



**January 24, 2018**

**CURRENT PRICE:** \$32.61  
**RATING:** HOLD  
**PRICE TARGET:** N/A  
**CURRENT YIELD:** 0.3%

**EPS Estimates - Non-GAAP**

	SEP 17A	SEP 18E
1Q	\$0.23	\$0.42A
2Q	\$0.39	\$0.24
3Q	\$0.36	\$0.43
4Q	\$0.23	\$0.30
	<b>\$1.17</b>	<b>\$1.39</b>

**Trading Data**

52-WEEK PRICE RANGE: **\$39.20 - \$23.20**  
 SHARES OUTSTANDING: **19.22(M)**  
 MARKET CAP: **\$626.8(M)**  
 AVG. DAILY TRADING VOLUME: **0.16(M)**  
 S&P 500: **2,834**

**Valuation Data**

BOOK VALUE: **\$11.72**  
 PRICE TO BOOK: **2.78x**  
 DIVIDEND: **\$0.12**

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

*1Q18 Earnings*

**Highlights**

- 1Q18 earnings of \$0.42/share vs. \$0.23/share during 1Q17
- Earnings helped by beneficial tax treatment and new tax laws
- Gross margins decrease from spread compression
- Price increase & positive outlook for next 2 quarters
- 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-\$32.61), 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 803 employees (as of 10/1/17), and generated total revenues of \$388.9 million during FY17. An estimated 85% of IIN's sales went towards nonresidential construction (approximately 50% 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 1Q18 earnings of \$0.42/share vs. \$0.23/share during 1Q17. 1Q18's results benefited from a gain on the re-measurement of deferred tax liabilities (+\$0.19/share) and reduction in income taxes due to the new lower corporate tax rate structure recently passed by the US Congress (+\$0.03/share). Operating results during 1Q18 were hurt by narrower spreads between IIIN's product selling prices and raw material costs. This negative was partly offset by increased shipments and lower manufacturing costs on the higher production volume relative to 1Q17.

Net sales increased 1.4% to \$97.7 million from \$93.9 million due to a 1.3% rise in shipments and a 2.8% rise in average selling prices. Management noted, on a geographic basis, the pickup in activity during the quarter was more pronounced in regions previously impacted by hurricanes Harvey and Irma with shipments to Florida and Texas rising by double digits when compared to 4Q17's results. When compared to 1Q17, shipments rose 13%, however current demand levels remain choppy.

The gross profit margin declined to 11.9% from 13.9% caused by the reductions in spreads between selling price raw material costs. However, the decrease was partly offset by lower unit manufacturing costs on higher production volume, and to a lesser extent, the increase in shipments.

When comparing 1Q18 to 1Q17, SG&A expense declined to \$5.76 million from \$6.26 million because of lower incentive compensation expense under IIIN's return on capital plans as well as a larger increase in the cash surrender value of the company's life insurance policies during the current year. EBIT decreased to \$5.93 million from \$6.73 million. Earlier this month, IIIN paid shareholders a \$1.00 special dividend given positive earnings results during the past year.

## Our Thoughts

On the surface, 1Q18's earnings looked good coming in at \$0.42/share vs. \$0.23 during 1Q17. However, 1Q18's results benefited from a gain on the re-measurement of deferred tax liabilities (+\$0.19/share) and reduction in income taxes due to the new lower corporate tax rate structure recently passed by the US Congress (+\$0.03/share). Operating results during 1Q18 were hurt by narrower spreads between IIIN's product selling prices and raw material costs. This negative was partly offset by higher shipments, and lower manufacturing costs on the higher production volume relative to 1Q17. Management noted, during the earnings call, the 2018 tax rate for IIIN should average 24%-25% based on the new US corporate tax rate.

Also, during the conference call, IIIN delivered positive news saying their channels continued to show good demand for their products and announced a \$60 per ton pricing increase on PC strand and welded wire products. Further pricing increases may materialize during 2018. Potentially, this could increase the company's spreads and gross profit margins resulting in earnings growth during the next two quarters-assuming customers accept the price



increase and orders remain intact. We continue to rate this stock a HOLD given IIN's recent share price appreciation and its volatility during the past 12-16 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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INSTEEL INDUSTRIES, INC.  
 FY ends 9/30  
 (in thousands except per share amounts)

	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18e	3Q18e	4Q18e	2Q18e
Revenues	\$93,888	\$101,159	\$96,938	\$96,886	\$388,871	\$97,741	\$104,268	\$108,494	\$97,563	\$408,066
Cost of sales	80,878	82,865	80,262	85,085	329,090	86,080	91,547	91,461	83,124	352,212
Inventory write-downs										
Gross profit	13,010	18,294	16,676	11,801	59,781	11,661	12,721	17,033	14,439	55,854
SG&A	6,264	7,055	6,216	5,973	25,508	5,763	6,815	5,927	6,984	25,489
Acquisition costs										
Bargain Purchase gain										
Gain on debt extinguishment										
Pension settlement loss										
Restructuring charges	48	25	60	31	164					
Other expenses/income	10	10	50	3	53	19	11	13	15	58
Income	6,726	11,204	10,350	5,939	34,219	5,379	5,395	11,093	7,640	29,507
Interest expense	34	35	34	33	136	28	29	32	35	124
Interest income	52	48	75	73	248	76	74	44	57	251
Income taxes	2,266	3,797	3,522	2,035	11,620	2,184	1,438	2,754	1,901	8,277
Earnings from continuing Ops.	4,460	7,420	6,869	3,799	22,548	8,111	4,552	8,351	5,761	26,775
Earnings from discount. Ops										
Net Earnings	4,460	7,420	6,869	3,799	22,548	\$8,111	\$4,552	\$8,351	\$5,761	\$26,775
Net earnings/share	\$0.23	\$0.39	\$0.36	\$0.20	\$1.17	\$0.42	\$0.24	\$0.43	\$0.30	\$1.39
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	19,209	19,224	19,225	19,225	19,211	19,224	19,224	19,224	19,224	19,224

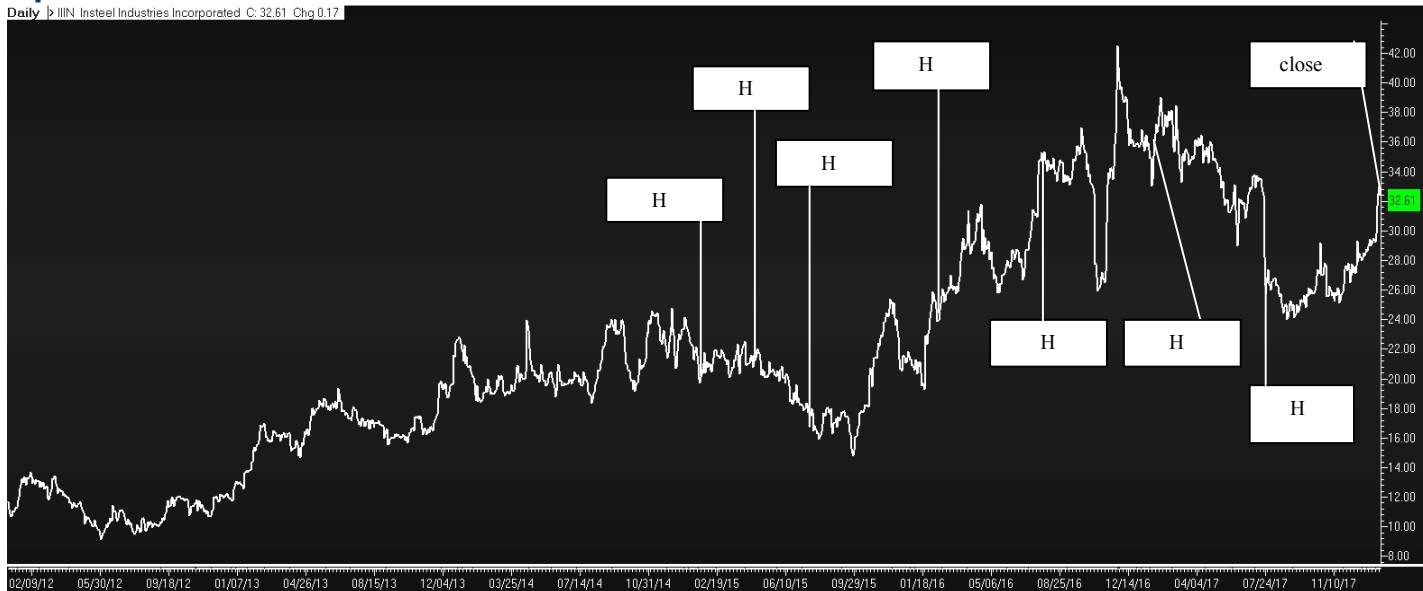




# EQUITY RESEARCH

## Important Disclosures

Daily | IIN Steel Industries Incorporated C.32.61 Chg 0.17



3/07/11 \$11.74 Initiate HOLD

Ratings:  
Buy: B  
Hold: H  
Sell: S

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