for each of the three-month periods ended March 30, 2019 and March 31, 2018, and $32,000 for each of the six-month periods ended March 30, 2019 and March 31, 2018.

(10) Earnings Per Share

The computation of basic and diluted earnings per share attributable to common shareholders is as follows:

	Three Months Ended		**Six Months Ended**	
(In thousands, except per share amounts)	**March 30, 2019**	**March 31, 2018**	**March 30, 2019**	**March 31, 2018**
Net earnings	$1,049	$5,879	$5,175	$13,990
Basic weighted average shares outstanding	19,242	19,052	19,233	19,047
Dilutive effect of stock-based compensation	98	206	105	194
Diluted weighted average shares outstanding	19,340	19,258	19,338	19,241
Net earnings per share:				
Basic	$0.05	$0.31	$0.27	$0.73
Diluted	$0.05	$0.31	$0.27	$0.73

Options and RSUs that were antidilutive and not included in the dilutive earnings per share calculation amounted to 228,000 and 97,000 shares for the three-month periods ended March 30, 2019 and March 31, 2018, respectively. Options and RSUs that were antidilutive and not included in the dilutive earnings per share calculation amounted to 193,000 and 98,000 shares for the six-month periods ended March 30, 2019 and March 31, 2018, respectively.

(11) Share Repurchases

On November 18, 2008, our Board of Directors approved a share repurchase authorization to buy back up to $25.0 million of our 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. We are not obligated to acquire any particular amount of common stock and the program may be commenced or suspended at any time at our discretion without prior notice. The Authorization continues in effect until terminated by the Board of Directors. As of March 30, 2019, there was $24.8 million remaining available for future share repurchases under this Authorization. There were no share repurchases during the three- and six-month periods ended March 30, 2019 and March 31, 2018.

(12) Other Financial Data

Balance sheet information:

(In thousands)	**March 30, 2019**	**September 29, 2018**
Accounts receivable, net:		
Accounts receivable	$50,862	$51,779
Less allowance for doubtful accounts	(288)	(295)
Total	$50,574	$51,484
Inventories:		
Raw materials	$59,065	$61,008
Work in process	5,810	4,779
Finished goods	52,352	28,370
Total	$117,227	$94,157
Other current assets:		
Prepaid insurance	$3,774	$3,845
Income tax receivable	1,430	-
Other	1,061	2,050
Total	$6,265	$5,895
Other assets:		
Cash surrender value of life insurance policies	$10,076	$9,769
Capitalized financing costs, net	8	40
Other	104	104
Total	$10,188	$9,913
Property, plant and equipment, net:		
Land and land improvements	$14,491	$14,438
Buildings	56,191	54,684
Machinery and equipment	169,362	160,068
Construction in progress	5,747	9,672
	245,791	238,862
Less accumulated depreciation	(136,414)	(132,714)
Total	$109,377	$106,148
Accrued expenses:		
Salaries, wages and related expenses	$2,567	$6,775
Sales allowance reserves	1,406	804
Customer rebates	624	1,531

Property taxes	623	1,585
Workers' compensation	113	113
Income taxes	-	469
Other	658	652
Total	$5,991	$11,929
Other liabilities:		
Deferred compensation	$11,085	$10,541
Deferred income taxes	7,476	5,340
Total	$18,561	$15,881

(13) Business Segment Information

Our operations are entirely focused on the manufacture and marketing of steel wire reinforcing products for concrete construction applications. Our concrete reinforcing products consist of two product lines: PC strand and welded wire reinforcement. Based on the criteria specified in ASC Topic 280, *Segment Reporting*, we have one reportable segment.

(14) Contingencies

Insurance recoveries. We maintain general liability, business interruption and replacement cost property insurance coverage on our facilities.

In August 2018, a transformer outage and electrical fire occurred at our Dayton, Texas manufacturing facility, which resulted in the temporary curtailment of operations. Alternative power arrangements for the facility were subsequently made, allowing for operations to continue until permanent repairs were completed during the first quarter. We are in the process of finalizing the insurance claim relating to the business interruption and property damage resulting from the fire. We believe the coverage provided for under our insurance policies is sufficient to cover the losses incurred from this claim. During the three months ended March 30, 2019, we received $1.4 million of insurance proceeds related to the claim that was partially applied against the December 29, 2018 receivable of $263,000 with the remainder recorded in other income ($950,000), cost of sales ($120,000) and selling, general and administrative expense (“SG&A expense”) ($40,000) on the consolidated statement of operations and comprehensive income. During the six-month period ended March 30, 2019, we received $1.8 million of insurance proceeds related to the claim that was partially applied against the September 29, 2018 receivable of $462,000 with the remainder recorded in other income ($950,000), cost of sales ($306,000) and SG&A expense ($45,000) on the consolidated statements of operations and comprehensive income. The insurance proceeds attributable to the property and equipment damaged are reported in cash flows from investing activities and all other insurance proceeds received are reported in cash flows from operating activities on the consolidated statement of cash flows.

In August 2017, operations at our manufacturing facility located in Dayton, Texas were adversely affected by hurricane Harvey. We reached a final settlement on the property damage and business interruption claim with our insurance carrier in the first quarter of this year. During the six-month period ended March 30, 2019, we received $150,000 of proceeds related to this claim of which $98,000 was recorded in other income on the consolidated statements of operations and comprehensive income. During the three- and six-month periods ended March 31, 2018, the Company received $439,000 of insurance proceeds related to the expenses that were incurred and business interruption losses resulting from the storm. During the six-month period ended March 31, 2018, the insurance proceeds were recorded in cost of sales ($418,000) and SG&A expense ($21,000) on the consolidated statement of operations and comprehensive income, and in cash flows from operating activities on the consolidated statement of cash flows.

***Legal proceedings*.** We are involved in lawsuits, claims, investigations and proceedings, including commercial, environmental and employment matters, which arise in the ordinary course of business. We do not expect the ultimate outcome or cost to resolve these matters will have a material adverse effect on our 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 ex 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 filings with the United States ("U.S.") Securities and Exchange Commission ("SEC"), in particular in our Annual Report on Form 10-K for the fiscal year ended September 29, 2018 (our "2018 Annual Report"). 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 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 include, but are not limited to, the following:

- general economic and competitive conditions in the markets in which we operate;
- changes in the spending levels 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 carbon steel wire rod, from domestic and foreign suppliers;
- competitive pricing pressures and our ability to raise selling prices in order to recover increases in raw material or operating costs;
- changes in U.S. 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 fluctuations in demand and 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; and

the “Risk Factors” discussed in our 2018 Annual Report and in other filings made by us 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. We sell our products nationwide across the U.S. and, to a much lesser extent, into Canada, Mexico, and Central and South America, delivering them 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 in our industry; and (3) pursuing growth opportunities within our core businesses that further our penetration of the markets we currently serve or expand our footprint.

Results of Operations

Statements of Operations – Selected Data

(Dollars in thousands)

	Three Months Ended			Six Months Ended		
	March 30, 2019	**Change**	**March 31, 2018**	**March 30, 2019**	**Change**	**March 31, 2018**
Net sales	$111,948	4.2 %	$107,417	$216,058	5.3 %	$205,158
Gross profit	7,021	(54.5%)	15,416	17,997	(33.5%)	27,077
Percentage of net sales	*6.3 %*		*14.4 %*	*8.3 %*		*13.2 %*
Selling, general and administrative expense	$6,556	(12.3%)	$7,475	$13,090	(1.1%)	$13,238
Percentage of net sales	*5.9 %*		*7.0 %*	*6.1 %*		*6.5 %*
Other expense (income), net	$(971)	N/M	$166	$(1,800)	N/M	$185
Interest expense	45	95.7 %	23	75	47.1 %	51
Interest income	(12)	(77.4%)	(53)	(167)	29.5 %	(129)
Effective income tax rate	25.2 %		24.7 %	23.9 %		(1.9%)
Net earnings	$1,049	(82.2%)	$5,879	$5,175	(63.0%)	$13,990

"N/M" = not meaningful

Second Quarter of Fiscal 2019 Compared to Second Quarter of Fiscal 2018

Net Sales

Net sales for the second quarter of 2019 increased 4.2% to $111.9 million from $107.4 million in the prior year quarter, reflecting a 21.0% increase in average selling prices partially offset by a 13.9% decrease in shipments. The increase in average selling prices was driven by price increases that were implemented over the course of the prior year to recover the escalation in raw material costs. Shipments for the current year quarter were unfavorably impacted by the adverse weather conditions in many of our markets together with an increase in low-priced import competition.

Gross Profit

Gross profit for the second quarter of 2019 decreased 54.5% to $7.0 million, or 6.3% of net sales, from $15.4 million, or 14.4% of net sales, in the prior year quarter due to lower spreads between average selling prices and raw material costs ($3.7 million), higher manufacturing costs ($2.4 million) and the reduction in shipments ($2.1 million). The decrease in spreads was driven by higher raw material costs ($22.6 million) and freight expense ($276,000) partially offset by higher average selling prices ($19.2 million).

Selling, General and Administrative Expense

Selling, general and administrative expense ("SG&A expense") for the second quarter of 2019 decreased 12.3% to $6.6 million, or 5.9% of net sales, from $7.5 million, or 7.0% of net sales in the prior year quarter primarily due to lower compensation expense ($597,000) together with the relative year-over-year changes in the cash surrender value of life insurance policies ($575,000). The decrease in compensation expense was largely driven by lower incentive plan expense based on our weaker results in the current year quarter. The cash surrender value of life insurance policies increased $594,000 in the current year quarter compared with an increase of $19,000 in the prior year quarter due to the corresponding changes in the value of the underlying investments.

Other Expense (Income)

Other income was $1.0 million for the second quarter of 2019 compared with other expense of $166,000 in the prior year quarter. Other income for the current year quarter was primarily related to a net gain from insurance proceeds. Other expense for the prior year quarter was primarily related to losses on the disposition of property, plant and equipment.

Income Taxes

Our effective tax rate for the second quarter of 2019 increased to 25.2% from 24.7% for the prior year quarter due to changes in permanent book versus tax differences.

Net Earnings

Net earnings for the second quarter of 2019 decreased to $1.0 million ($0.05 per share) from $5.9 million ($0.31 per share) in the prior year quarter primarily due to the decrease in gross profit partially offset by the decrease in SG&A expense and increase in other income.

First Half of Fiscal 2019 Compared to First Half of Fiscal 2018

Net Sales

Net sales for the first half of 2019 increased 5.3% to $216.1 million from $205.2 million in the same year-ago period, reflecting a 24.6% increase in average selling prices partially offset by a 15.5% decrease in shipments. The increase in average selling prices was driven by price increases that were implemented over the course of the prior year to recover the escalation in raw material costs. Shipments for the current year period were unfavorably impacted by the adverse weather conditions in many of our markets together with an increase in low-priced import competition.

Gross Profit

Gross profit for the first half of 2019 decreased 33.5% to $18.0 million, or 8.3% of net sales, from $27.1 million, or 13.2% of net sales, in the same year-ago period. The year-over-year decrease was primarily due to higher manufacturing costs ($4.8 million) and lower shipments ($4.3 million) partially offset by higher spreads between average selling prices and raw material costs ($556,000). The increase in spreads was driven by higher average selling prices ($42.1 million) partially offset by higher raw material costs ($41.1 million) and freight expense ($478,000).

Selling, General and Administrative Expense

SG&A expense for the first half of 2019 decreased 1.1% to $13.1 million, or 6.1% of net sales, from $13.2 million, or 6.5% of net sales, in the same year-ago period primarily due to lower compensation expense ($930,000), partially offset by the relative year-over-year changes in the cash surrender value of life insurance policies ($213,000). The decrease in compensation expense was largely driven by lower incentive plan expense based on our weaker results in the current year period. The cash surrender value of life insurance policies increased $62,000 in the current year period compared with $275,000 in the prior year period due to the changes in the value of the underlying investments.

Other Expense (Income)

Other income was $1.8 million for the first half of 2019 compared with other expense of $185,000 in the same year ago period. Other income for the current year period was primarily related to a gain from insurance proceeds ($1.0 million) and a net gain from the disposition of property, plant and equipment ($710,000). Other expense for the prior year period was primarily related to losses on the disposition of property, plant and equipment.

Income Taxes

Our effective tax rate for the first half of 2019 increased to 23.9% from (1.9%) for the same year ago period. The prior year rate benefited from a $3.7 million gain on the remeasurement of deferred tax liabilities related to the lower corporate tax rate enacted under the Tax Cuts and Jobs Act in December 2017. Excluding the deferred tax gain, our effective tax rate decreased to 23.9% from 24.8% in the prior year period reflecting the reduction in the federal statutory rate to 21% from 35% for three quarters of fiscal 2018.

Net Earnings

Net earnings for the first half of 2019 decreased to $5.2 million ($0.27 per share) from $14.0 million ($0.73 per share) in the same year-ago period primarily due to the decrease in gross profit together with the prior year income tax benefit related to enactment of the Tax Cuts and Jobs Act partially offset by the other income in the current year period.

Liquidity and Capital Resources

Selected Financial Data

(Dollars in thousands)

	Six Months Ended	
	March 30, 2019	**March 31, 2018**
Net cash provided by (used for) operating activities	$(40,191)	$24,493
Net cash used for investing activities	(7,296)	(12,740)
Net cash provided by (used for) financing activities	4,036	(20,394)
Net working capital	133,441	103,088
Total debt	5,365	-
Percentage of total capital	2.1 %	-
Shareholders' equity	$246,530	$218,045
Percentage of total capital	97.9 %	100.0 %
Total capital (total debt + shareholders' equity)	$251,895	$218,045

Operating Activities

Operating activities used $40.2 million of cash during the first half of 2019 primarily from a net increase in the 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 $52.5 million of cash due to a $30.3 million decrease in accounts payable and accrued expenses and a $23.1 million increase in inventories partially offset by a $0.9 million decrease in accounts receivable. The decrease in accounts payable and accrued expenses was largely due to lower raw material purchases during the period, and, to a lesser extent, the payment of accrued incentive compensation, property taxes and customer rebates for the prior year. The increase in inventories was primarily driven by the reduction in shipments and higher unit costs during the period. The decrease in accounts receivable was principally due to the usual seasonal downturn in sales compounded by the adverse weather.

Operating activities provided $24.5 million of cash during the first half of 2018 primarily from net earnings adjusted for non-cash items together with a decrease in the net working capital components of accounts receivable, inventories, and accounts payable and accrued expenses. Net working capital provided $4.3 million of cash due to an $18.7 million decrease in inventories, partially offset by a $10.2 million increase in accounts receivable and a $4.2 million decrease in accounts payable and accrued expenses. The decrease in inventories and increase in accounts receivable were primarily related to increasing sales during the latter part of the period. The decrease in accounts payable and accrued expenses was principally due to the payment of accrued incentive compensation and property taxes for the prior year.

We may elect to adjust our operating activities as there are changes 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 $7.3 million of cash during the first half of 2019 compared to $12.7 million during the same period last year primarily due to the acquisition of a business in the prior year ($3.3 million), lower capital expenditures ($1.2 million) and the receipt of insurance proceeds in the current year related to an insurance claim ($1.0 million). Capital expenditures decreased to $8.1 million from $9.3 million in the prior year period and are expected to total up to $22.0 million for fiscal 2019 primarily focused on cost and productivity improvement initiatives in addition to recurring maintenance.

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 $4.0 million of cash during the first half of 2019 while using $20.4 million during the same period last year primarily due to lower cash dividend payments ($19.0 million) and borrowings on our revolving credit facility in the current year period ($5.4 million). Cash dividends used $1.2 million of cash during the current year period compared with $20.2 million in the prior year period, which included a special cash dividend totaling $19.0 million, or $1.00 per share.

Cash Management

Our cash is principally concentrated 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”) maturing May 13, 2020 that is used to supplement our operating cash flow and fund our working capital, capital expenditure, general corporate and growth requirements. 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 March 30, 2019, $5.4 million of borrowings were outstanding on the Credit Facility, $92.8 million of borrowing capacity was available and outstanding letters of credit totaled $1.8 million (see Note 9 to the consolidated financial statements).

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, should we experience future reductions in our operating cash flows due to weakening conditions in our construction end-markets and reduced demand from our customers, 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 would be 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 our Credit Facility position us to meet our anticipated liquidity requirements for the foreseeable future, including the next 12 months.

Seasonality and Cyclicality

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, shipments typically reach their highest level of the year when weather conditions are the most conducive to construction activity. As a result, assuming normal seasonal weather patterns, shipments 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, construction activity and demand for our products is generally correlated with general economic conditions, although there can be significant differences between the relative strength of nonresidential and 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 carbon steel wire rod, and, to a much lesser extent, freight, energy and other consumables that are used in our manufacturing processes. We have generally been able to adjust our selling prices to pass through increases in these costs or offset them through various cost reduction and productivity improvement initiatives. However, our ability to raise our selling prices depends on market conditions and competitive dynamics, and there may be periods during which we are unable to fully recover increases in our costs. During the first half of fiscal 2019, the year-over-year escalation in our raw material costs exceeded the increase in our selling prices due to competitive pricing pressures. The timing and magnitude of any future increases in our raw material costs and the selling prices for our products is uncertain at this time.

Off-Balance Sheet Arrangements

We do not have any material transactions, arrangements, obligations (including contingent obligations), or other relationships with unconsolidated entities or other persons, as described by Item 303(a)(4) of Regulation S-K of the SEC, that have or are reasonably likely to have a material current or future impact on our financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses.

Contractual Obligations

There have been no material changes in our contractual obligations and commitments as disclosed in our 2018 Annual Report other than those which occur in the ordinary course of business.

Critical Accounting Policies

Our Management’s Discussion and Analysis of Financial Condition and Results of Operations is based on our unaudited financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information. The preparation of our financial statements requires the application of these accounting principles in addition to certain estimates and judgments based on current available information, actuarial estimates, historical results and other assumptions believed to be reasonable. Actual results could differ from these estimates. Please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies” included in our 2018 Annual Report for further information regarding our critical accounting policies and estimates. As of March 30, 2019, there were no changes in the nature of our critical accounting policies or the application of those policies from those reported in our 2018 Annual Report other than Accounting Standards Update No. 2014-09 “Revenue from Contracts with Customers”.

Recent Accounting Pronouncements

Refer to Note 2 of the Notes to Consolidated Financial Statements in Item 1 of this Quarterly Report for recently adopted and issued accounting pronouncements including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Outlook

Looking ahead to the remainder of 2019, we expect our financial results will be favorably impacted by the continued growth in our construction end-markets and the weather-related deferral of business from the first half of the year. The leading indicators and industry forecasts for nonresidential construction remain positive. The infrastructure-related portion of our business should benefit from increased federal funding through the FAST Act and supplementary measures together with higher state and local spending in many of our markets supported by various initiatives such as fuel tax increases, bond issuances and other ballot measures.

We expect business conditions will remain challenging, however, in view of the escalation in our raw material costs resulting from the Section 232 tariffs on imported steel and the duties that have been imposed against certain countries in response to the recent trade cases initiated by domestic wire rod producers. We will continue to focus on the operational fundamentals of our business: closely managing and controlling our expenses; aligning our production schedules with demand in a proactive manner as there are changes in market conditions to minimize our cash operating costs; and pursuing further improvements in the productivity and effectiveness of all of our manufacturing, selling and administrative activities. We also expect gradually increasing contributions from the substantial investments we have made in our facilities in the form of reduced operating costs and additional capacity to support future growth (see “Cautionary Note Regarding Forward-Looking Statements” and “Risk Factors”). In addition, we will continue to pursue further acquisitions in our existing businesses that expand our penetration of markets we currently serve or expand our footprint.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Commodity Prices

We are subject to significant fluctuations in the cost and availability of our primary raw material, hot-rolled carbon steel wire rod, which we purchase from both domestic and foreign suppliers. We negotiate quantities and pricing for both domestic and foreign wire rod purchases for varying periods (most recently monthly for domestic suppliers), depending upon market conditions, to manage our exposure to price fluctuations and to ensure adequate availability of material consistent with our requirements. We do not use derivative commodity instruments to hedge our exposure to changes in prices as such instruments are not currently available for wire rod. Our ability to acquire wire rod from foreign sources on favorable terms is impacted by fluctuations in foreign currency exchange rates, foreign taxes, duties, tariffs, quotas and other trade actions. Although changes in our wire rod costs and selling prices tend to be correlated, in weaker market environments, we may be unable to fully recover increased wire rod costs through higher selling prices, which would reduce our earnings and cash flows. Additionally, when raw material costs decline, our financial results may be negatively impacted if the selling prices for our products decrease to an even greater extent and if we are consuming higher cost material from inventory. Based on our shipments and average wire rod cost reflected in cost of sales for the first half of 2019, a 10% increase in the price of wire rod would have resulted in a $14.5 million decrease in our pre-tax earnings (assuming there was not a corresponding change in our selling prices).

Interest Rates

Borrowings under our revolving credit facility are subject to a variable rate of interest and are sensitive to changes in interest rates. Based on our interest rate exposure and the outstanding borrowings on the revolving credit facility as of March 30, 2019, a 25 basis point change in interest rates would have an estimated $13,000 impact on our pre-tax earnings over a one-year period.

Foreign Exchange Exposure

We have not typically hedged foreign currency exposures related to transactions denominated in currencies other than U.S. dollars, as such transactions have not been material historically. We will occasionally hedge firm commitments for certain equipment purchases that are denominated in foreign currencies. The decision to hedge any such transactions is made by us on a case-by-case basis. There were no forward contracts outstanding as of March 30, 2019.

Item 4. Controls and Procedures

We have conducted an evaluation of the effectiveness of our disclosure controls and procedures as of March 30, 2019. This evaluation was conducted under the supervision and with the participation of management, including our principal executive officer and our principal financial officer. Based upon that evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Further, they concluded that our disclosure controls and procedures were effective to ensure that information is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting that occurred during the quarter ended March 30, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

During the quarter ended March 30, 2019, there were no material changes from the risk factors set forth under Part I, Item 1A., “Risk Factors” in our 2018 Annual Report. You should carefully consider these factors in addition to the other information set forth in this report which could materially affect our business, financial condition or future results. The risks and uncertainties described in this report and in our 2018 Annual Report, as well as other reports and statements that we file with the SEC, are not the only risks and uncertainties facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also have a material adverse effect on our financial position, results of operations or cash flows.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On November 18, 2008, our Board of Directors approved a share repurchase authorization to buy back up to $25.0 million of our outstanding common stock (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. We are not obligated to acquire any particular amount of common stock and may commence or suspend the program at any time at our discretion without prior notice. The Authorization continues in effect until terminated by our Board of Directors. As of March 30, 2019, there was $24.8 million remaining available for future share repurchases under the Authorization. There were no share repurchases during the three- and six-month periods ended March 30, 2019 and March 31, 2018.

Item 6. Exhibits

31.1

	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial information from the Quarterly Report on Form 10-Q of Insteel Industries, Inc. for the quarter ended March 30, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statements of Operations and Comprehensive Income for the three and six months ended March 30, 2019 and March 31, 2018, (ii) the Consolidated Balance Sheets as of March 30, 2019 and September 29, 2018, (iii) the Consolidated Statements of Cash Flows for the six months ended March 30, 2019 and March 31, 2018, (iv) the Consolidated Statements of Shareholders' Equity as of March 30, 2019 and March 31, 2018, and (v) the Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INSTEEL INDUSTRIES, INC.

Registrant

Date: April 18, 2019 By: /s/ Michael C. Gazmarian
Michael C. Gazmarian
Vice President, Chief Financial Officer and Treasurer
(Duly Authorized Officer and Principal Financial Officer)