April 30, 2015

CURRENT PRICE:	**$20.26**
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	$0.14A
3Q	$0.31	$0.33
4Q	$0.24	$0.43
	$0.89	**$1.12**

Trading Data

52-WEEK PRICE RANGE:	**$24.85 - $18.71**
SHARES OUTSTANDING:	**18.82(M)**
MARKET CAP:	**$381.3(M)**
AVG. DAILY TRADING VOLUME:	**0.05(M)**
S&P 500:	**2,085**

Valuation Data

BOOK VALUE:	**$10.08**
PRICE TO BOOK:	**2.01x**
DIVIDEND:	**$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIIN)

2Q15 earnings results

Highlights

- 2Q15 earnings of $0.14/share vs. $0.19/share during 2Q14
- Earnings results impacted by severe winter weather
- IIIN anticipates increase of 2H15 customer orders
- Expects to remove $3 million of annual operating costs
- 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-$20.26), 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.

Recent Earnings

IIIN reported 2Q15 earnings of $0.14/share vs. $0.19/share during 2Q14. The decline in operating earnings was due mainly to negative weather effects on operations, higher unit conversion costs, and lower spreads between costs/selling prices. During 2Q15 IIN incurred a $1.6 million net gain from insurance proceeds associated with the 2014 fire at its Gallatin TN facility and $0.3 million restructuring charge related to the 2015 closure of the Newnan GA prestressed concrete strand facility. On combined basis, these two items added approximately $0.04/share towards 2Q15's results.

Net sales improved 11.3% to $101.8 million from $91.4 million during 2Q14 driven by the 2014 acquisition of the PC strand business of American Spring Wire Corporation (ASW). When comparing the two quarters, shipments increased 10.6% and average selling prices rose 0.7%. However, factoring out ASW's contribution, shipments declined 3.8% due primarily to the negative impact of severe winter weather. Sequential quarterly shipments were also negatively impacted by weather as shipments decreased 6.7%.

2Q15's gross profit fell to $8.7 million from $11.6 million during 2Q14 and the gross profit margin declined to 8.6% from 12.7%. These decreases were due to higher conversion costs caused primarily by lower than expected production and a unexpected spike in medical/workers compensation insurance costs of $1.5 million. Management stated this hurt earnings by $0.05/share but expects this to be a non-recurring item. The lower spread during 2Q15 came from IIIN's consumption of higher cost inventory (under FIFO inventory accounting) purchased during the preceding quarter prior to the recent drop in raw material costs, and a 1.4% decrease in average selling prices.

SG&A expense was flat at $6.0 million during 2Q15 and compared to the prior year's quarter. IIIN incurred a $300,000 in restructuring charges during the just completed quarter related to asset impairment, severance, and closing costs associated with the closure of the Newnan GA facility in March 2015. Management expects to incur an additional $500,000 in charges related to the Newnan closure and relocation of equipment.

EARNINGS CONFERENCE CALL

Management discussed 2Q15's operating results and its outlook for the remainder of 2015. Earnings were negatively impacted by severe winter weather, higher unit conversion costs, and lower selling spreads. Factoring out the ASW acquisition, comparative quarter shipments decreased 3.8% as severe weather caused a decrease in orders from IIIN's customers. Going forward into 2015, IIIN believes the recovery in non-residential construction will regain momentum as weather related issues subside and construction activity increases moving into the spring/summer months. Additionally, management anticipates both spreads and margins could improve as the effect of lower raw material costs are reflected in IIIN's cost of goods sold.

Regarding expenses, quarterly SG& A was flat when comparing 2Q15's amount of $5.98 million vs. $5.98 million during 2Q14. A decline in incentive plan compensation during 2Q15 was offset by increases in other compensation, health insurance, and intangible amortization expenses. In addition to the $300,000 restructuring charge incurred during 2Q15, IIIN anticipates incurring another $500,000 charge related to the closure of the GA facility and equipment relocation/facility closing costs during 2H15. The company believes the consolidation of its PC strand facilities will generate annual cost savings of approximately $3 million.

IIIN expects to spend $11 million-$13 million in capital expenditures in its facilities and technology infrastructure during 2015. One area of expenditures will be on reducing operating costs and rounding out capacity in the standard welded wire reinforcing product line. To this end, IIIN is commissioning a new high volume production line in its PA facility with the goal of replacing obsolete technology and increasing the production of certain SKUs which were previously limited by capacity restraints. Expectations are for this production line to be contributing to profits by the 2H15.

Other expenditures will be made to commission a new wire production line at IIIN's Florida welded wire reinforcing facility with the goal of rounding out capacity and producing lower operating costs. Further capital expenditures will be used for maintaining facilities, quality improvement, lowering operating expenses, and improving its IT infrastructure.

Our Thoughts

IIIN's 2Q15's earnings of $0.14/share was below street estimates as harsh winter weather affected customer orders. Additionally, the company dealt with higher unit conversion costs and lower spreads between costs/selling prices. Going forward into 2H15, management believes its order stream will improve due to improved weather and continued strength in the non-residential construction area. Additionally, gross profit margins are likely to rise from 8.6%, during 2Q15, to double digits in 2H15, based on lower materials cost and a steady pricing environment for products sold. IIIN anticipates removing $3 million/year in operating expenses due to the closure of its Newnan GA facility and the relocation of equipment to other production plants. Given the recent weakness in Durable Goods reports, and 1Q15 GDP numbers, we continue to rate IIIN a HOLD seeking evidence whether these "punk" numbers are an isolated incident, or an emerging trend towards a slowing US economy.

CAPITOL SECURITIES MANAGEMENT, INC.
EQUITY RESEARCH

Risks

There are no guarantees IIIN 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 IIIN's share price. Given the relatively small amount of daily trading activity in IIIN's stock, any increase in trading volume could significantly accelerate the volatility of its share price movement.

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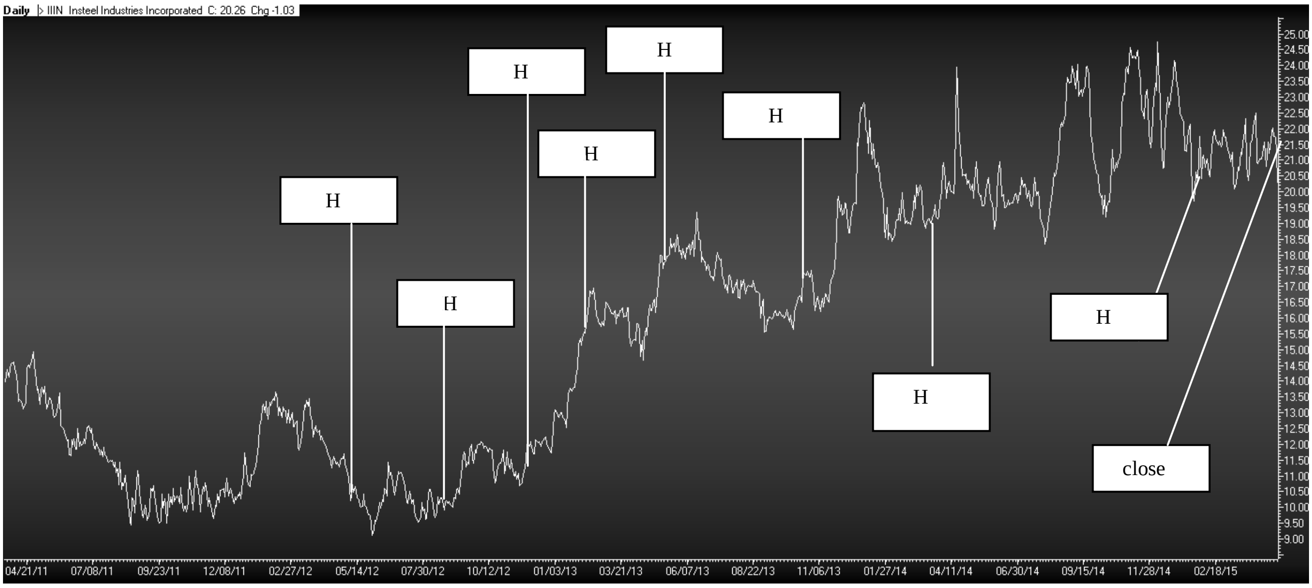
INSTEEL INDUSTRIES, INC.
FY ends 9/30
(in thousands except per share amounts)

	1Q14	2Q14	3Q14	4Q14	2014	1Q15	2Q15	3Q15e	4Q15e	2015e
Revenues	$87,218	$91,436	$113,227	$117,097	$408,978	$110,628	$101,767	$145,246	$164,921	$537,892
Cost of sales	78,163	79,830	98,964	103,248	360,205	98,585	93,065	129,559	145,790	479,862
Inventory write-downs										
Gross profit	9,055	11,606	14,263	13,649	48,773	12,043	8,702	15,687	19,131	58,502
SG&A	4,705	5,984	6,219	6,463	23,371	5,652	5,975	5,489	6,387	23,503
Acquisition costs				612	612					
Bargain Purchase gain										
Gain on debt exinguishment										
Restructuring charges				1,247	1,247		333			333
Other expe nses/income	32	228	849	1,254	1,907	40	1,599	706	723	3,068
Income	4,382	5,394	8,893	6,781	24,450	6,431	3,993	9,492	13,467	33,383
Interest expense	-56	-57	-56	-83	-252	-94	-114	-112	-114	-434
Interest income	5	1	4		10		4		4	8
Income from cont. operations	4,331	5,338	8,841	6,698	25,208	6,337	3,883	9,380	13,381	32,981
Income taxes	1,584	1,816	3,044	2,123	8,567	2,187	1,339	3,236	4,790	11,552
Earnings from continuing Ops.	2,747	3,552	5,797	4,575	16,641	4,150	2,544	6,144	8,591	21,429
Earnings from discont. Ops										
Net Earnings	2,747	3,552	5,797	4,575	16,641	4,150	2,544	6,144	8,591	21,429
Net earnings/share	$0.15	$0.19	$0.31	$0.24	$0.89	$0.22	$0.14	$0.33	$0.43	$1.12
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	18,822	18,822	18,822	18,822

Important Disclosures



3/07/11 $11.74 Initiate HOLD

Ratings:
Buy: B
Hold: H
Sell: S

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