



January 27, 2015

CURRENT PRICE: \$20.37
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.6%

EPS Estimates - Non-GAAP

	SEP 14A	SEP 15E
1Q	\$0.15	\$0.22A
2Q	\$0.19	\$0.20
3Q	\$0.31	\$0.34
4Q	\$0.24	\$0.46
	\$0.89	\$1.22

Trading Data

52-WEEK PRICE RANGE: **\$24.85 - \$17.91**
 SHARES OUTSTANDING: **18.82(M)**
 MARKET CAP: **\$383.4(M)**
 AVG. DAILY TRADING VOLUME: **0.06(M)**
 S&P 500: **2,029**

Valuation Data

BOOK VALUE: **\$9.84**
 PRICE TO BOOK: **2.07x**
 DIVIDEND: **\$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIIN)

1Q15 earnings results

Highlights

- 1Q15 earnings of \$0.22/share vs. 1Q14's \$0.15/share
- Benefitted from higher shipment volumes & widening spreads
- Benefitting from ASW asset acquisition
- End construction market has improved
- Maintain HOLD rating

Investment Thesis

IIIN could be an interesting speculative play for aggressive investors. Since most of IIIN's business is related to the US construction market, its stock has been volatile during the past four years as investor's have moved in and out of the shares based on expectations of a recovery in the construction industry. While an increase in meaningful customer orders may start to materialize, improvement in construction spending may lead to earnings growth for IIIN. Aggressive and speculative investors should look for attractive entry points into IIIN for potential price appreciation when the US construction market improves and increases demand for the company's products.

Company Summary

Insteel Industries (IIIN-\$20.37), headquartered in Mt. Airy NC, is one of the largest manufacturers of steel wire reinforcing products for concrete construction applications. It is the parent holding company of two wholly-owned subsidiaries, Insteel Wire Products Company and Intercontinental Metals Corporation. IIIN manufactures/markets PC strand and welded wire reinforcement (WWR) products. Products are sold through its sales force and a sales agent, primarily to concrete product manufacturers for use in nonresidential construction. Approximately 97% of sales were to US customers and the remaining 3% from Canada and Central/Latin America. Started in 1958, the company has approximately 847 employees (as of 9/27/14), and generated total revenues of \$409 million during FY14. An estimated 90% of IIIN's sales went towards nonresidential construction (approximately 35% infrastructure & 55% non-infrastructure) and 10% to residential construction. The company has very little debt on its balance sheet.

For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last two pages of this report.

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EQUITY RESEARCH

Recent Earnings

IIIN reported 1Q15 earnings of \$0.22/ diluted share compared to \$0.15/share during 1Q14. The just completed quarter's results were positively impacted by wider spreads between selling prices/raw material costs and an increase in shipments, partly offset by higher conversion costs when compared to 1Q14's levels. Net sales improved 26.8% to \$110.6 million due to the acquisition of American Spring Wire Corporation's (ASW) pre-stressed concrete strand business, acquired this past August, and higher sales at IIIN's other facilities. Shipments rose 20.9%, mainly from the ASW acquisition, together with growth in IIIN's existing businesses. Average selling prices increased 4.9% partly due to favorable changes in product mix related to the acquisition of ASW.

Gross profit rose to \$12 million from \$9.1 million and gross profit margins increased to 10.9% from 10.4% resulting from higher spreads between selling prices/raw material costs, in addition to the increase in shipments. These positives were partly offset by higher conversion costs.

The rise in conversion costs was largely related to the removal from an old production line at the PA facility in preparation for the installation of a new line, and the initial inefficiencies associated with the start-up of then new cleaning house at IIIN's TN facility. Management estimated the excess costs from reduced gross margin by 130 basis points during 1Q15. Capacity utilization, during 1Q15, rose to 54% when compared to 1Q14's level of 47%, and 57% during 4Q14.

SG&A expense rose to \$5.65 million from \$4.71 million largely due to higher compensation and employee benefit costs together with the relative year-over-year changes in the cash value of life insurance policies. Net cash flow from operations used \$9.5 million, while providing +\$6.32 million in the year ago period, primarily due to a \$22.7 million reduction in accounts payable/accrued expenses, resulting from lower raw material purchases during 1Q15, in addition to changes of vendors and payment terms. Interest expense rose to \$94,000 from \$56,000 as the company ended 1Q15 with \$10 million of borrowings outstanding on its \$100 million revolving credit facility.

EARNINGS CONFERENCE CALL

Management discussed recent earnings, the addition of ASW, & earnings growth prospects during the 1Q15 earnings conference call. IIIN noted 1Q15' earnings improvement to \$0.22/share vs. \$0.15/share during 1Q14 was due to higher sales, increased shipments, improving spreads, and improvement in its construction end-markets. Net sales rose 26.8% due to the additional business provided by the ASW acquisition, together with higher sales at IIIN's other facilities. Shipments increased 20.9% also because of the ASW acquisition and a continuing recovery in the construction markets. The ASW acquisition also was largely responsible for a 4.9% rise in average selling prices resulting from its favorable impact on mix.

The gross profit margin for 1Q15 improved to 10.9% from 10.4% due to higher spreads between selling prices and raw material costs, together with the increase in shipments. Given the recent downturn in commodity prices, management believes profit margins could improve during the next few quarters from lower raw material costs as



well as reduced conversion costs. It was pointed out 1Q15's gross profit margin would have been 130 basis points higher were it not for the excess conversion costs incurred at the TN and PA facilities.

IIN anticipates stable selling prices at current levels, assuming the favorable demand trends continues through FY15. The recent Architectural Billings Index readings point towards further improvement in non-residential building construction in the coming months

Last August IIN purchased the pre-stressed concrete strand business of ASW for approximately \$36 million. This acquisition added annual revenues of approximately \$70 million, and two production facilities in GA and TX, further expanding IIN's geographical footprint. Additionally, the ASW acquisition offers IIN the potential to accelerate earnings growth through continued improvement in its construction end-markets, as well as significant cost reduction opportunities as the ASW facilities are fully integrated into IIN's existing PC strand operations similar to the previous IVY acquisition in November 2010.

Our Thoughts

A good earnings report with 1Q15 diluted earnings of \$0.22/share vs. \$0.15/share as the quarterly results benefited from a positive widening of spreads between selling prices/raw material costs, and higher shipments. Results also benefited from the recent ASW asset acquisition, adding PC strand production facilities and revenues to IIN's balance sheet. Capacity utilization rose to 54%, from 47%, still below levels reached (70%-75%) prior to the 2008-2009 economic recession. Going forward, IIN's capacity utilization, profit margins, and earnings could improve assuming the US economy continues expanding in 2015-2016. Given weakness in the US December Durable Goods numbers, investors should wait to see if this was a precursor towards a slowing economy or a one month aberration. We maintain our HOLD rating on IIN.



Risks

There are no guarantees IIN will be able to grow future earnings. Declining customer orders, rising commodity prices, and rising operating costs could negatively affect the company's profits. Management has a labor union operating at one of its plants. An influx of foreign imports and increase in competition could cause a decrease in overall revenues. Negative equity markets, rising interest rates, terrorist attacks, and failure to comply with the Sarbanes Oxley Act could cause a decline in IIN's share price. Given the relatively small amount of daily trading activity in IIN's stock, any increase in trading volume could significantly accelerate the volatility of its share price movement.

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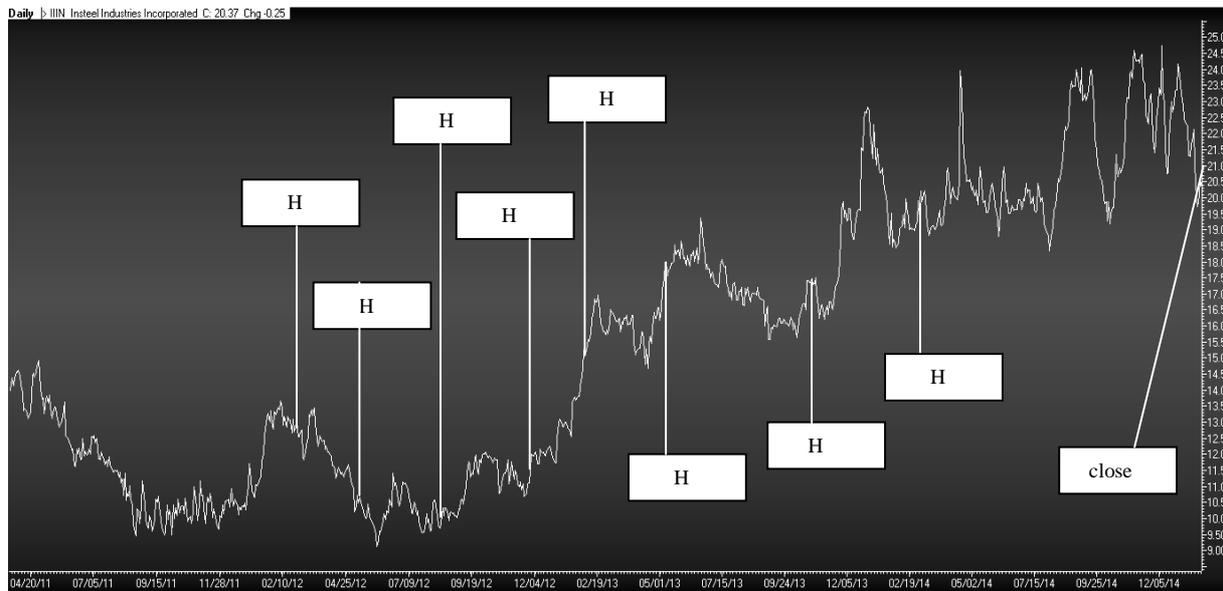


EQUITY RESEARCH

INSTEEL INDUSTRIES, INC.
 FY ends 9/30
 (in thousands except per share amounts)

	1Q14	2Q14	3Q14	4Q14	2014	1Q15	2Q15e	3Q15e	4Q15e	2015e
Revenues	\$87,218	\$91,436	\$113,227	\$117,097	\$408,978	\$110,628	\$117,097	\$145,246	\$164,921	\$537,892
Cost of sales	78,163	79,830	98,964	103,248	360,205	98,585	105,928	129,559	145,790	479,862
Inventory write-downs										
Gross profit	9,055	11,606	14,263	13,649	48,773	12,043	11,641	15,687	19,131	58,502
SG&A	4,705	5,984	6,219	6,463	23,371	5,652	6,213	6,231	6,387	24,483
Acquisition costs				612	612					
Bargain Purchase gain										
Gain on debt extinguishment										
Restructuring charges				1,247	1,247					
Other expenses/income	32	228	849	1,254	1,907	40	198	421	723	1,382
Income	4,382	5,394	8,893	6,781	24,450	6,431	5,626	9,877	13,467	35,401
Interest expense	-56	-57	-56	-83	-252	-94	-85	-88	-92	-359
Interest income	5	1	4		10		2		6	8
Income from cont. operations	4,331	5,338	8,841	6,698	25,208	6,337	5,533	9,789	13,381	35,040
Income taxes	1,584	1,816	3,044	2,123	8,567	2,187	1,881	3,426	4,790	12,284
Earnings from continuing Ops.	2,747	3,552	5,797	4,575	16,641	4,150	3,652	6,363	8,591	22,756
Earnings from discont. Ops										
Net Earnings	2,747	3,552	5,797	4,575	16,641	4,150	3,652	6,363	8,591	22,756
Net earnings/share	\$0.15	\$0.19	\$0.31	\$0.24	\$0.89	\$0.22	\$0.20	\$0.34	\$0.46	\$1.22
Cash dividends/share	\$0.03	\$0.03	\$0.03	\$0.03	\$0.12	\$0.03	\$0.03	\$0.03	\$0.03	\$0.12
Fully diluted shares outstanding	18,587	18,637	18,683	18,755	18,755	18,820	18,820	18,820	18,820	18,820

Important Disclosures



3/07/11 \$11.74 Initiate HOLD

Ratings:

Buy: B

Hold: H

Sell: S

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