



**January 30, 2017**

**CURRENT PRICE:** \$36.65  
**RATING:** HOLD  
**PRICE TARGET:** N/A  
**CURRENT YIELD:** 0.1%

**EPS Estimates - Non-GAAP**

	SEP 16A	SEP 17E
1Q	\$0.36	\$0.23A
2Q	\$0.38	\$0.40
3Q	\$0.71	\$0.67
4Q	\$0.51	\$0.63
	<b>\$1.96</b>	<b>\$2.03</b>

**Trading Data**

52-WEEK PRICE RANGE: \$42.81 - \$22.50  
 SHARES OUTSTANDING: 19.21(M)  
 MARKET CAP: \$704.1(M)  
 AVG. DAILY TRADING VOLUME: 0.35(M)  
 S&P 500: 2,281

**Valuation Data**

BOOK VALUE: \$12.15  
 PRICE TO BOOK: 3.01x  
 DIVIDEND: \$0.12

**INSTEEL INDUSTRIES, INC (NSDQ: IIN)**

*1Q17 earnings results*

**Highlights**

- 1Q17 earnings of \$0.23/share vs. \$0.36/share during 1Q16
- Declining spreads impacted earnings
- Positive momentum going into 2Q17
- Infrastructure rebuild 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-\$36.65), headquartered in Mt. Airy NC, is the nations largest manufacturer of steel wire reinforcing products for concrete construction applications. 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. Virtually all of the company's sales are from within the US.. Started in 1958, the company had approximately 848 employees (as of 10/1/16), and generated total revenues of \$418.6 million during FY16. An estimated 85% of IIN's sales went towards nonresidential construction (approximately 40% infrastructure & 40% 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 1Q17 earnings of \$0.23/share vs \$0.36/share during 1Q16. The decline in earnings was due to narrower spreads between selling prices and raw material costs which was partly offset by an increase in shipments when compared to 1Q16. The decrease in IIIN's spreads was caused by competitive pricing pressures and the consumption of higher cost inventory purchased in prior quarters.

When comparing 1Q17 to 1Q16, net sales rose to \$93.9 million from \$92.4 million while cost of sales increased to \$80.9 million from \$76.0 million. The higher cost of sales was created by higher priced inventory used in production, causing IIIN's gross profit to fall to \$13.0 million from \$16.4 million. Gross profit margin declined to 13.9% from 17.8 % due to higher materials cost and competitive pricing pressures. Overall shipments grew 8.5%, when comparing the two quarters, and decreased 4.7% when comparing 1Q17 with 4Q16.

SG&A declined to \$6.26 million from \$6.34 million and net restructuring charges was \$46,000 vs a net recovery of \$75,000. Interest expense fell to \$34,000 from \$41,000 and interest income rose to \$52,000 from \$18,000. The above factors contributed to EBIT decreasing to \$6.73 million from \$10.25 million.

During IIIN's 1Q17 the company paid a regular quarterly dividend of \$0.03/share and a special cash dividend of \$1.25/share.

## EARNINGS CONFERENCE CALL

Management discussed the factors leading to the decrease in earnings and stated the slowdown that was experienced in the fourth quarter seems to have abated, potentially leading to increased orders during the next two quarters. Shipments during 1Q17 rose 8.5% when compared to 1Q16 but decreased 4.7% when compared to 4Q16 which was significantly lower than the usual seasonal "drop-off". The positive impact of higher volumes was offset by narrower spreads between selling prices/raw materials due to higher cost inventory used during the quarter.

The negative effects of higher raw material costs were compounded by a 4.5% sequential reduction in average selling prices generated by competitive pressures in the industry. IIIN believes this occurred in response to softening shipments and the "drop-off" in steel metallic prices during the company's 4Q16. However, it appears these negatives diminished during 1Q17 as product demand rebounded and it became apparent the recent November uptick in steel prices will continue during the next few months. The company recently initiated product price increases to offset the higher raw material costs.

IIIN expects favorable conditions in its construction end markets going into 2017 given recent positive trends in monthly construction spending data, Architectural Billing Index, and the Dodge Momentum Index. Additionally, the company is encouraged by the Trump Administration's goal of increased spending on the US infrastructure.



## Our Thoughts

The company reported 1Q17 earnings of \$0.23/share vs \$0.36/share during 1Q16. IIN 1Q17's earnings were negatively impacted by narrower spreads between selling prices and cost of raw materials. This negative was partly offset by an increase in shipments when compared to 1Q16.. The decrease in IIN's spreads was caused by competitive pricing pressures and the consumption of higher cost inventory purchased in prior quarters.

The stock was volatile, to say the least, during the past quarter as IIN's shares rose to \$42.81/share on 11/28/16 as daily trading volume leapt to 3.3 million shares that day, from prior average daily trading volume of 110,000-130,000 shares, on hopes of a Trump Infrastructure build out plan would positively impact the company. Since then, IIN's shares have pulled back approximately 14% as investors assess the new President's prospects of pushing through his agenda given recent "inside-the-beltway" political gyrations. We rate IIN a HOLD given the rapid rise of its stock price and concerns over what type of infrastructure spending program will emerge from Washington DC 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)

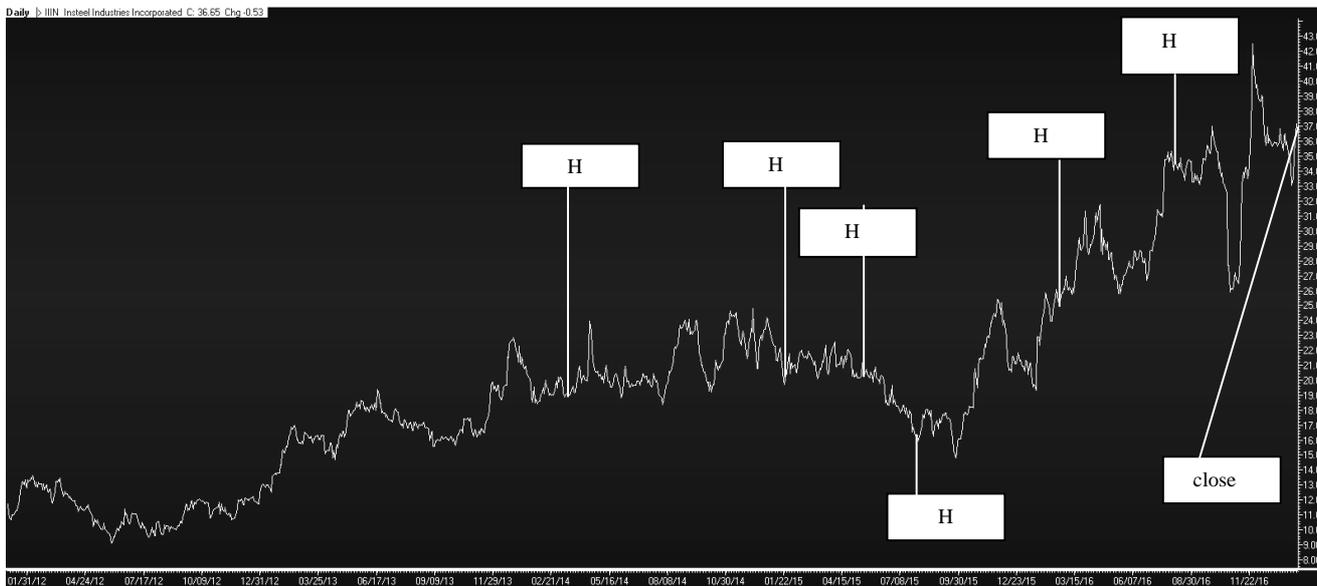
	1Q16	2Q16	3Q16	4Q16	2016	1Q17	2Q17e	3Q17e	4Q17e	2017e
Revenues	\$92,931	\$107,414	\$115,629	\$103,113	\$418,547	\$93,888	\$111,435	\$119,124	\$108,644	\$433,091
Cost of sales	75,968	88,799	88,082	80,510	333,359	80,878	92,491	92,917	84,742	351,028
Inventory write-downs										
Gross profit	16,423	18,615	27,547	22,603	85,188	13,010	18,944	26,207	23,902	82,063
SG&A	6,335	7,636	6,849	5,249	26,089	6,264	7,348	6,984	5,987	26,483
Acquisition costs										
Bargain Purchase gain										
Gain on debt extinguishment										
Pension settlement loss				2,539	2,539					
Restructuring charges	75	100	58	32	115	48	28	17	78	171
Other expenses/income	114	29	223	45	183	10	46	69	35	160
Income	10,277	10,850	20,417	14,738	48,666	6,726	11,614	19,275	17,972	55,541
Interest expense	-41	-40	-40	-37	-158	34	41	41	43	159
Interest income	18	32	53	63	166	52	34	27	28	141
Income taxes	3,546	3,690	6,899	4,910	19,045	2,266	2,946	6,433	5,926	18,571
Earnings from continuing Ops.	6,708	7,152	13,531	9,854	37,245	4,460	7,661	12,828	12,031	36,980
Earnings from discont. Ops										
Net Earnings	6,708	7,152	13,531	9,854	37,245	4,460	7,661	12,828	12,031	36,980
Net earnings/share	\$0.36	\$0.38	\$0.71	\$0.51	\$1.95	\$0.23	\$0.40	\$0.67	\$0.63	\$2.03
Cash dividends/share	\$0.03	\$0.03	\$0.03	\$0.03	\$0.12	\$0.03	\$0.03	\$0.03	\$0.03	\$0.03
Fully diluted shares outstanding	18,883	19,015	19,135	19,188	19,188	19,209	19,209	19,209	19,209	19,209



# EQUITY RESEARCH

## Important Disclosures

Daily | IIN | Insteel Industries Incorporated C. 36.65 Chg. 0.53



3/07/11 \$11.74 Initiate HOLD

Ratings:

Buy: B

Hold: H

Sell: S

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