



August 1, 2016

CURRENT PRICE: \$35.32
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.4%

EPS Estimates - Non-GAAP

	SEP 15A	SEP 16E
1Q	\$0.22	\$0.36A
2Q	\$0.14	\$0.38A
3Q	\$0.29	\$0.71A
4Q	\$0.51	\$0.24
	\$1.15	\$1.67

Trading Data

52-WEEK PRICE RANGE: **\$35.68 - \$14.61**
 SHARES OUTSTANDING: **19.16(M)**
 MARKET CAP: **\$676.7(M)**
 AVG. DAILY TRADING VOLUME: **0.11(M)**
 S&P 500: **2,171**

Valuation Data

BOOK VALUE: **\$9.92**
 PRICE TO BOOK: **3.56x**
 DIVIDEND: **\$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIN)

3Q16 earnings results

Highlights

- 3Q16 earnings of \$0.71/share vs. \$0.29/share during 3Q15
- Widening spreads and higher shipments
- Positive momentum going into 2H16 & FY17
- FAST Act could increase demand for IIN's products
- 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-\$35.32), 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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EQUITY RESEARCH

Recent Earnings

IIIN reported 3Q16 diluted earnings of \$0.71/share vs. \$0.29/share during 3Q15. The improved results were due mainly to widening spreads between selling prices and raw material costs, along with increased shipments, and lower conversion costs when compared to 3Q15. IIIN's gross profit rose to \$27.6 million from \$15.7 million, and gross margins rose to 23.8% from 13.4% as slightly lower total sales (\$115.6 million vs. \$117.0 million) was more than offset by a decrease in cost of sales (\$88.1 million vs. \$101.3 million), resulting from lower raw material and conversion costs.

SG&A expenses rose to \$6.85 million, from \$6.43 million, due to higher expenses under the company's return on capital incentive compensation plan, driven by improved operating results, and was partially offset by a \$200,000 favorable year-over-year change in IIIN's cash surrender value of life insurance policies. Additionally, there was a \$200,000 reduction in employee health insurance costs related to high dollar claims incurred during 2Q15.

IIIN's operating cash flow, when comparing 3Q16 to 3Q15, increased to \$21.9 million from \$18.1 million due to improved earnings and net working capital generated \$6.3 million of cash compared to \$10.5 million in the prior year. Cash and Cash equivalents rose \$17.4 million to \$53.8 million.

EARNINGS CONFERENCE CALL

Management noted conditions in its construction end market remain strong as shipments during 3Q16 rose 8.9% on a sequential quarterly basis and benefiting from the traditional seasonal increase in demand. When comparing 3Q16 to 3Q15, shipments improved 9.8% as both periods were negatively impacted by heavy rainfall in south central US, especially in Texas-IIIN's largest market.

The company's average selling prices declined 1.1% on a sequential quarterly basis due to a less favorable product mix, however, but improved during 3Q16 with June's ASPs rising 3.5% from March levels. IIIN believes 4Q16's average selling price should benefit for the full quarter from 3Q16's increases along with additional increases that took effect at the beginning of July.

The near doubling of the gross profit when comparing 3Q16 and 3Q15 was due to the higher spreads in shipments and lower conversion costs. Spreads for 3Q16 benefitted from the consumption of lower cost inventory which was purchased prior to previous price increases for wire rod. Since IIIN normally carries about three months of inventory (valued on a FIFO basis), normally there is a on quarter lag before raw material purchases are reflected in its cost of sales.

Going into 4Q16, management expects continued strength in its construction end markets based on recent monthly construction spending data, and leading construction indicators, pointing to continued positive conditions in this sector. On a year to date basis, there has been increases in private non-residential (+9.2%), public (+3.8%), private residential (+9.9%), and public highway spending/street construction (+6.9%). Moreover, this trend appears



confirmed from recent positive reports from Architectural Billing Index, Dodge Momentum Index, the American Institute of Architect, and consensus construction forecast. Furthermore, moving further into 2H16 and into 2017, federal highway funding provided by the recently passed FACT Act should begin to have a favorable impact on infrastructure construction activity and demand for IIIN's products.

Our Thoughts

IIIN reported a large increase in quarterly profits as 3Q16 earnings rose to \$0.71/share from \$0.29/share during 3Q15. The improved results were due mainly to widening spreads between selling prices and raw material costs, along with increased shipments, and lower conversion costs when compared to 3Q15. The company is benefitting from rising customer demand for its products and appears this will continue during the next two quarters as forward channels indicate strength in various construction markets. We rate IIIN a HOLD given its share price has doubled since 2015 and our concerns whether the macro forces creating the positives in construction markets will continue should a slowdown materialize in the US economy during the next 12 months.



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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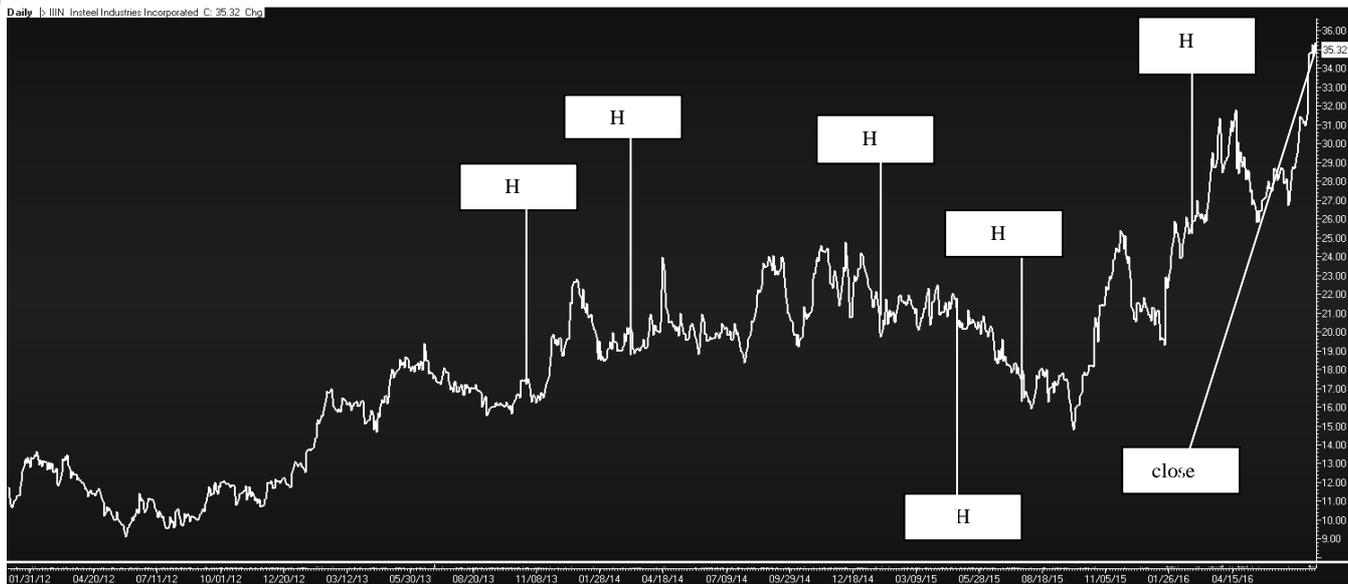
EQUITY RESEARCH

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

	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16	3Q16	4Q16e	2016e
Revenues	\$110,628	\$101,767	\$117,016	\$110,093	\$447,504	\$92,931	\$107,414	\$115,629	\$114,257	\$430,231
Cost of sales	98,585	93,065	101,322	96,199	389,171	75,968	88,799	88,082	100,546	353,395
Inventory write-downs										
Gross profit	12,043	8,702	15,694	21,894	58,333	16,423	18,615	27,547	13,711	76,296
SG&A	5,652	5,975	6,427	7,770	25,824	6,335	7,636	6,849	6,625	27,445
Acquisition costs										
Bargain Purchase gain										
Gain on debt extinguishment										
Restructuring charges		333	345	329	349	75	100	58	38	271
Other expenses/income	40	1,599	601	75	1,113	114	29	223	74	440
Income	6,431	3,993	8,321	14,528	33,273	10,277	10,850	20,417	7,122	48,666
Interest expense	-94	-114	-65	-47	-320	-41	-40	-40	-44	-165
Interest income		4	1	6	11	18	32	53	12	105
Income from cont. operations	6,337	3,883	8,257	14,487	32,964	10,254	10,842	20,430	7,090	48,616
Income taxes	2,187	1,339	2,865	4,863	11,524	3,546	3,690	6,899	2,482	16,617
Earnings from continuing Ops.	4,150	2,544	5,392	9,624	21,710	6,708	7,152	13,531	4,608	31,999
Earnings from discont. Ops										
Net Earnings	4,150	2,544	5,392	9,624	21,710	6,708	7,152	13,531	4,608	31,999
Net earnings/share	\$0.22	\$0.14	\$0.29	\$0.51	\$1.15	\$0.36	\$0.38	\$0.71	\$0.24	\$1.67
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	19,015	19,135	19,135	19,135

Important Disclosures

Daily | IIN | Insteel Industries Incorporated | C: 35.32 | Chg



3/07/11 \$11.74 Initiate HOLD

Ratings:

Buy: B

Hold: H

Sell: S

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- (1) Buy – The stock's total return including dividends is expected to exceed the industry or market average by at least 10% over the next twelve months.
- (2) Hold – The stock's total return including dividends is expected to be in line with the industry or market average of +/- 10% over the next twelve months.
- (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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