



September 4, 2019

CURRENT PRICE: \$18.30
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.7%

EPS Estimates - Non-GAAP

	SEP 18A	SEP 19E
1Q	\$0.42	\$0.21A
2Q	\$0.31	\$0.15A
3Q	\$0.67	\$0.11A
4Q	\$0.49	\$0.19
	\$1.88	\$0.56

Trading Data

52-WEEK PRICE RANGE: **\$39.04 - \$17.50**
SHARES OUTSTANDING: **19.33(M)**
MARKET CAP: **\$354.3(M)**
AVG. DAILY TRADING VOLUME: **87.5(K)**
S&P 500: **2,938**

Valuation Data

BOOK VALUE: **\$12.89**
PRICE TO BOOK: **1.42x**
DIVIDEND: **\$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIN)

3Q19 Earnings Results

Highlights

- 3Q19 earnings of \$0.11/share vs. \$0.67/share during 3Q18
- Earnings hurt by construction delays, shipments, & tariffs
- Gross margins decrease
- Infrastructure spending stable
- 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 as US construction market improves, and increasing demand for the company's products, and an end to the Section 232 tariff.

Company Summary

Insteel Industries (IIN-\$18.30), 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 has approximately 800 employees, and generated total revenues of \$453.2 million during FY18. 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.



EQUITY RESEARCH

Recent Earnings

IIIN reported 3Q19 earnings of \$0.11/share vs. \$0.67/share during 3Q18. The lower results came from lower shipping/production volumes attributable to growing import competition and adverse weather conditions affecting IIIN's customers. Additionally, 3Q19's results were negatively impacted by narrower spreads between selling prices/raw materials and higher manufacturing costs. Net sales were flat at \$126.3 million. While average selling prices did rise by 3.7%, these were offset by a 3.9% decrease in shipments. Lower shipments came from adverse weather conditions (rain) in many of IIIN's customers' areas causing a delay, or reduction, in construction activity, and low-priced import competition, resulting from the Section 232 tariff program.

Gross profit margins decreased to 6.5% from 19.1% due to lower spreads, higher manufacturing costs, and reduction in overall shipments. Cost of sales rose to \$118.0 million from \$102.5 million while SG&A fell to \$5.5 million from \$7.5 million. The decrease in SG&A expense came from lower incentive compensation expense under IIIN's capital plan due to lower profit results.

IIIN's PC strand and stranded welded wire reinforcement product lines continued to be negatively impacted by increased low-price import competition arising from the Section 232 tariff program implemented by the Trump administration. This tariff provides a substantial cost advantage to offshore producers of PC strand and welded wire reinforcement products.

The Section 232 tariff program was implemented in March of 2018 and imposed a 25% import tariff on certain steel products. Included was IIIN's primary raw material, hot rolled wire rod, and did not apply to downstream steel products such as PC strand and welded wire reinforcement. Thus, US prices for hot rolled wire rod are significantly higher relative to the world market and create entry incentive to the US for foreign competitors by allowing them to circumvent the tariff by shifting their production to products not covered by tariffs. As a result, PC strand imports are up 55% since 3Q18.

MANAGEMENT'S COMMENTS

The company said 3Q19's results were hurt by adverse weather conditions in its customers' territories and the Section 232 tariff-increasing foreign competitors' ability to sell into the US with lower cost products. IIIN has asked the White House for an exemption for the tariff but as of yet has not been granted one by the Trump administration.

Management stated raw material costs have been rising while experiencing a decline in selling prices, thereby equating to a potential continuation of the current spread compression in its profit margins during 4Q19. Improved weather has allowed IIIN's customers to resume delayed orders of products and may allow for some volume increases going into 2020. Additionally, US infrastructure project has been positive for IIIN and the commercial sector is growing, but at a lesser pace than the past couple of years. Management stated recent Architectural Billings and Dodge Momentum indexes, recognized as indicators for non-residential building construction, indicated softening activity levels with relatively stable conditions which could persist over the short-term, and produce low single-digit growth.



Our Thoughts

IIN's decrease in 3Q19 results, \$0.11/share, vs. \$0.67/share during 3Q18, reflect the negative effects of tariffs and bad weather in its customers service territories. While improving weather could improve revenues going forward, negating this positive may be continued margin compression as material costs rise coupled with decreases in average selling prices. Moreover, the continued pressure from Section 232 tariffs are unlikely to abate until there is a resolution in the US/China trade war. Another concern for investors regarding all material supply companies is whether a recession will materialize in the US. These factors caused IIN's stock price to fall from a high of approximately \$43/share, reached in August 2018, to a current price of \$18.30/share. Should a recession occur IIN's share price could continue its recent decent. Under this scenario, IIN should be able to ride out the storm given their lack of balance sheet debt and potentially benefit when the US economy returns to a post-recessionary "growth mode". We rate this stock a HOLD.

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)

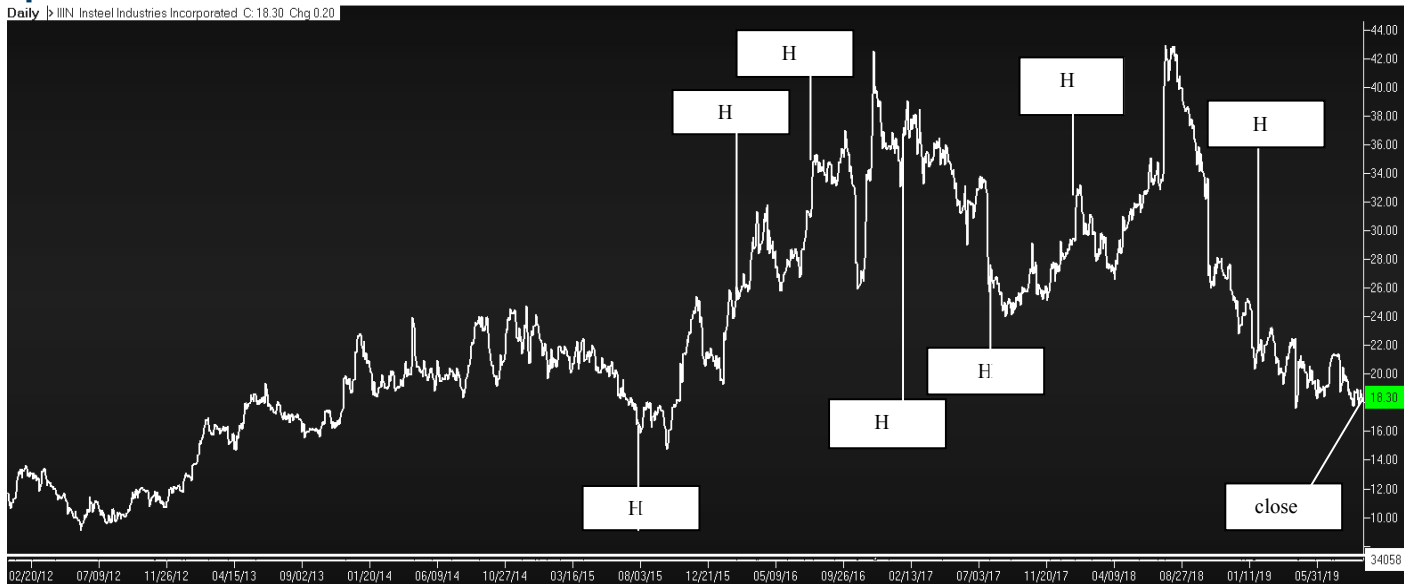
	1Q18	2Q18	3Q18	4Q18	2018	1Q19	2Q19	3Q19	4Q19e	2019e
Revenues	\$97,741	\$107,417	\$126,688	\$121,371	\$453,217	\$104,110	\$111,948	\$126,252	\$135,844	\$490,129
Cost of sales	86,080	92,001	102,502	101,827	382,410	93,134	104,927	118,016	124,271	440,348
Inventory write-downs		15,416								
Gross profit	11,661	7,475	24,186	19,544	70,087	10,976	7,021	8,236	11,573	37,806
SG&A	5,763	6,815	7,541	7,525	28,304	6,534	6,556	5,516	7,113	27,330
Acquisition costs										
Bargain Purchase gain										
Gain on debt extinguishment										
Pension settlement loss										
Restructuring charges										
Other expenses/income	19	166	32	121	274	829	971	23	42	470
Income	5,379	7,775	16,677	11,898	42,229	5,271	1,436	5,539	4,502	16,748
Interest expense	28	23	23	40	114	30	45	62	38	141
Interest income	76	53	150	236	515	155	12	9	127	451
Income taxes	2,184	1,026	3,936	2,686	6,364	1,270	354	500	964	3,088
Earnings from continuing Ops.	8,111	5,879	12,868	9,408	36,266	4,126	1,049	2,190	3,627	9,992
Earnings from discount. Ops										
Net Earnings	\$8,111	\$5,879	\$12,868	\$9,408	\$26,775	\$4,126	\$1,409	\$2,190	\$3,627	\$9,992
Net earnings/share	\$0.42	\$0.31	\$0.67	\$0.49	\$1.88	\$0.21	\$0.05	\$0.11	\$0.19	\$0.56
Cash dividends/share	\$1.28	\$0.03	\$0.03	\$0.03	\$1.37	\$0.03	\$0.03	\$0.03	\$0.03	\$0.12
Fully diluted shares outstanding	19,224	19,258	19,274	19,353	19,217	19,336	19,340	19,336	19,334	19,334



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Important Disclosures

Daily | IIN Insteel Industries Incorporated C:18.30 Chg:0.20



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.
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