INSTEEL INDUSTRIES 2007 ANNUAL REPORT

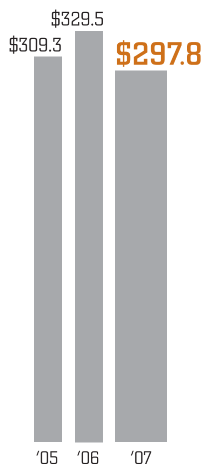
Rebuilding America's Infrastructure

FINANCIAL HIGHLIGHTS

(In thousands, except for per share amounts)	2007	2006	2005
Operating Results:			
Net sales	$297,806	$329,507	$309,320
Gross profit	56,061	70,871	57,898
% of net sales	18.8%	21.5%	18.7%
Earnings from continuing operations	$ 24,284	$ 34,377	$ 24,499
% of net sales	8.2%	10.4%	7.9%
Net earnings	$ 24,162	$ 33,040	$ 25,045
Per Share Data:			
Basic:			
Earnings from continuing operations	$ 1.34	$ 1.88	$ 1.31
Net earnings	1.33	1.80	1.34
Diluted:			
Earnings from continuing operations	1.33	1.86	1.29
Net earnings	1.32	1.79	1.32
Cash dividends declared	0.12	0.12	0.06
Returns:			
Return on capital[1]	18.2%	29.7%	21.1%
Return on equity[2]	18.2%	31.3%	29.1%
Financial Position:			
Total assets	$173,529	$166,596	$138,276
Total long-term debt	–	–	11,860
Shareholders' equity	143,850	122,438	97,036
Cash Flows:			
Net cash provided by operating activities of continuing operations	$ 17,065	$ 42,650	$ 41,830
Capital expenditures	17,013	18,959	6,302
Depreciation and amortization	6,209	5,107	5,627
Repurchase of common stock	–	8,529	–
Cash dividends paid	2,176	2,222	566

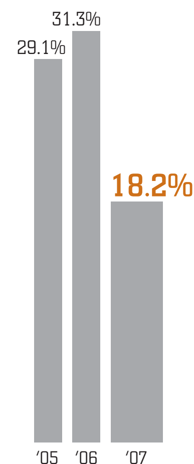
[1]Earnings from continuing operations/(average total long-term debt + average shareholders' equity).
[2]Earnings from continuing operations/(average shareholders' equity).

Net Sales
(in millions)



Diluted Earnings Per Share From Continuing Operations

Return on Equity[2]



Insteel Industries is one of the nation's largest manufacturers of steel wire reinforcing products for concrete construction applications. We manufacture and market prestressed concrete strand ("PC strand") and welded wire reinforcement, including concrete pipe reinforcement, engineered structural mesh and standard welded wire reinforcement. Our products are sold primarily to manufacturers of concrete products that are used in nonresidential construction. Headquartered in Mount Airy, North Carolina, we operate six manufacturing facilities located in the United States.

WELDED WIRE REINFORCEMENT

Prefabricated reinforcement consisting of high-strength, cold-drawn or cold-rolled longitudinal and transverse wires welded together in square or rectangular grids according to customer requirements. Wire intersections are electrically resistance-welded by a computer-controlled continuous automatic welder which uses pressure and heat to fuse all wires in their proper position, creating a consistent high-quality reinforcing product.

CONCRETE PIPE REINFORCEMENT

Engineered made-to-order product that is used as the primary reinforcement in concrete pipe and box culverts for drainage and sewage systems, water treatment facilities and other related applications.

PLANT LOCATIONS	CUSTOMER SEGMENTS	END USES
Dayton, Texas Mount Airy, North Carolina Wilmington, Delaware	Concrete Pipe and Precast Producers	Nonresidential Construction Residential Construction

ENGINEERED STRUCTURAL MESH

Engineered made-to-order product that is used as the primary reinforcement in concrete elements or structures, frequently serving as a replacement for hot-rolled rebar.

PLANT LOCATIONS	CUSTOMER SEGMENTS	END USES
Dayton, Texas Mount Airy, North Carolina	Precast and Prestressed Producers Rebar Fabricators Distributors	Nonresidential Construction

STANDARD WELDED WIRE REINFORCEMENT

Secondary reinforcing product that is produced in standard styles for crack control applications in residential and light nonresidential construction, including driveways, sidewalks and a wide range of slab-on-grade applications.

PLANT LOCATIONS	CUSTOMER SEGMENTS	END USES
Dayton, Texas Hickman, Kentucky Mount Airy, North Carolina Wilmington, Delaware	Rebar Fabricators Distributors	Nonresidential Construction Residential Construction

PRESTRESSED CONCRETE STRAND

High-strength seven-wire reinforcement consisting of six cold-drawn wires that are continuously wrapped around a center wire forming a strand. The strand is heat-treated while under tension, which imparts low relaxation characteristics and increases the working range of the product, providing engineers with greater flexibility in its application and the ability to better utilize its reinforcing properties. PC strand is used to impart compression forces into prestressed concrete elements and structures, which may be either pretensioned or posttensioned. Pretensioned means that the strands are tensioned to their design load and anchored at the ends of a form. After concrete has been placed and allowed to cure to sufficient strength, the load on the strand is transferred from the external anchors to the cured member, creating compression forces within the element, or "prestressing" it. Posttensioned means that the strands are tensioned after the concrete has been placed and allowed to cure.

PLANT LOCATIONS	CUSTOMER SEGMENTS	END USES
Gallatin, Tennessee Sanderson, Florida	Precast Prestress Producers Posttension Suppliers	Nonresidential Construction Residential Construction

America faces a growing infrastructure crisis.

Deterioration. Congestion. Reduced reliability. A projected funding gap of $1.6 trillion over the next five years.

After years of neglect, the warning signs are becoming increasingly apparent across all sectors of our nation's infrastructure. Nearly 30% of the bridges in the U.S. are structurally deficient or functionally obsolete. Our interstate highway system is reaching the end of its 50-year life cycle and will require substantial rebuilding and maintenance. A recent study indicates that 83% of our transportation infrastructure is incapable of meeting the country's needs over the next 10 years. In its most recent report card on America's infrastructure, the American Society of Civil Engineers gave our system an overall "D" which included 4 Cs and 10 Ds.

Our roads are becoming increasingly congested as the number of miles driven rose 23% from 1995 to 2005 while the length of roads increased only 2%. The average metropolitan driver spends 46 hours a year stuck in traffic which doubles for daily rush-hour commuters in large cities. The lack of comprehensive and coordinated long-term strategies and financing solutions has left us playing catch-up to other nations. Addressing these needs will require substantial increases in funding at the federal, state and local level, which are likely to come from higher taxes and user fees in addition to various forms of public/private partnerships and bond issues funded by user fees and general tax revenues.

How does our nation's infrastructure strategy impact Insteel? Through the intensive use of our concrete reinforcing products in highway and infrastructure construction…PC strand and ESM in bridges and overpasses, concrete pipe reinforcement in road drainage systems and ESM in concrete barrier medians. We believe the heightened interest in addressing our nation's infrastructure needs will ultimately yield financing solutions that represent a substantial growth opportunity for Insteel.

Insteel Industries

A name largely unfamiliar outside of the building materials industry. A company that is one of the largest manufacturers of steel wire reinforcing products for concrete construction applications. A leader in its markets with state-of-the-art facilities and manufacturing capabilities. A provider of concrete reinforcing solutions ideally positioned to capitalize on the critical infrastructure needs of our nation.

US82—Greenville Bridge

The new Greenville Bridge on I-82 crossing the Mississippi River which incorporated Insteel's concrete reinforcing products and was previously featured on the cover of our 2005 annual report.

Engineered structural mesh

A welded wire reinforcing product manufactured to customer specifications that frequently serves as a replacement for hot-rolled rebar. A product produced as prefabricated sheets that offers significant labor savings versus the time-intensive placing and tying inherent to rebar and requires less steel due to its superior strength. A product gaining momentum in penetrating the rebar market in response to: (1) increasing construction labor constraints and costs; and (2) improvements in welding equipment technology that have made small batch production and quick delivery feasible. A product that can serve as

New ESM production line at our Mount Airy, NC plant

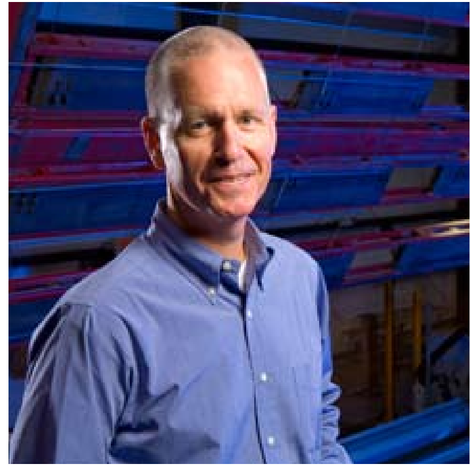
a substitute for rebar sizes representing approximately 80% of domestic rebar consumption. A market for Insteel that could double in volume on just a few percentage points of market share growth. A product frequently used with PC strand to provide a comprehensive concrete reinforcing solution.

With the two new production lines that started up during 2007 in our North Carolina and Texas facilities, each with the capacity to generate $16–$20 million of revenues annually (at current average selling prices), we are well-positioned to capitalize on the growing acceptance of ESM as a superior reinforcing solution for many concrete construction applications.

Investing for the future

During 2006 and 2007, we've invested $36 million in our manufacturing facilities. Adding new ESM production lines in our North Carolina and Texas plants. Upgrading the equipment and reconfiguring the process flow of our Tennessee and Florida PC strand facilities. Adding a new standard welded wire reinforcement line in our Delaware plant. These projects share common characteristics by providing additional capacity to satisfy future growth in demand and facilitating substantial improvements in our labor productivity and unit conversion costs. When fully ramped up, they should add over $70 million of revenue-generating capacity annually (at current average selling prices) and advance our ongoing initiatives to operate as the lowest cost producer.

In 2007, Insteel posted solid financial results coming off the record highs that were achieved in 2006 despite facing increasing headwinds in our markets. We continued to make strategic investments that position us for future growth and enhance our manufacturing capabilities. Our business strategy remains focused on generating returns that exceed our cost of capital by (1) achieving leadership positions in our markets and operating as the lowest cost producer, and (2) pursuing growth opportunities in our core businesses that further our penetration of existing markets or expand our geographic footprint.



FINANCIAL HIGHLIGHTS

Sales for 2007 decreased 9.6% to $297.8 million from $329.5 million in 2006 as an 11.4% drop-off in shipments offset a 2.0% increase in average selling prices. Earnings from continuing operations fell to $24.3 million ($1.33 per diluted share) from $34.4 million ($1.86 per diluted share) in the prior year due to the reduced shipments, increasing raw material costs and higher unit conversion costs resulting from lower production levels.

Business conditions continued to be mixed during the year, characterized by strong demand for concrete reinforcing products that are primarily used in nonresidential construction and weak demand from customers with significant exposure to the housing market. During the second half of the year, our sales of PC strand to commercial posttension accounts focused on residential construction applications declined due to the elevated level of irrationally priced import competition, primarily from China. As a result, shipments to posttensioners, which represented 14% of our total shipments in 2006 were minimal during the second half of 2007.

We ended the year debt-free with $8.7 million of cash on hand. Our strong balance sheet and flexible capital structure position us to enhance value for our shareholders by investing in the growth of our core businesses through capital expenditures and acquisitions, paying cash dividends and utilizing our share repurchase program on an opportunistic basis.

CAPITAL EXPENDITURE PROGRAM

Capital expenditures were $17.0 million in 2007 as we continued to invest in a wide range of important initiatives to expand revenues and drive cost improvements at our manufacturing facilities. When fully operational, these projects have the capability of generating over $70.0 million of incremental revenues annually (at current average selling prices) in addition to significantly reducing our unit conversion costs through higher productivity and increased throughput.

With most of the outlays for these projects behind us, we plan on significantly scaling back capital expenditures in 2008 as we assess the uncertainty in our markets and in the economy in general. At the same time, our financial flexibility will allow us to capitalize on any growth opportunities that may develop.

Engineered Structural Mesh ("ESM"). We started up a new ESM production line in our North Carolina facility during the first quarter and a second new line at our Texas plant during the fourth quarter. These expansions position us to benefit from the growing market acceptance for ESM as a replacement for hot-rolled rebar due to the inherent labor, cycle time and material cost advantages it offers for many concrete reinforcing applications. With total domestic consumption of ESM representing less than 5% of the rebar volume it could potentially replace, the product is still early in its life cycle where just a few percentage points of market share growth translate into a substantial increase in demand. We expect each of the new lines to generate $16.0 to $20.0 million of annual revenues (at current average selling prices) when ramped up to capacity.

PC strand. During the first quarter, we completed the reconfiguration and expansion of our Tennessee PC strand operation which entailed the consolidation of manufacturing processes previously performed in two adjacent facilities together with the installation of a new production line. We also began work on the upgrading of our Florida PC strand facility which is expected to be completed during the third quarter of 2008. These projects add a combined $30.0 million of annual revenue capacity (at current average selling prices)—$25.0 million at the Tennessee facility and $5.0 million at the Florida plant. While the timing of these additions may not coincide with robust market conditions, we view them as critical to extending our leadership position in the North American market.

Standard welded wire reinforcement. During the fourth quarter, we started up a new standard welded wire reinforcement line in our Delaware plant that adds $7.0 million of annual revenue capacity (at current average selling prices).

LOOKING AHEAD

As we move into 2008, we face significant near-term challenges in the form of rising raw material costs, PC strand import competition and the continuation of mixed market conditions.

Raw materials. Prices for hot-rolled steel wire rod, our primary raw material, are on the rise and are likely to continue trending up until the pricing for imports into the U.S. becomes more competitive with domestic producers. These additional costs may be difficult to recover in our markets depending upon the strength of demand and competitive dynamics, although we are hopeful that the increased discipline that has been evident in our markets since 2004 continues going forward.

PC strand imports. Imports of PC strand from China continue to enter the U.S. market at unrealistically low prices reflecting the dysfunctional nature of China's non-market economy. It is clear that Chinese producers lack any inherent manufacturing cost advantage relative to state-of-the-art domestic producers such as Insteel. The Chinese pursuit of the U.S. market is largely a result of distorted economics resulting

from the availability of low-cost financing and government subsidies that have resulted in an explosion of capacity well in excess of China's home market requirements. In July 2007, the Chinese government took the first step towards leveling the competitive playing field by reducing the VAT rebate for exported PC strand from 13% to 5%. This reduction, together with recent escalation in wire rod costs and ocean freight rates, has made exporting to the U.S. substantially less attractive for Chinese producers, forcing them to raise their selling prices. Although it would be premature to assume that these favorable trends will continue, we believe the unfair trade practices of the Chinese will ultimately be resolved—either through further proactive changes on the part of the Chinese government that allow true economics to prevail or through the filing of trade actions on the part of U.S. strand producers should market conditions deteriorate to the point where we can demonstrate injury. Under either scenario, Insteel will be well-positioned to capitalize through the expansion and upgrading of our Tennessee and Florida PC strand facilities and our world-class cost structure.

Market outlook. We expect market conditions to remain mixed in 2008 with some moderation in the growth rate for nonresidential construction from the elevated level of recent years due to the anticipated softening in commercial construction. Other categories within nonresidential construction, however, are expected to remain strong driven by continued growth in infrastructure-related spending and post-hurricane reconstruction in the Gulf region. Longer term, we believe the heightened focus on addressing the critical infrastructure needs that exist will yield creative financing solutions that favorably impact demand for our concrete reinforcing products for an extended period.

In view of the inventory overhang of unsold homes and tightening in the credit markets, we expect the weakness in residential construction to persist through 2009 and continue to adversely affect shipments to customers that have greater exposure to the housing sector.

Despite these challenges, we anticipate gradually increasing returns from the substantial investments we have made in our facilities over the past two years through reduced operating costs and additional revenues, particularly for ESM as we further our penetration of the rebar market. In addition, we will continue to evaluate and pursue other growth opportunities—organic as well as through acquisitions—that strengthen our competitive position and create value for our shareholders.

We wish to thank our customers, employees and shareholders for their continued trust, confidence and support. As we move into 2008, we are well-positioned to capitalize on the opportunities and respond to the challenges that lie ahead.

Sincerely,

H.O. Woltz III
President and Chief Executive Officer

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. When used in this report, the words "believes," "anticipates," "expects," "estimates," "plans," "intends," "may," "should" and similar expressions are intended to identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, such forward-looking statements are subject to a number of risks and uncertainties, and we can provide no assurances that such plans, intentions or expectations will be achieved. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. All forward-looking statements speak only to the respective dates on which such statements are made and we do not undertake and specifically decline any obligation to publicly release the results of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

It is not possible to anticipate and list all risks and uncertainties that may affect our future operations or financial performance; however, they include, but are not limited to, the risks discussed below and in our Form 10-K for the year ended September 29, 2007 under the caption "Risk Factors" which includes the following:

- *Our business is cyclical and prolonged economic declines, particularly in the level of construction activity, could have a material adverse effect on our financial results.*
- *Demand for our products is highly variable and difficult to forecast due to our minimal backlog and the unanticipated changes that can occur in customer order patterns or inventory levels.*
- *Our financial results can be negatively impacted by the volatility in the cost and availability of our primary raw material, hot-rolled carbon steel wire rod.*
- *Foreign competition could adversely impact our financial results.*
- *Our manufacturing facilities are subject to unexpected equipment failures, operational interruptions and casualty losses.*
- *Our financial results could be adversely impacted by the continued escalation in certain of our operating costs.*
- *Our capital resources may not be adequate to provide for our capital investment and maintenance expenditures if we were to experience a substantial downturn in our financial performance.*
- *Environmental compliance and remediation could result in substantially increased capital investments and operating costs.*
- *Our production and earnings could be reduced by strikes or work stoppages by our unionized employees.*
- *Our stock price can be volatile, often in connection with matters beyond our control.*

OVERVIEW

Following our exit from the industrial wire business (see Note 7 to the consolidated financial statements), our operations are entirely focused on the manufacture and marketing of concrete reinforcing products for the concrete construction industry. The results of operations for the industrial wire business have been reported as discontinued operations for all periods presented. Our business strategy is focused on: (1) achieving leadership positions in our markets and operating as the lowest cost producer; and (2) pursuing growth opportunities within our core businesses that further our penetration of current markets served or expand our geographic reach.

CRITICAL ACCOUNTING POLICIES

Our financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. Our discussion and analysis of our financial condition and results of operations are based on these financial statements. The preparation of our financial statements requires the application of these accounting 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.

The following critical accounting policies are used in the preparation of the financial statements:

Revenue recognition and credit risk. We recognize revenue from product sales in accordance with Staff Accounting Bulletin ("SAB") No. 104 when products are shipped and risk of loss and title has passed to the customer. Substantially all of our accounts receivable are due from customers that are located in the United States and we generally require no collateral depending

upon the creditworthiness of the account. We provide an allowance for doubtful accounts based upon our assessment of the credit risk of specific customers, historical trends and other information. There is no disproportionate concentration of credit risk.

Allowance for doubtful accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the potential inability of our customers to make required payments. If the financial condition of our customers were to change significantly, adjustments to the allowances may be required. While we believe our recorded trade receivables will be collected, in the event of default in payment of a trade receivable, we would follow normal collection procedures.

Excess and obsolete inventory reserves. We write down the carrying value of our inventory for estimated obsolescence to reflect the lower of the cost of the inventory or its estimated net realizable value based upon assumptions about future demand and market conditions. If actual market conditions for our products are substantially different than our projections, adjustments to these reserves may be required.

Accruals for self-insured liabilities and litigation. We accrue estimates of the probable costs related to self-insured medical and workers' compensation claims and legal matters. These estimates have been developed in consultation with actuaries, our legal counsel and other advisors and are based on our current understanding of the underlying facts and circumstances. Because of uncertainties related to the ultimate outcome of these issues as well as the possibility of changes in the underlying facts and circumstances, adjustments to these reserves may be required in the future.

Recent accounting pronouncements. In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") which clarifies the criteria for the recognition of tax benefits under Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." FIN No. 48 specifies how tax benefits for uncertain tax positions are to be recognized, measured and derecognized in financial statements; requires certain disclosures of uncertain tax matters; specifies how reserves for uncertain tax positions should be classified on the balance sheet; and provides transition and interim period guidance, among other provisions. FIN No. 48 is effective for us beginning in fiscal 2008 and requires that the cumulative effect of applying its provisions be disclosed separately as a one-time, non-cash charge against the opening balance of retained earnings in the year of adoption. Based on our preliminary analysis, the adoption of FIN No. 48 is expected to result in an estimated charge to retained earnings of approximately $260,000. The actual amount of the adjustment will be recorded in the first quarter of 2008 upon the finalization of our analysis.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for us beginning in fiscal 2009. At this time, we have not determined what effect, if any, the adoption of SFAS No. 157 will have on our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires that an employer recognize the overfunded or underfunded status of a defined benefit postretirement plan in its statement of financial position and changes in the funded status through other comprehensive income in the year in which the changes occur. SFAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position. The provisions regarding the recognition of a plan's funding status were effective for us in fiscal 2007 and resulted in a $2.1 million decrease in shareholders' equity, net of tax. The provisions regarding the change in the measurement date are effective for us beginning in fiscal 2009. The adoption of SFAS No. 158 is further discussed in Note 8 to the consolidated financial statements.

RESULTS OF OPERATIONS

Statements of Operations—Selected Data

(Dollars in thousands)	Year Ended September 29, 2007	Change	September 30, 2006	Change	October 1, 2005
Net sales	**$297,806**	(9.6%)	$329,507	6.5%	$309,320
Gross profit	**56,061**	(20.9%)	70,871	22.4%	57,898
Percentage of net sales	**18.8%**		21.5%		18.7%
Selling, general and administrative expense	**$ 17,583**	3.5%	$ 16,996	5.1%	$ 16,175
Percentage of net sales	**5.9%**		5.2%		5.2%
Other expense (income), net	**$ 4**	N/M	$ (446)	N/M	$ (73)
Interest expense	**592**	(11.5%)	669	(80.5%)	3,427
Effective income tax rate	**36.6%**		36.2%		36.1%
Earnings from continuing operations	**$ 24,284**	(29.4%)	$ 34,377	40.3%	$ 24,499
Earnings (loss) from discontinued operations	**(122)**	N/M	(1,337)	N/M	546
Net earnings	**24,162**	(26.9%)	33,040	31.9%	25,045

"N/M" = not meaningful

2007 COMPARED WITH 2006

Net Sales

Net sales decreased 9.6% to $297.8 million in 2007 from $329.5 million in 2006 as lower shipments more than offset higher average selling prices. Shipments for the year decreased 11.4% while average selling prices rose 2.0% from the prior year. The reduction in shipments was driven by a combination of factors including: (1) the continuation of weak demand and inventory reduction measures pursued by customers that have been negatively impacted by the downturn in residential construction activity; (2) our decision to solicit minimal new business from posttension customers in the PC strand market due to low-priced import competition; and (3) less favorable weather conditions in certain of our markets relative to the prior year which reduced the level of construction activity.

Gross Profit

Gross profit decreased 20.9% to $56.1 million, or 18.8% of net sales in 2007 from $70.9 million, or 21.5% of net sales in 2006. The decrease was primarily due to the reduction in shipments, higher unit manufacturing costs resulting from lower operating levels and higher raw material costs which were partially offset by the increase in average selling prices.

Selling, General and Administrative Expense

Selling, general and administrative expense ("SG&A expense") increased 3.5% to $17.6 million, or 5.9% of net sales in 2007 from $17.0 million, or 5.2% of net sales in 2006. The increase was primarily due to higher compensation expense ($989,000) which was partially offset by lower employee benefit costs ($387,000).

Other Expense (Income), Net

Other expense was $4,000 in 2007 compared with income of $446,000 in 2006. The income for the prior year was primarily related to a $247,000 litigation settlement and $128,000 of duties related to the dumping and countervailing duty cases that were filed by a coalition of domestic PC strand producers which included us.

Interest Expense

Interest expense decreased $77,000, or 11.5%, to $592,000 in 2007 from $669,000 in 2006. The decrease was primarily due to lower average outstanding balances on the revolving credit facility in the current year together with lower amortization expense associated with capitalized financing costs.

Income Taxes

Our effective income tax rate was relatively flat for 2007 at 36.6% compared with 36.2% in 2006.

Earnings From Continuing Operations

Earnings from continuing operations for 2007 decreased to $24.3 million, or $1.33 per diluted share, compared to $34.4 million, or $1.86 per diluted share in 2006 primarily due to the lower sales and gross profit.

Earnings (Loss) From Discontinued Operations

The loss from discontinued operations for 2007 was $122,000, or $0.01 per diluted share compared to $1.3 million, or $0.07 per diluted share in 2006. The current year loss reflects the closure costs incurred to exit the industrial wire business and close our Fredericksburg, Virginia manufacturing facility. The prior year loss reflects the operating losses incurred by the industrial wire business together with the closure costs which were partially offset by a $1.3 million pre-tax gain on the sale of certain machinery and equipment associated with the industrial wire business for $6.0 million.

Net Earnings

Net earnings for 2007 decreased to $24.2 million, or $1.32 per diluted share, compared to $33.0 million, or $1.79 per diluted share in 2006 primarily due to the lower sales and gross profit which was partially offset by the reduction in the loss from discontinued operations associated with our exit from the industrial wire business and closure of our Fredericksburg, Virginia manufacturing facility.

2006 COMPARED WITH 2005

Net Sales

Net sales increased 6.5% to $329.5 million in 2006 from $309.3 million in 2005 as higher shipments more than offset lower average selling prices. Shipments for the year increased 11.0% while average selling prices decreased 4.0% from the prior year. The increase in shipments was primarily due to the continued improvement in nonresidential construction activity and demand for our concrete reinforcing products together with the completion of the inventory reduction measures pursued by customers during the prior year. The decrease in average selling prices was due to competitive activity in our markets which was offset by reductions in raw material costs.

Gross Profit

Gross profit increased 22.4% to $70.9 million, or 21.5% of net sales in 2006 from $57.9 million, or 18.7% of net sales in 2005. The increase in gross profit was driven by higher shipments together with wider spreads between average selling prices and raw material costs. In addition, gross profit for 2005 was negatively impacted by the sale of higher cost inventory as raw material costs and selling prices declined over the course of the year.

Selling, General and Administrative Expense

SG&A expense increased 5.1% to $17.0 million, or 5.2% of net sales in 2006 from $16.2 million, or 5.2% of net sales in 2005. We adopted SFAS No. 123(R) as of the beginning of fiscal 2006 which required all share-based payments to be recognized as expense over the requisite service period based upon their fair values as of the grant dates. Under the provisions of SFAS No. 123(R), total stock-based compensation expense for 2006 amounted to $1.2 million comprised of $535,000 of stock option expense and $638,000 of restricted stock amortization. Although we elected to adopt SFAS No. 123(R) using the modified prospective method, the 2005 amounts also reflect stock option expense due to certain previous option plans that were required to be accounted for as variable plans. Under variable plan accounting, compensation expense was recognized for the excess of the market price over the exercise price and adjusted to reflect changes in market valuation. As a result, total stock-based compensation expense for 2005 amounted to $805,000 comprised of $571,000 of stock option expense resulting from the increase in our share price that occurred during 2005 and $234,000 of restricted stock amortization. Excluding the stock-based compensation expense from both periods, SG&A expense increased $453,000 primarily due to increases in compensation expense ($445,000), allowance for doubtful accounts ($299,000), employee benefit costs ($295,000), and travel-related expenses ($211,000) partially offset by lower legal expenses ($556,000) and consulting fees ($244,000).

Other Expense (Income), Net

Other income was $446,000 in 2006 compared with $73,000 in 2005. The income for 2005 was primarily related to a $247,000 litigation settlement and $128,000 of duties related to the dumping and countervailing duty cases that were filed by a coalition of domestic PC strand producers which included us.

Interest Expense

Interest expense decreased $2.8 million, or 80.5%, to $669,000 in 2006 from $3.4 million in 2005. The decrease was primarily due to the reduction in average borrowing levels on our senior secured credit facility ($1.8 million) and lower amortization expense associated with capitalized financing costs and the unrealized loss on the terminated interest rate swaps which was fully amortized in 2005 ($959,000).

Income Taxes

Our effective income tax rate was relatively flat for 2006 at 36.2% compared with 36.1% in 2005.

Earnings From Continuing Operations

Earnings from continuing operations for 2006 increased to $34.4 million, or $1.86 per diluted share, compared to $24.5 million, or $1.29 per diluted share in 2005 primarily due to the higher sales and gross profit together with the reduction in interest expense in 2006.

Earnings (Loss) From Discontinued Operations

The loss from discontinued operations for 2006 was $1.3 million, or $0.07 per diluted share compared with earnings from discontinued operations of $546,000, or $0.03 per diluted share in 2005. The 2006 loss related to the operating losses and closure costs associated with our exit from the industrial wire business and closure of our Fredericksburg, Virginia manufacturing facility. In 2006, we completed the sale of certain machinery and equipment associated with the industrial wire business for $6.0 million and recorded a pre-tax gain of $1.3 million. The 2005 earnings consisted of a $793,000 gain on the disposal of real estate, the collection of a note receivable and the settlement on the release of an equipment lien associated with Insteel Construction Systems, a discontinued operation that we had previously exited in 1997, partially offset by a loss of $247,000 from the operations of the industrial wire business.

Net Earnings

Net earnings for 2006 increased to $33.0 million, or $1.79 per diluted share, compared to $25.0 million, or $1.32 per diluted share in 2005 primarily due to the higher sales and gross profit together with the reduction in interest expense during 2006 which was partially offset by the loss from discontinued operations.

LIQUIDITY AND CAPITAL RESOURCES

Selected Financial Data

	Year Ended		
(Dollars in thousands)	**September 29, 2007**	September 30, 2006	October 1, 2005
Net cash provided by operating activities of continuing operations	**$ 17,065**	$ 42,650	$ 41,830
Net cash used for investing activities of continuing operations	**(17,062)**	(19,472)	(6,036)
Net cash used for financing activities of continuing operations	**(1,842)**	(22,008)	(40,931)
Net cash provided by (used for) operating activities of discontinued operations	**(147)**	2,185	2,630
Net cash provided by investing activities of discontinued operations	–	5,963	2,120
Net cash used for financing activities of discontinued operations	–	–	(560)
Working capital	**70,697**	56,938	51,662
Total long-term debt	–	–	11,860
Percentage of total capital	–	–	11%
Shareholders' equity	**$143,850**	$122,438	$ 97,036
Percentage of total capital	**100%**	100%	89%
Total capital (total long-term debt + shareholders' equity)	**$143,850**	$122,438	$108,896

CASH FLOW ANALYSIS

Operating activities of continuing operations provided $17.1 million of cash in 2007 compared with $42.7 million in 2006 and $41.8 million in 2005. The year-over-year decrease in 2007 was largely due to the $10.1 million reduction in earnings from continuing operations and $18.9 million decrease in cash provided by working capital. In 2007, the net change in receivables, inventory and accounts payable and accrued expenses used $14.6 million of cash while providing $4.3 million and $7.9 million in 2006 and 2005, respectively. The cash used by working capital in the current year was primarily due to the $17.0 million decrease in accounts payable and accrued expenses resulting from the sharp reduction in raw material purchases during the fourth quarter together with changes in the mix of vendor payment terms. Depreciation and amortization rose $1.1 million, or 24.7%, primarily due to the increase in capital expenditures during the current and prior years and related asset additions. Deferred income taxes provided $2.0 million of cash during 2007 while using $1.6 million in 2006 primarily due to higher tax basis gains on the sale of fixed assets in the prior year.

Investing activities of continuing operations used $17.1 million of cash in 2007 compared with $19.5 million in 2006 and $6.0 million in 2005. Capital expenditures amounted to $17.0 million, $19.0 million and $6.3 million in 2007, 2006 and 2005, respectively, with the higher levels in the current and prior years primarily related to capital outlays for the expansions of the ESM and PC strand businesses. Capital expenditures are expected to be $10.0 million in 2008 primarily related to the upgrading of our Florida PC strand facility. The actual timing of these expenditures as well as the amounts are subject to change based on adjustments in the project timelines or scope, future market conditions, our financial performance and additional growth opportunities that may arise. In 2007, we sold an idle facility which had been classified as assets held for sale and realized net proceeds of $590,000. Investing activities from discontinued operations did not provide or utilize cash in 2007 while providing $6.0 million in 2006 from the net proceeds on the sale of certain machinery and equipment associated with our discontinued industrial wire business.

Financing activities of continuing operations used $1.8 million of cash in 2007 compared with $22.0 million in 2006 and $40.9 million in 2005. The year-over-year decrease in 2007 was due to the $16.0 million reduction in long-term debt and the $8.5 million of share repurchases in the prior year.

CREDIT FACILITIES

As of September 29, 2007, we had a $100.0 million revolving credit facility in place to supplement our operating cash flow in funding our working capital, capital expenditure and general corporate requirements. No borrowings were outstanding on the credit facility as of September 29, 2007 and September 30, 2006 and outstanding letters of credit totaled $1.9 million and $1.4 million, respectively. As of September 29, 2007, $54.7 million of borrowing capacity was available on the credit facility (see Note 4 to the consolidated financial statements).

Our balance sheet was debt-free as of September 29, 2007 and September 30, 2006. We believe that, in the absence of significant unanticipated cash demands, net cash generated by operating activities and amounts available under our revolving credit facility will be sufficient to satisfy our expected requirements for working capital, capital expenditures, dividends and share repurchases, if any.

OFF-BALANCE SHEET ARRANGEMENTS

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

CONTRACTUAL OBLIGATIONS

Our contractual obligations and commitments at September 29, 2007 are as follows:

Contractual Obligations (In thousands)	Payments Due by Period Total	Less Than 1 Year	1–3 Years	3–5 Years	More Than 5 Years
Operating leases	$ 1,466	$ 781	$ 658	$ 27	$ –
Raw material purchase commitments[1]	31,831	31,831	–	–	–
Other unconditional purchase obligations[2]	3,843	3,843	–	–	–
Pension benefit obligations	10,204	428	864	642	8,270
Supplemental employee retirement plan	18,312	80	160	418	17,654
Total	$65,656	$36,963	$1,682	$1,087	$25,924

(1) Non-cancelable fixed price purchase commitments for raw materials.
(2) Contractual commitments for equipment purchases.

OUTLOOK

We expect continued growth in nonresidential construction, our primary demand driver, in 2008, but at a reduced rate from the elevated levels of recent years. The outlook for commercial construction has weakened due to the ongoing housing downturn and recent tightening in the credit markets. However, other segments within nonresidential construction are expected to remain strong supported by: (1) higher spending for infrastructure-related construction associated with the recently enacted federal transportation funding authorization, the improved fiscal positions of most states and the heightened focus on addressing the critical infrastructure needs that exist; and (2) post-hurricane reconstruction in the Gulf region of the U.S.

At the same time, the drop-off in residential construction is expected to continue through 2008, which will adversely affect shipments to customers that have greater exposure to the housing sector. We now believe that a recovery in the housing market is unlikely to occur until sometime in 2009, although the exact timing remains highly uncertain. In addition, increasing imports of PC strand and escalating raw material costs could compress margins depending upon the strength of demand, competitive dynamics and our ability to recover these additional costs in our markets.

Despite these near-term challenges, we expect gradually increasing contributions during 2008 from the substantial investments that have been made in our facilities over the past two years to expand and reconfigure our Tennessee PC strand facility, add new ESM production lines in our North Carolina and Texas plants and a new standard welded wire reinforcing line at our Delaware facility, and upgrade our Florida PC strand operation which is expected to be completed in the third quarter of 2008. As we ramp up production on the new equipment, we anticipate dual benefits in the form of reduced operating costs and additional capacity to support future growth. In addition to these organic growth and cost reduction initiatives, we are continually evaluating potential acquisitions in our existing businesses that further our penetration in current markets served or expand our geographic reach. We anticipate that these actions, together with the positive overall outlook for our nonresidential construction-related markets, should have a favorable impact on our financial performance in 2008 (see "Forward-Looking Statements").

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 deemed appropriate, through the use of derivative financial instruments. We do not use financial instruments for trading purposes and we are not a party to any leveraged derivatives. We monitor our underlying market risk exposures on an ongoing basis and believe that we can modify or adapt our hedging strategies as necessary.

Commodity Prices

We have not generally used derivative commodity instruments to hedge our exposures to changes in commodity prices. Our principal commodity price exposure is hot-rolled carbon steel wire rod, our primary raw material, which we purchase from both domestic and

foreign suppliers and is denominated in U.S. dollars. Prior to 2004, we typically negotiated quantities and pricing on a quarterly basis for both domestic and foreign steel wire rod purchases to manage our exposure to price fluctuations and to ensure adequate availability of material consistent with our requirements. However, beginning in 2004, a tightening of supply in the rod market together with fluctuations in the raw material costs of rod producers resulted in increased price volatility which has continued through 2007. In some instances, wire rod producers have resorted to increasing the frequency of price adjustments, typically on a monthly basis as well as unilaterally changing the terms of prior commitments. Our ability to acquire steel wire rod from foreign sources on favorable terms is impacted by fluctuations in foreign currency exchange rates, foreign taxes, duties, tariffs and other trade actions. Although changes in wire rod costs and our selling prices may be correlated over extended periods of time, depending upon market conditions, there may be periods during which we are unable to fully recover increased rod costs through higher selling prices, which reduces our gross profit and cash flow from operations.

Interest Rates

Although we were debt-free as of September 29, 2007, future borrowings under our senior secured credit facility are sensitive to changes in interest rates.

Foreign Exchange Exposure

We have not typically hedged foreign currency exposures related to transactions denominated in currencies other than U.S. dollars and any such transactions have not been material in the past. We will occasionally hedge firm commitments for 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 September 29, 2007.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Insteel's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Insteel's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those written policies and procedures that: (1) pertain to maintaining records that in reasonable detail accurately and fairly reflect the transactions and dispositions of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are made in accordance with authorizations of management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Insteel's internal control over financial reporting as of September 29, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework. Based on its assessment, management believes that, as of September 29, 2007, Insteel's internal control over financial reporting was effective based on those criteria.

Grant Thornton LLP, an independent registered public accounting firm, has audited management's assessment of the effectiveness of Insteel's internal control over financial reporting and has issued an attestation report concurring with management's assessment which is on page 23.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM CONSOLIDATED FINANCIAL STATEMENTS

The Board of Directors and Shareholders
Insteel Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Insteel Industries, Inc. and subsidiary (a North Carolina corporation) as of September 29, 2007 and September 30, 2006 and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows for each of the three years in the period ended September 29, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Insteel Industries, Inc. and subsidiary as of September 29, 2007 and September 30, 2006 and the results of their operations and their cash flows for each of the three years in the period ended September 29, 2007, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 8 to the financial statements, the Company has adopted Financial Accounting Standards Board Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," as of September 29, 2007. In addition, as discussed in Note 1, the Company adopted Financial Accounting Standards Board Statement No. 123(R), "Share-Based Payment" on October 2, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Insteel Industries, Inc. and subsidiary's internal control over financial reporting as of September 29, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated November 19, 2007 expressed an unqualified opinion.

Grant Thornton LLP

Greensboro, North Carolina
November 19, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders
Insteel Industries, Inc.:

We have audited Insteel Industries, Inc. and subsidiary's (a North Carolina corporation) internal control over financial reporting as of September 29, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Insteel Industries, Inc. and subsidiary's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on Insteel Industries, Inc. and subsidiary's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Insteel Industries, Inc. and subsidiary maintained, in all material respects, effective internal control over financial reporting as of September 29, 2007 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Insteel Industries, Inc. and subsidiary as of September 29, 2007 and September 30, 2006 and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows for each of the three years in the period ended September 29, 2007, and our report dated November 19, 2007, expressed an unqualified opinion on those financial statements and contains an explanatory paragraph relating to the adoption of Financial Accounting Standards Board Statement ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." In addition, as discussed in Note 1, the Company adopted SFAS No. 123(R), "Share-Based Payment" on October 2, 2005.

Grant Thornton LLP

Greensboro, North Carolina
November 19, 2007

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except for per share amounts)	Year Ended September 29, 2007	September 30, 2006	October 1, 2005
Net sales	$297,806	$329,507	$309,320
Cost of sales	241,745	258,636	251,422
Gross profit	56,061	70,871	57,898
Selling, general and administrative expense	17,583	16,996	16,175
Other expense (income), net	4	(446)	(73)
Interest expense	592	669	3,427
Interest income	(415)	(255)	–
Earnings from continuing operations before income taxes	38,297	53,907	38,369
Income taxes	14,013	19,530	13,870
Earnings from continuing operations	24,284	34,377	24,499
Earnings (loss) from discontinued operations net of income taxes of ($77), ($851) and $330	(122)	(1,337)	546
Net earnings	$ 24,162	$ 33,040	$ 25,045
Per share amounts:			
Basic:			
Earnings from continuing operations	$ 1.34	$ 1.88	$ 1.31
Earnings (loss) from discontinued operations	(0.01)	(0.08)	0.03
Net earnings	$ 1.33	$ 1.80	$ 1.34
Diluted:			
Earnings from continuing operations	$ 1.33	$ 1.86	$ 1.29
Earnings (loss) from discontinued operations	(0.01)	(0.07)	0.03
Net earnings	$ 1.32	$ 1.79	$ 1.32
Cash dividends declared	$ 0.12	$ 0.12	$ 0.06
Weighted shares outstanding:			
Basic	18,142	18,307	18,656
Diluted	18,314	18,473	18,954

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

(In thousands, except for per share amounts)	September 29, 2007	September 30, 2006
Assets:		
Current assets:		
Cash and cash equivalents	$ 8,703	$ 10,689
Accounts receivable, net	34,518	37,519
Inventories	47,401	46,797
Prepaid expenses and other	4,640	2,675
Current assets of discontinued operations	–	411
Total current assets	95,262	98,091
Property, plant and equipment, net	67,147	55,217
Other assets	7,485	9,653
Non-current assets of discontinued operations	3,635	3,635
Total assets	$173,529	$166,596
Liabilities and shareholders' equity:		
Current liabilities:		
Accounts payable	$ 16,705	$ 30,691
Accrued expenses	7,613	9,819
Current liabilities of discontinued operations	247	643
Total current liabilities	24,565	41,153
Other liabilities	4,862	2,713
Long-term liabilities of discontinued operations	252	292
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value		
Authorized shares: 1,000		
None issued	–	–
Common stock, $1 stated value		
Authorized shares: 40,000		
Issued and outstanding shares: 2007, 18,303; 2006, 18,213	18,303	18,213
Additional paid-in capital	48,939	47,005
Deferred stock compensation	(1,132)	(662)
Retained earnings	79,859	57,882
Accumulated other comprehensive loss	(2,119)	–
Total shareholders' equity	143,850	122,438
Total liabilities and shareholders' equity	$173,529	$166,596

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Year Ended **September 29, 2007**	 September 30, 2006	 October 1, 2005
Cash Flows From Operating Activities:			
Net earnings	**$24,162**	$ 33,040	$ 25,045
Earnings (loss) from discontinued operations	**122**	1,337	(546)
Earnings from continuing operations	**24,284**	34,377	24,499
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities of continuing operations:			
Depreciation and amortization	**5,711**	4,578	4,139
Amortization of capitalized financing costs	**498**	529	651
Amortization of unrealized loss on financial instruments	**–**	–	837
Stock-based compensation expense	**1,258**	1,173	805
Excess tax benefits from exercise of stock options	**(122)**	(459)	–
Loss on sale of property, plant and equipment	**301**	82	63
Deferred income taxes	**2,003**	(1,627)	2,004
Increase in cash surrender value of life insurance over premiums paid	**(277)**	(193)	–
Net changes in assets and liabilities:			
Accounts receivable, net	**3,001**	1,082	481
Inventories	**(604)**	(15,228)	6,753
Accounts payable and accrued expenses	**(17,019)**	18,456	640
Other changes	**(1,969)**	(120)	958
Total adjustments	**(7,219)**	8,273	17,331
Net cash provided by operating activities—continuing operations	**17,065**	42,650	41,830
Net cash provided by (used for) operating activities—discontinued operations	**(147)**	2,185	2,630
Net cash provided by operating activities	**16,918**	44,835	44,460
Cash Flows From Investing Activities:			
Capital expenditures	**(17,013)**	(18,959)	(6,302)
Proceeds from sale of assets held for sale	**590**	–	904
Proceeds from sale of property, plant and equipment	**–**	52	27
Premium payments on life insurance policies	**(639)**	(565)	(665)
Net cash used for investing activities—continuing operations	**(17,062)**	(19,472)	(6,036)
Net cash provided by investing activities—discontinued operations	**–**	5,963	2,120
Net cash used for investing activities	**(17,062)**	(13,509)	(3,916)

(continued)

(In thousands)	Year Ended September 29, 2007	September 30, 2006	October 1, 2005
Cash Flows From Financing Activities:			
Proceeds from long-term debt	**16,999**	135,219	329,562
Principal payments on long-term debt	**(16,999)**	(147,079)	(370,070)
Financing costs	–	(307)	(23)
Cash received from exercise of stock options	**162**	360	175
Excess tax benefits from exercise of stock options	**122**	459	–
Repurchase of common stock	–	(8,529)	–
Cash dividends paid	**(2,176)**	(2,222)	(566)
Other	**50**	91	(9)
Net cash used for financing activities—continuing operations	**(1,842)**	(22,008)	(40,931)
Net cash used for financing activities—discontinued operations	–	–	(560)
Net cash used for financing activities	**(1,842)**	(22,008)	(41,491)
Net increase (decrease) in cash and cash equivalents	**(1,986)**	9,318	(947)
Cash and cash equivalents at beginning of period	**10,689**	1,371	2,318
Cash and cash equivalents at end of period	**$ 8,703**	$ 10,689	$ 1,371
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the period for:			
Interest	**$ 93**	$ 202	$ 3,531
Income taxes	**16,785**	17,489	12,001
Non-cash financing activity:			
Cashless exercise of stock options	–	–	338
Purchases of property, plant and equipment in accounts payable	**937**	–	–
Issuance of restricted stock	**1,215**	792	742
Declaration of cash dividends to be paid	**544**	543	565
Other	–	–	105

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Deferred Compensation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)[1]	Total Shareholders' Equity
Balance at October 2, 2004	18,244	$ 18,244	$ 43,677	$ –	$ 10,927	$(1,637)	$ 71,211
Comprehensive income:							
Net earnings					25,045		25,045
Amortization of loss on financial instruments included in net earnings						656	656
Recognition of additional pension plan liability						(111)	(111)
Comprehensive income[1]							25,590
Stock options exercised	570	570	(395)				175
Restricted stock granted	82	83	659	(742)			–
Restricted stock shares from dividend			3				3
Compensation expense associated with stock-based plans			571	234			805
Retirement of shares held within grantor trust	(36)	(36)			(69)		(105)
Cash dividends declared					(1,131)		(1,131)
Excess tax benefits from exercise of stock options			488				488
Balance at October 1, 2005	18,860	$ 18,861	$ 45,003	$ (508)	$ 34,772	$(1,092)	$ 97,036
Comprehensive income:							
Net earnings					33,040		33,040
Reduction in pension liability						1,092	1,092
Comprehensive income[1]							34,132
Stock options exercised	101	101	259				360
Restricted stock granted	51	50	742	(792)			–
Restricted stock shares from dividend	1	1	7				8
Compensation expense associated with stock-based plans			535	638			1,173
Excess tax benefits from exercise of stock options			459				459
Repurchase of common stock	(800)	(800)			(7,729)		(8,529)
Cash dividends declared					(2,201)		(2,201)
Balance at September 30, 2006	18,213	$ 18,213	$ 47,005	$ (662)	$ 57,882	$ –	$ 122,438
Comprehensive income:							
Net earnings					24,162		24,162
Recognition of additional pension plan liability						(9)	(9)
Adjustment to adopt SFAS No. 158						(2,110)	(2,110)
Comprehensive income[1]							22,043
Stock options exercised	23	23	139				162
Restricted stock granted	67	67	1,148	(1,215)			–
Restricted stock shares from dividend			12				12
Compensation expense associated with stock-based plans			513	745			1,258
Excess tax benefits from exercise of stock options			122				122
Cash dividends declared					(2,185)		(2,185)
Balance at September 29, 2007	**18,303**	**$18,303**	**$48,939**	**$(1,132)**	**$79,859**	**$(2,119)**	**$143,850**

(1) Components of accumulated other comprehensive income (loss) are reported net of related income taxes.

See accompanying notes to consolidated financial statements.

(1) DESCRIPTION OF BUSINESS

Insteel Industries, Inc. ("Insteel" or "the Company") is one of the nation's largest manufacturers of steel wire reinforcing products for concrete construction applications. Insteel is the parent holding company for a wholly-owned operating subsidiary, Insteel Wire Products Company ("IWP"). The Company manufactures and markets PC strand and welded wire reinforcement products, including concrete pipe reinforcement, engineered structural mesh and standard welded wire reinforcement. The Company's products are primarily sold to manufacturers of concrete products and to a lesser extent to distributors and rebar fabricators that are located nationwide as well as into Canada, Mexico, and Central and South America.

The Company's exit from the industrial wire business in June 2006 (see Note 7 to the consolidated financial statements) narrowed its strategic and operational focus to concrete reinforcing products. The results of operations for the industrial wire products business have been reported as discontinued operations for all periods presented.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fiscal year. The Company's fiscal year is the 52 or 53 weeks ending on the Saturday closest to September 30. Fiscal years 2007, 2006 and 2005 were 52-week fiscal years. All references to years relate to fiscal years rather than calendar years.

Principles of consolidation. The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. There is no assurance that actual results will not differ from these estimates.

Cash equivalents. The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents.

Stock options. Effective October 2, 2005, the Company began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment" as interpreted by Staff Accounting Bulletin ("SAB") No. 107. Previously the Company had accounted for stock option plans under the intrinsic value method prescribed by Accounting Principals Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and therefore no related compensation expense was recorded for awards granted with no intrinsic value. The Company adopted the modified prospective transition method provided for under SFAS No. 123(R) and consequently, has not retroactively adjusted results from prior periods. Under this transition method, (1) stock compensation expense associated with options granted on or after October 2, 2005 is recorded in accordance with the provisions of SFAS No. 123(R); and (2) stock compensation expense associated with the remaining unvested portion of stock options granted prior to October 2, 2005 is recorded based on the grant date fair value of the options estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

Under the provisions of SFAS No. 123(R), the Company recorded $513,000 and $535,000 of compensation expense for stock options within selling, general and administrative expense for the years ended September 29, 2007 and September 30, 2006, respectively. The Company recorded $571,000 of compensation expense for the year ended October 1, 2005 for stock options associated with certain previous option plans that were required to be accounted for as variable plans under the provisions of APB No. 25. Under variable plan accounting, compensation expense was recognized for the excess of the market price over the exercise price and adjusted each reporting period to reflect changes in market valuation. Under the provisions of SFAS No. 123(R), these options are now accounted for as equity awards and, since the options were fully vested as of October 2, 2005, no compensation expense was recorded in 2006 and 2007.

Prior to the adoption of SFAS No. 123(R), the benefit of tax deductions in excess of recognized stock compensation expense was reported as a reduction of taxes paid within operating cash flow. SFAS No. 123(R) requires that such benefits be reported as a financing cash flow. For the years ended September 29, 2007 and September 30, 2006, $122,000 and $459,000 of excess tax benefits were generated from option exercises, respectively.

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company's option plans for the year ended October 1, 2005:

(In thousands, except for per share amounts)	Year Ended October 1, 2005
Net earnings—as reported	$25,045
Stock-based compensation expense included in reported net earnings, net of related tax effects	(214)
Total stock-based compensation expense determined under fair-value based method for all awards, net of related tax effects	(141)
Net earnings—pro forma	$24,690
Basic net earnings per share—as reported	$ 1.34
Basic net earnings per share—pro forma	1.32
Diluted net earnings per share—as reported	1.32
Diluted net earnings per share—pro forma	1.30
Basic shares outstanding—as reported and pro forma	18,656
Diluted shares outstanding—as reported	18,954
Diluted shares outstanding—pro forma	18,940

Revenue recognition and credit risk. The Company recognizes revenue from product sales in accordance with SAB No. 104 when the products are shipped and risk of loss and title has passed to the customer. Substantially all of the Company's accounts receivable are due from customers that are located in the U.S. and the Company generally requires no collateral depending upon the creditworthiness of the account. The Company provides an allowance for doubtful accounts based upon its assessment of the credit risk of specific customers, historical trends and other information. The Company writes off accounts receivable when they become uncollectible and payments subsequently received are credited to the allowance for doubtful accounts. There is no disproportionate concentration of credit risk.

Shipping and handling costs. The Company includes all of the outbound freight, shipping and handling costs associated with the shipment of products to customers in cost of sales. Any amounts paid by customers to the Company for shipping and handling are recorded in net sales on the consolidated statement of operations.

Inventories. Inventories are valued at the lower of average cost (which approximates computation on a first-in, first-out basis) or market (net realizable value or replacement cost).

Property, plant and equipment. Property, plant and equipment are stated at cost or otherwise at reduced values to the extent there have been asset impairment write-downs. Expenditures for maintenance and repairs are charged directly to expense when incurred, while major improvements are capitalized. Depreciation is computed for financial reporting purposes principally by use of the straight-line method over the following estimated useful lives: machinery and equipment, 3–15 years; buildings, 10–30 years; land improvements, 5–15 years. Depreciation expense was approximately $5.7 million in 2007, $4.6 million in 2006 and $4.1 million in 2005. Capitalized software is amortized over the shorter of the estimated useful life or 5 years. No interest costs were capitalized in 2007, 2006 or 2005.

Other assets. Other assets consist principally of non-current deferred tax assets, capitalized financing costs, the cash surrender value of life insurance policies and assets held for sale. Capitalized financing costs are amortized using the straight-line method, which approximates the effective interest method over the life of the related credit agreement.

Long-lived assets. Long-lived assets include property, plant and equipment and identifiable intangible assets with definite useful lives. The Company assesses the impairment of long-lived assets whenever events or changes in circumstance indicate that the carrying value may not be fully recoverable. When the Company determines that the carrying value of such assets may not be recoverable, it measures recoverability based on the undiscounted cash flows expected to be generated by the related asset or asset group. If it is determined that an impairment loss has occurred, the loss is recognized during the period incurred. An impairment loss is calculated as the difference between the carrying

value and the present value of estimated future net cash flows or comparable market values. There were no impairment losses in 2007, 2006 or 2005.

Fair value of financial instruments. The carrying amounts for cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses approximate fair value because of their short maturities.

Income taxes. Income taxes are based on pretax financial accounting income. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. The Company assesses the need to establish a valuation allowance against its deferred tax assets to the extent the Company no longer believes it is more likely than not that the tax assets will be fully utilized.

Earnings per share. Basic earnings per share ("EPS") are computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted EPS are computed by dividing net earnings by the weighted average number of common shares and other dilutive equity securities outstanding during the period. Securities that have the effect of increasing EPS are considered to be anti-dilutive and are not included in the computation of diluted EPS.

Recent accounting pronouncements. In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48") which clarifies the criteria for the recognition of tax benefits under SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 specifies how tax benefits for uncertain tax positions are to be recognized, measured and derecognized in financial statements; requires certain disclosures of uncertain tax matters; specifies how reserves for uncertain tax positions should be classified on the balance sheet; and provides transition and interim period guidance, among other provisions. FIN No. 48 is effective for the Company beginning in fiscal 2008 and requires that the cumulative effect of applying its provisions be disclosed separately as a one-time, non-cash charge against the opening balance of retained earnings in the year of adoption. Based on the Company's preliminary analysis, the adoption of FIN No. 48 is expected to result in an estimated charge to retained earnings of approximately $260,000. The actual amount of the adjustment will be recorded in the first quarter of 2008 upon the finalization of the Company's analysis.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company beginning in fiscal 2009. At this time, the Company has not determined what effect, if any, the adoption of SFAS No. 157 will have on its financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS No. 158 requires that an employer recognize the overfunded or underfunded status of a defined benefit postretirement plan in its statement of financial position and changes in the funded status through comprehensive income in the year in which the changes occur. SFAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position. The provisions regarding the recognition of a plan's funding status were effective for the Company in fiscal 2007 and resulted in a $2.1 million decrease in shareholders' equity, net of tax. The provisions regarding the change in the measurement date are effective for the Company beginning in fiscal 2009. The adoption of SFAS No. 158 is further discussed in Note 8 to the consolidated financial statements.

(3) STOCK SPLIT

On May 16, 2006, the Board of Directors approved a two-for-one split of the Company's common stock payable in the form of a stock dividend. The stock split entitled each shareholder of record on June 2, 2006 to receive one share of common stock for each outstanding share of common stock held on that date and was distributed on June 16, 2006. Unless otherwise indicated, the capital stock accounts and all share and earnings per share amounts in this report give effect to the stock split, applied retroactively, to all periods presented.

(4) CREDIT FACILITIES

As of September 29, 2007, the Company had a $100.0 million revolving credit facility in place to supplement its operating cash flow in funding its working capital, capital expenditure and general corporate requirements. No borrowings were outstanding on the credit facility as of September 29, 2007 and September 30, 2006 and outstanding letters of credit totaled $1.9 million and $1.4 million, respectively. As of September 29, 2007, $54.7 million of borrowing capacity was available on the credit facility.

Advances under the credit facility are limited to the lesser of the revolving credit commitment or a borrowing base amount that is calculated based upon a percentage of eligible receivables and inventories plus, upon the Company's request and subject to certain conditions, a percentage of eligible equipment and real estate. Interest rates on the revolver are based upon (1) a base rate that is established at the higher of the prime rate or 0.50% plus the federal funds rate, or (2) at the election of the Company, a LIBOR rate, plus in either case, an applicable interest rate margin. The applicable interest rate margins are adjusted on a quarterly basis based upon the amount of excess availability on the revolver within the range of 0.00%–0.50% for the base rate and 1.25%–2.00% for the LIBOR rate. In addition, the applicable interest rate margins would be adjusted to the highest percentage indicated for each range upon the occurrence of certain events of default provided for under the credit facility. Based on the Company's excess availability as of September 29, 2007, the applicable interest rate margins were 0.00% for the base rate and 1.25% for the LIBOR rate on the revolver.

In connection with the refinancing of the previous credit facility, the Company terminated interest rate swap agreements for payments totaling $2.1 million and recorded a corresponding unrealized loss for hedging instruments in fiscal 2004 which, in accordance with generally accepted accounting principals ("GAAP") was amortized and recorded as interest expense through the original termination date of the swap agreement of January 31, 2005.

The Company's ability to borrow available amounts under the revolving credit facility will be restricted or eliminated in the event of certain covenant breaches, events of default or if the Company is unable to make certain representations and warranties.

Financial Covenants

The terms of the credit facility require the Company to maintain a Fixed Charge Coverage Ratio (as defined in the Credit Agreement) of not less than: (1) 1.10 at the end of each fiscal quarter for the twelve-month period then ended when the amount of excess availability on the revolving credit facility is less than $10.0 million and the applicable borrowing base only includes eligible receivables and inventories; or (2) 1.15 at the end of each fiscal quarter for the twelve-month period then ended when the amount of excess availability on the revolving credit facility is less than $10.0 million and the applicable borrowing base includes eligible receivables, inventories, equipment and real estate. As of September 29, 2007, the Company was in compliance with all of the financial covenants under the credit facility.

Negative Covenants

In addition, the terms of the credit facility restrict the Company's ability to, among other things: engage in certain business combinations or divestitures; make investments in or loans to third parties, unless certain conditions are met with respect to such investments or loans; pay cash dividends or repurchase shares of the Company's stock subject to certain minimum borrowing availability requirements; incur or assume indebtedness; issue securities; enter into certain transactions with affiliates of the Company; or permit liens to encumber the Company's property and assets. As of September 29, 2007, the Company was in compliance with all of the negative covenants under the credit facility.

Events of Default

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

Amortization of capitalized financing costs associated with the senior secured facility was $498,000 in 2007, $529,000 in 2006 and $651,000 in 2005. Accumulated amortization of capitalized financing costs was $2.6 million and $2.1 million as of September 29, 2007 and September 30, 2006, respectively. The Company expects the amortization of capitalized financing costs to approximate the following amounts for the next five fiscal years:

Fiscal year	In thousands
2008	$499
2009	499
2010	345
2011	–
2012	–

(5) STOCK-BASED COMPENSATION

Under the Company's stock option plans, employees and directors may be granted options to purchase shares of common stock at the fair market value on the date of the grant. Options granted under these plans generally vest over three years and expire ten years from the date of the grant. The fair value of each option award granted prior to October 1, 2005 was estimated on the date of grant using a Black-Scholes option-pricing model. With the adoption of SFAS No. 123(R), the Company determined that it would use a Monte Carlo valuation model for options that are granted subsequent to October 1, 2005. The weighted average estimated fair values of stock options granted during 2007, 2006, and 2005 were $8.69, $8.82 and $7.74 per share, respectively, based on the following weighted average assumptions:

	Year Ended		
	September 29, 2007	September 30, 2006	October 1, 2005
Expected term (in years)	**3.16**	3.20	7.00
Risk-free interest rate	**4.70%**	4.82%	4.14%
Expected volatility	**65.84%**	74.72%	180.40%
Expected dividend yield	**0.65%**	0.70%	0.79%

The assumptions utilized in the 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 the Company's 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 the Company's 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.

At September 29, 2007, there were 1,340,000 shares available for future grants under the Company's equity incentive plans. The following table summarizes stock option activity during 2005, 2006 and 2007:

		Exercise Price Per Share			
(Share amounts in thousands)	Options Outstanding	Range	Weighted Average	Contractual Term–Weighted Average	Aggregate Intrinsic Value (in thousands)
Outstanding at October 2, 2004	938	$ 0.18 – $ 5.43	$ 2.36		
Granted	96	6.89 – 9.12	8.24		
Exercised	(706)	0.18 – 5.43	2.17		$4,762
Outstanding at October 1, 2005	328	0.18 – 9.12	4.48		
Granted	55	15.64 – 20.26	17.54		
Exercised	(101)	0.18 – 9.12	3.56		1,396
Outstanding at September 30, 2006	282	0.18 – 20.26	7.37		
Granted	79	17.11 – 20.27	18.54		
Exercised	(23)	4.56 – 15.64	7.12		228
Forfeited	(2)	20.26 – 20.26	20.26		
Outstanding at September 29, 2007	**336**	**0.18 – 20.27**	**9.95**	**6.70 years**	**2,179**
Vested and anticipated to vest in future at September 29, 2007	**327**		**9.79**	**6.64 years**	**2,165**
Exercisable at September 29, 2007	**196**		**5.41**	**5.08 years**	**1,989**

The remaining unrecognized compensation cost related to unvested awards at September 29, 2007 was $582,000 which is expected to be recognized over a weighted average period of 1.26 years.

Restricted stock awards. During the years ended September 29, 2007, September 30, 2006 and October 1, 2005, the Company granted 67,000, 51,000 and 82,000 shares of restricted stock, respectively, to key employees and directors which had a total market value of $1.2 million, $792,000 and $742,000, respectively, as of the grant date. The following table summarizes restricted stock activity during 2005, 2006 and 2007:

(Share amounts in thousands)	Restricted Stock Awards Outstanding	Weighted Average Grant Date Fair Value
Balance, October 2, 2004	–	$ –
Granted	82	8.98
Released	–	–
Balance, October 1, 2005	82	8.98
Granted	51	15.64
Released	(30)	8.72
Balance, September 30, 2006	103	12.27
Granted	67	18.18
Released	(28)	12.51
Balance, September 29, 2007	**142**	**15.00**

The Company recorded amortization expense of $745,000, $638,000 and $234,000 pertaining to the restricted stock for the years ended September 29, 2007, September 30, 2006 and October 1, 2005, respectively. The Company will continue to amortize the remaining unamortized balance of $1.1 million over the vesting period of one to three years.

(6) INCOME TAXES

The components of the provision for income taxes on continuing operations are as follows:

(Dollars in thousands)	Year Ended September 29, 2007	September 30, 2006	October 1, 2005
Provision for income taxes:			
Current:			
Federal	**$10,801**	$18,603	$10,457
State	**1,209**	2,554	1,409
	12,010	21,157	11,866
Deferred:			
Federal	**1,821**	(1,437)	1,802
State	**182**	(190)	202
	2,003	(1,627)	2,004
Income taxes	**$14,013**	$19,530	$13,870
Effective income tax rate	**36.6%**	36.2%	36.1%

The reconciliation between income taxes computed at the federal statutory rate and the provision for income taxes on continuing operations is as follows:

(Dollars in thousands)	Year Ended September 29, 2007		September 30, 2006		October 1, 2005	
Provision for income taxes at federal statutory rate	**$13,403**	**35.0%**	$18,867	35.0%	$13,429	35.0%
State income taxes, net of federal tax benefit	**904**	**2.4**	1,381	2.6	1,166	3.0
Qualified production activities deduction	**(374)**	**(1.0)**	(490)	(0.9)	–	–
Other permanent book and tax differences, net	–	–	–	–	77	0.2
Stock option expense (benefit)	**126**	**0.3**	151	0.3	(575)	(1.5)
Valuation allowance	–	–	(37)	(0.1)	(227)	(0.6)
Revisions to estimates based on filing of final tax return	**(32)**	**(0.1)**	(21)	(0.1)	–	–
Other, net	**(14)**	**(0.0)**	(321)	(0.6)	–	–
Provision for income taxes	**$14,013**	**36.6%**	$19,530	36.2%	$13,870	36.1%

The components of deferred tax assets and liabilities are as follows:

(In thousands)	**September 29, 2007**	September 30, 2006
Deferred tax assets:		
Accrued expenses or asset reserves for financial statements, not yet deductible for tax purposes	**$ 2,492**	$ 2,440
State net operating loss carryforwards	**601**	944
Goodwill, amortizable for tax purposes	**2,346**	2,686
Defined benefit plans	**1,299**	–
Nonqualified stock options not deductible in current year	**239**	204
Valuation allowance	**(601)**	(599)
Gross deferred tax assets	**6,376**	5,675
Deferred tax liabilities:		
Plant and equipment principally due to differences in depreciation and impairment charges	**(3,001)**	(1,467)
Other reserves	**(671)**	(800)
Gross deferred tax liabilities	**(3,672)**	(2,267)
Net deferred tax asset	**$ 2,704**	$ 3,408

The Company has recorded the following amounts for deferred taxes on its consolidated balance sheets as of September 29, 2007 and September 30, 2006: a current deferred tax asset (net of valuation allowance) of $1.2 million for both years in prepaid expenses and other, and a non-current deferred tax asset (net of valuation allowance) of $1.5 million and $2.2 million, respectively, in other assets. The Company has $9.6 million of gross state operating loss carryforwards that begin to expire in six years, but principally expire in 13–17 years.

The realization of the Company's deferred tax assets is entirely dependent upon the Company's ability to generate future taxable income in applicable jurisdictions. GAAP requires that the Company periodically assess the need to establish a valuation allowance against its deferred tax assets to the extent the Company no longer believes it is more likely than not that they will be fully utilized. As of September 29, 2007, the Company had recorded a valuation allowance of $601,000 pertaining to various state NOLs that were not anticipated to be utilized. The valuation allowance established by the Company is subject to periodic review and adjustment based on changes in facts and circumstances and would be reduced should the Company utilize the state net operating loss carryforwards against which an allowance had been provided or determine that such utilization is more likely than not.

(7) DISCONTINUED OPERATIONS

In April 2006, the Company decided to exit the industrial wire business with the closure of its Fredericksburg, Virginia facility which manufactured tire bead wire and other industrial wire for commercial and industrial applications. The Company's decision was based on the weakening in the business outlook for the facility and the expected continuation of difficult market conditions and reduced operating levels. Manufacturing activities at the Virginia facility ceased in June 2006 and the Company is currently in the process of liquidating the remaining assets of the business.

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

The following table summarizes the results of discontinued operations for the years ended September 29, 2007, September 30, 2006 and October 1, 2005, respectively:

	Year Ended		
(In thousands)	**September 29, 2007**	September 30, 2006	October 1, 2005
Net sales	**$ –**	$22,544	$36,216
Earnings (loss) before income taxes	**(199)**	(2,188)	876
Income taxes	**(77)**	851	(330)
Net earnings (loss)	**(122)**	(1,337)	546

Included within results from discontinued operations is an allocation of interest expense which was calculated based on the net assets of the industrial wire business relative to the consolidated net assets of the Company. Interest expense allocated to discontinued

operations was $64,000 and $802,000 for the years ended September 30, 2006 and October 1, 2005, respectively.

The net loss from discontinued operations for the year ended September 30, 2006 includes a pre-tax gain of $1.3 million on the sale of certain machinery and equipment associated with the industrial wire business. The net earnings from discontinued operations for the year ended October 1, 2005 includes a pre-tax gain of $1.3 million relating to the disposal of real estate, the collection of a note receivable, and the settlement on the release of an equipment lien associated with Insteel Construction Systems ("ICS"), a discontinued operation that the Company had previously exited in 1997.

Assets and liabilities of discontinued operations as of September 29, 2007 and September 30, 2006 are as follows:

(In thousands)	September 29, 2007	September 30, 2006
Assets:		
Current assets:		
Accounts receivable, net	$ –	$ 407
Prepaid expenses and other	–	4
Total current assets	–	411
Other assets	3,635	3,635
Total assets	$3,635	$4,046
Liabilities:		
Current liabilities:		
Accounts payable	$ 4	$ 25
Accrued expenses	243	618
Total current liabilities	247	643
Other liabilities	252	292
Total liabilities	$ 499	$ 935

As of September 29, 2007, there was approximately $285,000 of accrued expenses and other liabilities related to ongoing lease obligations and closure-related liabilities incurred as a result of the Company's exit from the industrial wire business.

(8) EMPLOYEE BENEFIT PLANS

Adoption of SFAS No. 158. On September 29, 2007, the Company adopted the recognition and disclosure provisions of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." Prior to the adoption of SFAS No. 158, the Company accounted for its defined benefit postretirement plans under SFAS No. 87, "Employers' Accounting for Pensions" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." SFAS No. 158 requires an employer to recognize the funded status of its defined benefit plans in its statement of financial position, with a corresponding adjustment to accumulated other comprehensive income, net of tax. The adjustment to accumulated other comprehensive income at adoption represents the net unrecognized actuarial gains and unrecognized prior service costs which were previously netted against the funded status of the plans in the Company's statement of financial position. These amounts will subsequently be recognized as net benefit cost consistent with the Company's historical accounting policy for amortizing such amounts. In addition, actuarial gains and losses that arise in subsequent periods and are not recognized as net periodic benefit cost in the same periods will be recognized as a component of net periodic benefit cost on the same basis as the amount recognized in accumulated other comprehensive income at the adoption of SFAS No. 158.

SFAS No. 158 affects the accounting for the Company's defined benefit pension plan and its supplemental employee retirement plan, both of which are discussed below. The effects of adopting the provisions of SFAS No. 158 on the Company's consolidated balance sheet as of September 29, 2007 are presented in the following table. The adoption of SFAS No. 158 had no effect on the Company's consolidated statement of operations for the year ended September 29, 2007 or for any prior period presented, and will not affect the Company's operating results in future periods.

(In thousands)	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Prepaid expenses and other	$5,960	$(1,320)	$4,640
Deferred tax asset	1,410	1,294	2,704
Other non-current liabilities	2,779	2,083	4,862
Accumulated other comprehensive income	9	2,110	2,119

Retirement plans. The Company has one defined benefit pension plan, the Insteel Wire Products Company Retirement Income Plan for Hourly Employees, Wilmington, Delaware ("the Delaware Plan"). The Delaware Plan provides benefits for eligible employees based primarily upon years of service and compensation levels. The Company's funding policy is to contribute amounts at least equal to those required by law. No contributions were made to the Delaware Plan during 2007. The Company expects to contribute $200,000 to the Delaware Plan in 2008.

The reconciliation of the projected benefit obligation, plan assets, funded status of the plan and amounts recognized in the Company's consolidated balance sheets at September 29, 2007, September 30, 2006 and October 1, 2005 is as follows:

	Year Ended		
(In thousands)	**September 29, 2007**	September 30, 2006	October 1, 2005
Change in benefit obligation:			
Benefit obligation at beginning of year	**$4,527**	$4,702	$ 4,036
Service cost	**78**	82	91
Interest cost	**269**	253	268
Actuarial loss (gain)	**203**	(306)	512
Distributions	**(642)**	(204)	(205)
Benefit obligation at end of year	**$4,435**	$4,527	$ 4,702
Change in plan assets:			
Fair value of plan assets at beginning of year	**$4,527**	$3,334	$ 2,633
Actual return on plan assets	**536**	79	350
Employer contributions	**–**	1,318	556
Distributions	**(642)**	(204)	(205)
Fair value of plan assets at end of year	**$4,421**	$4,527	$ 3,334
Reconciliation of funded status to net amount recognized:			
Funded status	**$ (14)**	$ –	$(1,368)
Unrecognized net loss	**–**	1,476	1,762
Unrecognized prior service cost	**–**	2	2
Net amount recognized	**$ (14)**	$1,478	$ 396
Amounts recognized in the consolidated balance sheet consist of:			
Current prepaid pension asset	**$ –**	$ 236	$ 396
Non-current prepaid pension asset	**–**	1,242	–
Accrued benefit liability	**(14)**	–	(1,764)
Intangible asset related to prior service cost	**–**	–	2
Accumulated other comprehensive loss (net of tax)	**827**	–	1,092
Net amount recognized	**$ 813**	$1,478	$ (274)
Amounts recognized in accumulated other comprehensive income:			
Unrecognized net loss	**$1,333**		
Unrecognized prior service cost	**1**		
Net amount recognized	**$1,334**		
Other changes in plan assets and benefit obligations recognized in other comprehensive income:			
Net gain	**$ (143)**		
Amortization of prior service cost	**(1)**		
Total recognized in other comprehensive income	**$ (144)**		

Net periodic pension cost includes the following components:

	Year Ended		
(In thousands)	**September 29, 2007**	September 30, 2006	October 1, 2005
Service cost	**$ 78**	$ 82	$ 91
Interest cost	**269**	253	268
Expected return on plan assets	**(324)**	(243)	(217)
Amortization of prior service cost	**1**	1	3
Recognized net actuarial loss	**134**	143	151
Net periodic pension cost	**$ 158**	$ 236	$ 296

The estimated net loss and prior service cost that will be amortized from accumulated other comprehensive income into net periodic pension cost over the next fiscal year is $96,000 and $1,000, respectively.

The assumptions used in the valuation of the plan are as follows:

	Measurement Date		
	September 29, 2007	September 30, 2006	October 1, 2005
Assumptions at year-end:			
Discount rate	**6.50%**	6.25%	6.00%
Rate of increase in compensation levels	**N/A**	N/A	N/A
Expected long-term rate of return on assets	**8.00%**	8.00%	8.00%

The projected benefit payments under the plan are as follows:

Fiscal year(s)	In thousands
2008	$ 428
2009	428
2010	436
2011	437
2012	205
2013–2017	1,617

The Delaware Plan has a long-term target asset mix of 65% equities and 35% fixed income. The ranges for the long-term allocation are: equities 60% to 80%, fixed income 20% to 40% and cash reserves 0 to 10%. The investment strategy for equities emphasizes U.S. large cap equities with the portfolio's performance measured against the S&P 500 index or other applicable indices. The investment strategy for fixed income investments is focused on maintaining an overall portfolio with a minimum credit rating of A-1 as well as a minimum rating of any security at the time of purchase of Baa/BBB by Moody's or Standard & Poor's, if rated. The total fund has an expected return of 8.0% based on the overall policy allocation and historical market returns, compared to the expected long-term rate of return of 8.0% used to develop the plan's net periodic pension cost.

Supplemental employee retirement plan. The Company has Retirement Security Agreements (each, a "SERP") with certain of its employees (each, a "Participant"). Under the SERP, if the Participant remains in continuous service with the Company for a period of at least 30 years, the Company will pay to the Participant a supplemental retirement benefit for the 15-year period following the Participant's retirement equal to 50% of the Participant's highest average annual base salary for five consecutive years in the 10-year period preceding the Participant's retirement. If the Participant retires prior to the later of age 65 or the completion of 30 years of continuous service with the Company, but has completed at least 10 years of continuous service with the Company, the amount of the supplemental retirement benefit will be reduced by 1/360th for each month short of 30 years that the Participant was employed by the Company. In 2005, the Company amended the SERP to add Participants and increase benefits to certain Participants already included in the plan.

The reconciliation of the projected benefit obligation, plan assets, funded status of the plan and amounts recognized in the Company's consolidated balance sheets for the SERP at September 29, 2007, September 30, 2006 and October 1, 2005 is as follows:

(In thousands)	Year Ended September 29, 2007	(Revised) September 30, 2006	(Revised) October 1, 2005
Change in benefit obligation:			
Benefit obligation at beginning of year	**$ 3,868**	$ 3,574	$ 3,315
Service cost	**163**	106	103
Interest cost	**230**	207	196
Actuarial loss	**11**	61	–
Distributions	**(80)**	(80)	(40)
Benefit obligation at end of year	**$ 4,192**	$ 3,868	$ 3,574
Change in plan assets:			
Actual employer contributions	**$ 80**	$ 80	$ 40
Actual distributions	**(80)**	(80)	(40)
Plan assets at fair value at end of year	**$ –**	$ –	$ –
Reconciliation of funded status to net amount recognized:			
Funded status	**$(4,192)**	$(3,868)	$(3,574)
Unrecognized net loss	**–**	510	451
Unrecognized prior service cost	**–**	1,588	1,815
Net amount recognized	**$(4,192)**	$(1,770)	$(1,308)
Amounts recognized in accumulated other comprehensive loss:			
Unrecognized prior service costs	**$ 2,083**		
Net amount recognized	**$ 2,083**		
Other changes in plan assets and benefit obligations recognized in other comprehensive loss:			
Net loss	**$ 1**		
Prior service costs	**(227)**		
Total recognized in other comprehensive loss	**$ (226)**		

Net periodic pension cost includes the following components:

(In thousands)	Year Ended September 29, 2007	September 30, 2006	October 1, 2005
Service cost	**$ 163**	$ 106	$ 103
Interest cost	**230**	207	196
Prior service cost	**227**	227	227
Recognized net actuarial loss	**10**	2	11
Net periodic pension cost	**$ 630**	$ 542	$ 537

The estimated net loss and prior service costs that will be amortized from accumulated other comprehensive income into net periodic pension cost over the next fiscal year is $8,000 and $227,000, respectively.

The assumptions used in the valuation of the SERP are as follows:

	Measurement Date		
	September 29, 2007	December 1, 2005	December 1, 2004
Assumptions at year-end:			
Discount rate	**6.25%**	5.60%	5.60%
Rate of increase in compensation levels	**3.00%**	3.00%	3.00%

The projected benefit payments under the SERP are as follows:

Fiscal year(s)	In thousands
2008	$ 80
2009	80
2010	80
2011	169
2012	249
2013–2017	1,375

As noted above, the SERP was amended in 2005 to add Participants and increase benefits to certain Participants already included in the plan. However, for certain Participants the Company still maintains the benefits of the SERP that were in effect prior to the 2005 amendment. These Participants are entitled to fixed cash benefits upon retirement at age 65, payable annually for 15 years. This plan is supported by life insurance polices on the Participants purchased and owned by the Company. The cash benefits paid under this plan were $74,000 in 2007, 2006 and 2005, respectively. The plan expense was $11,000 in 2007, $10,000 in 2006 and $3,000 in 2005.

Retirement savings plan. In 1996, the Company adopted the Retirement Savings Plan of Insteel Industries, Inc. ("the Plan") to provide retirement benefits and stock ownership for its employees. The Plan is an amendment and restatement of the Company's Employee Stock Ownership Plan ("ESOP"). As allowed under Sections 401(a) and 401(k) of the Internal Revenue Code, the Plan provides for tax-deferred salary deductions for eligible employees.

Employees may contribute up to 15% of their annual compensation to the Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Code. The Plan allows for discretionary contributions to be made by the Company as determined by the Board of Directors. Such contributions to the Plan are allocated among eligible participants based on their compensation relative to the total compensation of all participants. In 2007, the Company matched employee contributions up to 50% of the first 7% of eligible compensation that was contributed by employees. In 2006 and 2005, the Company matched employee contributions up to 50% of the first 5% of eligible compensation that was contributed by employees. Company contributions to the Plan were $402,000 in 2007, $351,000 in 2006 and $265,000 in 2005.

Voluntary Employee Beneficiary Associations ("VEBA"). The Company has a VEBA. Under the plan, both employees and the Company may make contributions to pay for medical costs. Company contributions to the VEBA were $2.4 million in 2007, $3.1 million in 2006 and $2.5 million in 2005. The Company is primarily self-insured for employee's healthcare costs, carrying stop-loss insurance coverage for individual claims in excess of $150,000. The Company's self-insurance liabilities are based on the total estimated costs of claims filed and claims incurred but not reported, less amounts paid against such claims. Management reviews current and historical claims data in developing its estimates.

(9) COMMITMENTS AND CONTINGENCIES

Leases and purchase commitments. The Company leases a portion of its equipment under operating leases that expire at various dates through 2010. Under most lease agreements, the Company pays insurance, taxes and maintenance. Rental expense for operating leases was $920,000 in 2007, $836,000 in 2006 and $701,000 in 2005. Minimum rental commitments under all noncancelable leases with an initial term in excess of one year are payable as follows: 2008, $781,000; 2009, $445,000; 2010, $213,000; 2011, $27,000; 2012 and beyond, $0.

As of September 29, 2007, the Company had $31.8 million in non-cancelable fixed price purchase commitments for raw material extending as long as approximately 120 days. In addition, the Company has contractual commitments for the purchase of certain equipment. Portions of such contracts not completed at year-end are not reflected in the consolidated financial statements and amounted to $3.8 million as of September 29, 2007.

Legal proceedings. On November 19, 2007, Dywidag Systems International, Inc. ("DSI") filed a third-party lawsuit in the Ohio Court of Claims alleging that certain epoxy-coated strand sold by the Company to DSI in 2002, and supplied by DSI to the Ohio Department of Transportation ("ODOT") for a bridge project, was defective. The third-party action seeks recovery of any damages which may be assessed against DSI in the action against it filed by ODOT, which allegedly could be in excess of $8.3 million, plus $2.7 million in damages allegedly incurred by DSI. The Company had previously filed a lawsuit in North Carolina against DSI seeking recovery of $1.4 million (plus interest) owed for other products sold to DSI and a judgment declaring that the Company had no liability to DSI arising out of the bridge project. The Company believes North Carolina is the appropriate venue for these proceedings and otherwise intends to vigorously defend the claims asserted against it by DSI in addition to pursuing full recovery of the amounts owed to it by DSI.

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

Severance and change of control agreements. The Company has entered into severance agreements with its Chief Executive Officer and Chief Financial Officer that provide certain termination benefits to these executives in the event that an executive's employment with the Company is terminated without cause. The initial term of each agreement is two years and the agreements provide for an automatic renewal of one year unless the Company or the executive provides notice of termination as specified in the agreement. Under the terms of these agreements, in the event of termination without cause, the executives would receive termination benefits equal to one and one-half times the executive's annual base salary in effect on the termination date and the continuation of health and welfare benefits for eighteen months. In addition, all of the executive's stock options and restricted stock would vest immediately and outplacement services would be provided.

The Company has also entered into change in control agreements with key members of management, including its executive officers, which specify the terms of separation in the event that termination of employment followed a change in control of the Company. The initial term of each agreement is two years and the agreements provide for an automatic renewal of one year unless the Company or the executive provides notice of termination as specified in the agreement. The agreements do not provide assurances of continued employment, nor do they specify the terms of an executive's termination should the termination occur in the absence of a change in control. Under the terms of these agreements, in the event of termination within two years of a change of control, the Chief Executive Officer and Chief Financial Officer would receive severance benefits equal to two times base compensation, two times the average bonus for the prior three years and the continuation of health and welfare benefits for two years. The other key members of management, including the Company's other two executive officers, would receive severance benefits equal to one times base compensation, one times the average bonus for the prior three years and the continuation of health and welfare benefits for one year. In addition, all of the executive's stock options and restricted stock would vest immediately and outplacement services would be provided.

(10) EARNINGS PER SHARE

The reconciliation of basic and diluted earnings per share ("EPS") is as follows:

	Year Ended		
(In thousands, except for per share amounts)	**September 29, 2007**	September 30, 2006	October 1, 2005
Net earnings	**$24,162**	$33,040	$25,045
Weighted average shares outstanding:			
Weighted average shares outstanding (basic)	**18,142**	18,307	18,656
Dilutive effect of stock-based compensation	**172**	166	298
Weighted average shares outstanding (diluted)	**18,314**	18,473	18,954
Per share (basic):			
Earnings from continuing operations	**$ 1.34**	$ 1.88	$ 1.31
Earnings (loss) from discontinued operations	**(0.01)**	(0.08)	0.03
Net earnings	**$ 1.33**	$ 1.80	$ 1.34
Per share (diluted):			
Earnings from continuing operations	**$ 1.33**	$ 1.86	$ 1.29
Earnings (loss) from discontinued operations	**(0.01)**	(0.07)	0.03
Net earnings	**$ 1.32**	$ 1.79	$ 1.32

Options to purchase 67,000 shares in 2007, 42,000 shares in 2006 and 34,000 shares in 2005 were anti-dilutive and were not included in the diluted EPS computation.

(11) BUSINESS SEGMENT INFORMATION

Following the Company's exit from the industrial wire business (see Note 7 to the consolidated financial statements), the Company's operations are entirely focused on the manufacture and marketing of concrete reinforcing products for the concrete construction industry. Based on the criteria specified in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the Company has one reportable segment. The results of operations for the industrial wire products business have been reported as discontinued operations for all periods presented.

(12) RELATED PARTY TRANSACTIONS

In connection with the Company's stock repurchase program, on January 30, 2006, the Company repurchased approximately 400,000 shares of its common stock held by the Chairman of the Company's Board of Directors and his wife. The purchase price for the shares repurchased was $21.322 per share based on a predetermined formula, which represented a 15% discount from the closing price on January 27, 2006. The number of shares repurchased and purchase price per share are prior to the effect of the two-for-one split of the Company's common stock that was distributed as a stock dividend on June 16, 2006.

Sales to a company affiliated with one of the Company's directors amounted to $967,000 in 2007, $929,000 in 2006 and $701,000 in 2005. Purchases from a company affiliated with one of the Company's directors amounted to $418,000 in 2007 and $1.5 million in 2006.

(13) COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss are as follows:

(In thousands)	**September 29, 2007**	September 30, 2006
Adjustment to adopt SFAS No. 158	**$(2,110)**	$–
Additional pension plan liability	**(9)**	–
Accumulated other comprehensive loss	**$(2,119)**	$–

(14) OTHER FINANCIAL DATA

Balance sheet information:

(In thousands)	September 29, 2007	September 30, 2006
Accounts receivable, net:		
Accounts receivable	$ 35,128	$ 38,183
Less allowance for doubtful accounts	(610)	(664)
Total	$ 34,518	$ 37,519
Inventories:		
Raw materials	$ 25,443	$ 27,160
Work in process	2,083	1,657
Finished goods	19,875	17,980
Total	$ 47,401	$ 46,797
Other assets:		
Cash surrender value of life insurance policies	$ 4,367	$ 3,500
Non-current deferred tax assets	1,480	2,176
Capitalized financing costs, net	1,342	1,841
Prepaid pension cost	–	1,242
Assets held for sale	–	583
Other	296	311
Total	$ 7,485	$ 9,653
Property, plant and equipment, net:		
Land and land improvements	$ 5,621	$ 5,345
Buildings	31,981	28,473
Machinery and equipment	86,560	60,090
Construction in progress	3,955	18,013
	128,117	111,921
Less accumulated depreciation	(60,970)	(56,704)
Total	$ 67,147	$ 55,217
Accrued expenses:		
Salaries, wages and related expenses	$ 4,278	$ 4,084
Customer rebates	840	758
Property taxes	749	641
Cash dividends	544	543
Worker's compensation	499	119
Sales allowance reserve	236	236
Income taxes	–	2,805
Other	467	633
Total	$ 7,613	$ 9,819
Other liabilities:		
Deferred compensation	$ 4,584	$ 2,147
Deferred revenues	278	566
Total	$ 4,862	$ 2,713

(15) RIGHTS AGREEMENT

On April 26, 1999, the Company's Board of Directors adopted a Rights Agreement and declared a dividend distribution of one right per share of the Company's common stock to shareholders of record as of May 17, 1999. In addition, the Rights Agreement provides that one right will attach to each share of the Company's common stock issued after May 17, 1999 until the tenth business day following a public announcement that a person or group has acquired, obtained the right to acquire or made a tender or exchange offer for 20% or more of the outstanding shares of the Company's common stock (such tenth business day, the "Distribution Date").

Currently, the rights are not exercisable but trade automatically with the Company's common stock shares. The rights become exercisable on the Distribution Date. Each right will entitle the holder, other than the acquiring person or group, to purchase one one-hundredth of a share (a "Unit") of the Company's Series A Junior Participating Preferred Stock at a purchase price of $80 per Unit, subject to adjustment as described in the Rights Agreement (the "Purchase Price"). All rights beneficially owned or acquired by the acquiring person or group will become null and void as of the Distribution Date. If an acquiring person or group acquires 20% or more of the Company's outstanding common stock, each rights holder, other than the acquiring person or group, upon exercise of his or her rights and payment of the Purchase Price, will severally have the right to receive shares of the Company's common stock having a value equal to two times the Purchase Price or, at the discretion of the Board of Directors, upon exercise and without payment of the Purchase Price, will have the right to purchase the number of shares of the Company's common stock having a value equal to two times the Purchase Price at a 50% discount.

In addition, each rights holder, other than an acquiring person or group, upon exercise of his or her rights will have the right to receive shares of the common stock of the acquiring corporation having a value equal to two times the Purchase Price for such holder's rights if the Company engages in a merger or other business combination where it is not the surviving entity or where it is the surviving entity and all or part of the Company's common stock is exchanged for the stock or other securities of the other company, or if 50% or more of the Company's assets or earning power is sold or transferred.

The rights will expire on April 26, 2009, and may be redeemed by the Company at any time prior to the Distribution Date at a price of $0.01 per right.

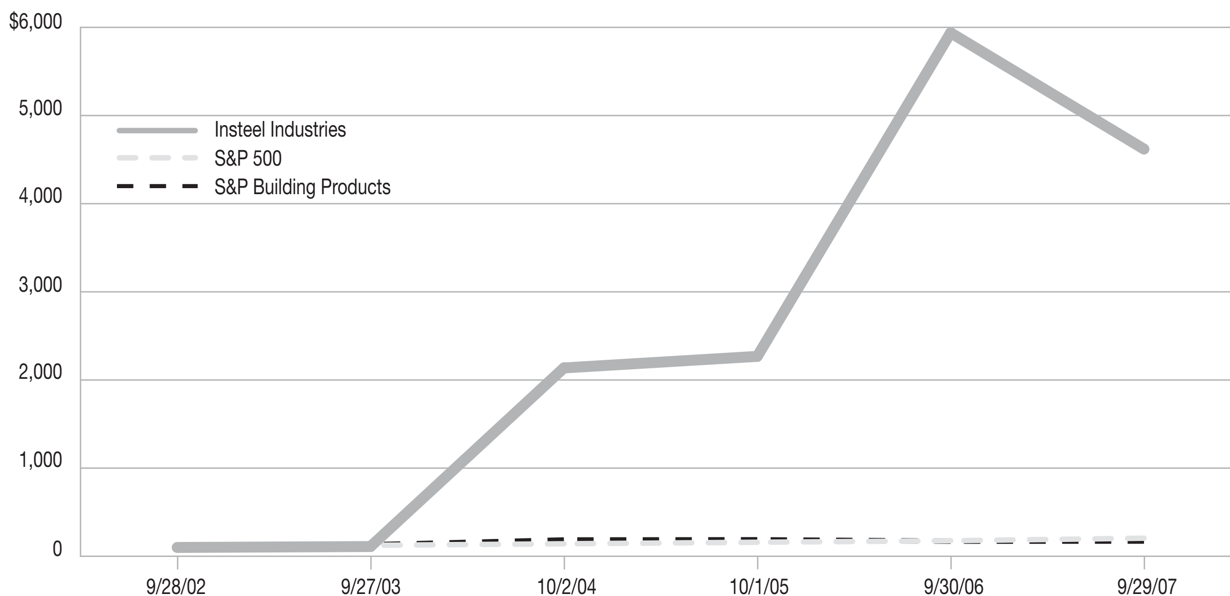
(16) PRODUCT WARRANTIES

The Company's products are used in applications which are subject to inherent risks including performance deficiencies, personal injury, property damage, environmental contamination or loss of production. The Company warrants its products to meet certain specifications and actual or claimed deficiencies from these specifications may give rise to claims. The Company does not maintain a reserve for warranties as the historical claims have been immaterial. The Company maintains product liability insurance coverage to minimize its exposure to such risks.

STOCK PERFORMANCE GRAPH

TOTAL RETURN TO SHAREHOLDERS

The following graph compares the total returns (including the reinvestment of dividends) of the Company, the S&P 500 Index and the S&P Building Products Index. The graph assumes $100 invested on September 28, 2002 in the Company's stock and September 30, 2002 in each of the indices. Total returns for the indices are calculated on a month-end basis.



(In dollars)	9/28/02	9/27/03	10/2/04	10/1/05	9/30/06	**9/29/07**
Insteel Industries	100.00	110.29	2,136.62	2,267.65	5,938.86	**4,619.25**
S&P 500	100.00	124.40	141.65	159.01	176.17	**205.13**
S&P Building Products	100.00	130.00	184.61	186.79	171.61	**172.86**

FINANCIAL INFORMATION BY QUARTER (UNAUDITED)

(In thousands, except for per share and price data)	Quarter Ended			
	December 30	March 31	June 30	September 29
2007				
Operating results:				
Net sales	$69,716	$74,766	$78,966	$74,358
Gross profit	13,624	12,358	17,352	12,727
Earnings from continuing operations	5,931	4,944	8,344	5,065
Earnings (loss) from discontinued operations	(152)	(31)	(37)	98
Net earnings	5,779	4,913	8,307	5,163
Per share data:				
Basic:				
Earnings from continuing operations	0.33	0.27	0.46	0.28
Earnings (loss) from discontinued operations	(0.01)	–	–	–
Net earnings	0.32	0.27	0.46	0.28
Diluted:				
Earnings from continuing operations	0.32	0.27	0.46	0.28
Earnings (loss) from discontinued operations	–	–	(0.01)	–
Net earnings	0.32	0.27	0.45	0.28
Stock prices[(1)]				
High	21.97	19.06	19.66	23.00
Low	16.58	15.89	16.43	15.35
Cash dividends declared	0.03	0.03	0.03	0.03

	Quarter Ended			
	December 31	April 1	July 1	September 30
2006				
Operating results:				
Net sales	$ 75,604	$ 79,776	$ 91,644	$ 82,483
Gross profit	17,113	16,979	18,486	18,293
Earnings from continuing operations	8,013	7,845	9,066	9,453
Earnings (loss) from discontinued operations	(335)	(444)	(1,184)	626
Net earnings	7,678	7,401	7,882	10,079
Per share data:				
Basic:				
Earnings from continuing operations	0.43	0.43	0.50	0.52
Earnings (loss) from discontinued operations	(0.02)	(0.02)	(0.07)	0.04
Net earnings	0.41	0.41	0.43	0.56
Diluted:				
Earnings from continuing operations	0.42	0.42	0.50	0.52
Earnings (loss) from discontinued operations	(0.02)	(0.02)	(0.07)	0.03
Net earnings	0.40	0.40	0.43	0.55
Stock prices[(1)]				
High	8.68	29.70	30.00	24.85
Low	6.89	8.13	18.77	16.33
Cash dividends declared	0.03	0.03	0.03	0.03

(1) Prices adjusted to reflect 2-for-1 stock split on June 16, 2006.

SELECTED FINANCIAL DATA—FIVE-YEAR HISTORY

(In thousands, except for per share amounts)	Year Ended (52 weeks) September 29, 2007	(52 weeks) September 30, 2006	(52 weeks) October 1, 2005	(53 weeks) October 2, 2004	(52 weeks) September 27, 2003
Operating Results:					
Net sales	**$297,806**	$329,507	$309,320	$298,754	$184,868
Gross profit	**56,061**	70,871	57,898	78,956	19,632
% of net sales	**18.8%**	21.5%	18.7%	26.4%	10.6%
Selling, general and administrative expense	**$ 17,583**	$ 16,996	$ 16,175	$ 21,194	$ 11,165
Interest expense	**592**	669	3,427	5,832	4,126
Earnings from continuing operations	**24,284**	34,377	24,499	32,035	9,512
% of net sales	**8.2%**	10.4%	7.9%	10.7%	5.1%
Earnings (loss) from discontinued operations	**$ (122)**	$ (1,337)	$ 546	$ (546)	$ (2,790)
Net earnings	**24,162**	33,040	25,045	31,489	6,722
Per Share Data:					
Per share (basic):					
Earnings from continuing operations	**$ 1.34**	$ 1.88	$ 1.31	$ 1.85	$ 0.56
Earnings (loss) from discontinued operations	**(0.01)**	(0.08)	0.03	(0.03)	(0.16)
Net earnings	**1.33**	1.80	1.34	1.82	0.40
Per share (diluted):					
Earnings from continuing operations	**1.33**	1.86	1.29	1.78	0.55
Earnings (loss) from discontinued operations	**(0.01)**	(0.07)	0.03	(0.03)	(0.16)
Net earnings	**1.32**	1.79	1.32	1.75	0.39
Cash dividends declared	**0.12**	0.12	0.06	–	–
Returns:					
Return on capital[1]	**18.2%**	29.7%	21.1%	28.6%	9.7%
Return on equity[2]	**18.2%**	31.3%	29.1%	62.5%	34.8%
Financial Position:					
Total assets	**$173,529**	$166,596	$138,276	$151,291	$132,930
Total long-term debt	–	–	11,860	52,368	69,453
Shareholders' equity	**143,850**	122,438	97,036	71,211	31,272
Cash Flows:					
Net cash provided by operating activities	**$ 16,918**	$ 44,835	$ 44,460	$ 28,122	$ 5,290
Capital expenditures	**17,013**	18,959	6,302	2,921	933
Depreciation and amortization	**6,209**	5,108	5,627	6,209	5,143
Repurchase of common stock	–	8,529	–	–	–
Cash dividends paid	**2,176**	2,222	566	–	–
Other Data:					
Number of employees at year-end	**559**	621	655	669	677

(1) Earnings from continuing operations/(average total long-term debt + average shareholders' equity).
(2) Earnings from continuing operations/(average shareholders' equity).

CORPORATE INFORMATION

BOARD OF DIRECTORS

Louis E. Hannen[1]
Retired Senior Vice President
Wheat, First Securities, Inc.

Charles B. Newsome[2]
Executive Vice President
Johnson Concrete Company

Gary L. Pechota[1]
Retired Chairman, President and
Chief Executive Officer
Giant Cement Holding, Inc.

W. Allen Rogers II[1]
Principal
Ewing Capital Partners, LLC

William J. Shields[2]
Retired Chairman and
Chief Executive Officer
Co-Steel, Inc.

C. Richard Vaughn[2,3]
Chairman
John S. Clark Company, Inc.

Howard O. Woltz, Jr.[3]
Chairman of the Board
Insteel Industries, Inc.

H.O. Woltz III[3]
President and Chief Executive Officer
Insteel Industries, Inc.

(1) Member of the Audit Committee
(2) Member of the Executive Compensation Committee
(3) Member of the Executive Committee

EXECUTIVE OFFICERS

H.O. Woltz III
President and Chief Executive Officer

Michael C. Gazmarian
Vice President, Chief Financial Officer
and Treasurer

James F. Petelle
Vice President—Administration
and Secretary

Richard T. Wagner
Vice President and General Manager—Insteel
Wire Products Company

SHAREHOLDER INFORMATION

Corporate Headquarters
1373 Boggs Drive
Mount Airy, North Carolina 27030-2148
(336) 786-2141

Independent Public Accountants
Grant Thornton LLP
Greensboro, North Carolina

Annual Meeting
Insteel shareholders are invited to attend our annual meeting which will be held at 10:00 A.M. on Tuesday, February 19, 2008, at the Cross Creek Country Club, 845 Greenhill Road, Mount Airy, North Carolina.

Common Stock
The Common Stock of Insteel Industries, Inc. is traded on the NASDAQ Global Select Market under the symbol IIIN. At November 27, 2007, there were 1,142 shareholders of record.

Shareholder Services
For change of name, address, ownership of stock; to replace lost stock certificates; or to consolidate accounts, please contact:

American Stock Transfer &
Trust Company
59 Maiden Lane
New York, New York 10038
(866) 627-2704
www.amstock.com

Investor Relations
For information on the Company, additional copies of this report, Form 10-K, or other financial information, contact Michael C. Gazmarian, Vice President, Chief Financial Officer and Treasurer, at the Company's headquarters. You may also visit the Investor Information section on the Company's Web site at www.investor.insteel.com.

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