



February 19, 2016

CURRENT PRICE: \$25.20
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.5%

EPS Estimates - Non-GAAP

	SEP 15A	SEP 16E
1Q	\$0.22	\$0.36A
2Q	\$0.14	\$0.43
3Q	\$0.29	\$0.37
4Q	\$0.51	\$0.24
	\$1.15	\$1.40

Trading Data

52-WEEK PRICE RANGE: **\$26.51 - \$14.61**
 SHARES OUTSTANDING: **18.88(M)**
 MARKET CAP: **\$475.8(M)**
 AVG. DAILY TRADING VOLUME: **0.11(M)**
 S&P 500: **1,918**

Valuation Data

BOOK VALUE: **\$9.92**
 PRICE TO BOOK: **2.54x**
 DIVIDEND: **\$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIN)

1Q16 earnings results

Highlights

- 1Q16 earnings of \$0.36/share vs. \$0.22/share during 1Q15
- Lower sales and higher margins
- Positive momentum going into current quarter
- FAST Act could spur surface and infrastructure spending
- Maintain HOLD rating

Investment Thesis

IIN could be an interesting speculative play for aggressive investors. Since most of IIN'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 IIN. Aggressive and speculative investors should look for attractive entry points into IIN for potential price appreciation when the US construction market improves and increases demand for the company's products.

Company Summary

Insteel Industries (IIN-\$25.20), headquartered in Mt. Airy NC, is the nations largest manufacturer 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. IIN manufactures/markets PC strand and welded wire reinforcement (WWR) products. Products are sold through its sales force, primarily to concrete product manufacturers for use in nonresidential construction. Approximately 99.1% of sales were to US customers and the remaining 1% from Canada and Central/Latin America. Started in 1958, the company had approximately 790 employees (as of 10/3/15), and generated total revenues of \$447.5 million during FY15. An estimated 90% of IIN's sales went towards nonresidential construction (approximately 35% infrastructure & 50% non-infrastructure) and 15% to residential construction. IIN is debt free and has a \$100 million revolving credit facility.

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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Recent Earnings

IIIN reported 1Q16 diluted earnings of \$0.36/share vs. \$0.22/share during 1Q15. The improved results were driven by higher spreads between selling prices and raw material costs and were partly offset by a decrease in shipments. Net sales decreased 16.5% to \$92.4 million from \$110.6 million due to a 9% decline in shipments and average selling prices falling 8.3%. When adjusting for the year-over-year differences in IIIN's fiscal calendar, net sales fell approximately 4.6%.

Cost of sales-to-net sales fell to 81.8% from 89.1% during last year's comparable quarter. As a result, gross profit-to-net sales rose to 17.8% from 11.0% (\$16.4 million vs. \$12.0 million) coming from higher spreads as a continued decrease in raw material costs exceeded a smaller decrease in average selling prices, and offset lower shipments.

SG&A expenses rose to \$6.34 million from \$5.65 million due to higher accrued incentive compensation expense as a result of higher profitability when comparing 1Q16 and 1Q15. Net restructuring recoveries increased to \$75,000 from \$0, net other income rose to \$114,000 from \$40,000, interest income improved to \$18,000 from \$0, and interest expenses decreased to \$41,000 from \$94,000. These factors allowed EBIT to improve to \$10.25 million from \$6.34 million.

EARNINGS CONFERENCE CALL

Based on recent macro-indicators and customer sentiment, management stated it expects market conditions, to remain positive which should support continued growth for the company. It was noted the leading indicators for nonresidential construction point towards further improvement in 2016.

Recent reports indicated an increase in commercial project planning activities and infrastructure construction may increase given the Congressional passage of FAST act, providing \$305 billion of funding for US surface transportation programs. IIIN noted the FAST Act provides a higher degree of funding certainty and could shift the project mix towards larger and longer term projects that potentially could require greater usage of the company's concrete reinforcing products.

IIIN has experienced a "more robust rate" of order entry through the first half of January, as shipping trends have exceeded the company's expectations. Additionally, management noted the falling price of scrap metal, slower declining selling prices and a recovery in the construction sector during the past few quarters should continue to support higher spreads.

IIIN is currently carrying about three months of inventory valued on a FICO basis and raw material costs reflected in cost of sales figures are mainly associated with purchases made in the prior quarter. Given the declining price environment during the past year, the time lag of inventory costs tends to defer the favorable impact of lower raw material costs until the higher cost of earlier inventory purchases are sold to customers. Thus, potential exists for improving spreads going into 2Q16.



Our Thoughts

IIIN reported strong results for 1Q16 as the company reported diluted earnings of \$0.36/share vs. \$0.22/share during 1Q15. The improved results were due to by higher spreads between selling prices and raw material costs and were partly offset by a decrease in shipments. Net sales decreased 16.5% to \$92.4 million from \$110.6 million due to a 9% decline in shipments and average selling prices falling 8.3%. When adjusting for the variance in calendar days, which added another week to 1Q16, net sales fell approximately 4.6%. During the conference call IIIN stated its short-term channel indications signaled further positive momentum going into 2Q16. However, given recent softening economic reports, we are concerned whether a recession will descend upon the US. Given, IIIN does have exposure to economic cycles, we continue to rate this stock a HOLD in order to see how the company's business fares during 2H16.



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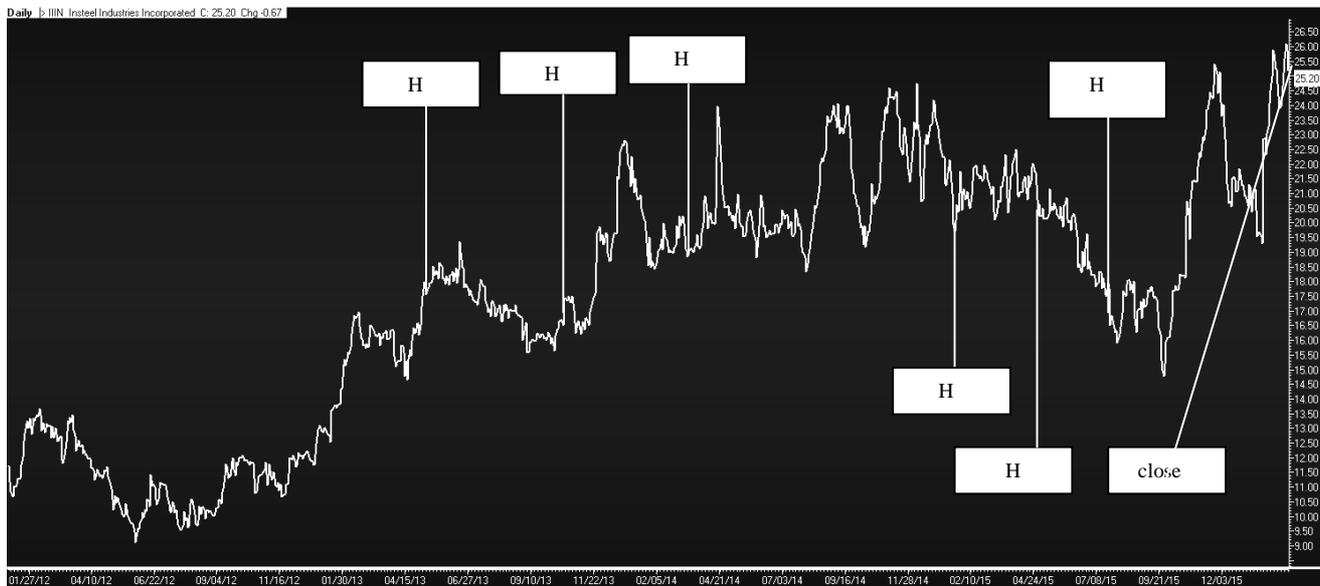
INSTEEL INDUSTRIES, INC.
 FY ends 9/30
 (in thousands except per share amounts)

	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16e	3Q16e	4Q16e	2016e
Revenues	\$110,628	\$101,767	\$117,016	\$110,093	\$447,504	\$92,931	\$103,672	\$115,177	\$114,257	\$426,037
Cost of sales	98,585	93,065	101,322	96,199	389,171	75,968	84,703	97,849	100,546	359,066
Inventory write-downs										
Gross profit	12,043	8,702	15,694	21,894	58,333	16,423	18,969	17,328	13,711	66,431
SG&A	5,652	5,975	6,427	7,770	25,824	6,335	6,412	6,529	6,625	25,901
Acquisition costs										
Bargain Purchase gain		333	345	329	349	75	82	216	38	411
Gain on debt extinguishment										
Restructuring charges										
Other expenses/income	40	1,599	601	75	1,113	114	121	66	74	375
Income	6,431	3,993	8,321	14,528	33,273	10,277	12,596	10,649	7,122	40,644
Interest expense	-94	-114	-65	-47	-320	-41	-42	-41	-44	-168
Interest income		4	1	6	11	18	2	5	12	37
Income from cont. operations	6,337	3,883	8,257	14,487	32,964	10,254	12,556	10,613	7,090	40,513
Income taxes	2,187	1,339	2,865	4,863	11,524	3,546	4,395	3,715	2,482	14,138
Earnings from continuing Ops.	4,150	2,544	5,392	9,624	21,710	6,708	8,161	6,898	4,608	26,375
Earnings from discont. Ops										
Net Earnings	4,150	2,544	5,392	9,624	21,710	6,708	8,161	6,898	4,608	26,375
Net earnings/share	\$0.22	\$0.14	\$0.29	\$0.51	\$1.15	\$0.36	\$0.43	\$0.37	\$0.24	\$1.40
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	18,820	18,822	18,828	18,740	18,803	18,883	18,883	18,883	18,883	18,883



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Important Disclosures



3/07/11 \$11.74 Initiate HOLD

Ratings:
Buy: B
Hold: H
Sell: S

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- (3) Sell – The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

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