



April 29, 2021

CURRENT PRICE: \$38.57
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.3%

EPS Estimates - Non-GAAP

	SEP 20A	SEP 21E
1Q	\$0.03	\$0.42A
2Q	\$0.23	\$0.76A
3Q	\$0.34	\$0.67
4Q	\$0.38	\$0.38
	\$0.98	\$2.23

Trading Data

52-WEEK PRICE RANGE: \$38.96 - \$13.84
SHARES OUTSTANDING: 19.37(M)
MARKET CAP: \$747.1(M)
AVG. DAILY TRADING VOLUME: 98(K)
S&P 500: 4,211

Valuation Data

BOOK VALUE: \$2.88
PRICE TO BOOK: 13.4x
DIVIDEND: \$0.12

INSTEEL INDUSTRIES, INC (NSDQ: IIIN)

2Q21 Earnings Results

Highlights

- 2Q21 earnings of \$0.76/share vs. \$0.23/share during 2Q20
- Earnings helped by increased demand & wider spreads
- Gross margins rose to 21.7% from 13.3%
- Strong customer demand bodes well for IIIN's product pricing
- Maintain HOLD rating

Investment Thesis

IIIN could be an interesting speculative play for aggressive investors. Since most of IIIN'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 IIIN. Aggressive and speculative investors should look for attractive entry points into IIIN 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 (IIIN-\$38.57), headquartered in Mt. Airy NC, is the nations largest manufacturer of steel wire reinforcing products for concrete construction applications. IIIN 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 834 employees, and generated total revenues of \$472.6 million during FY20. An estimated 85% of IIIN's sales went towards nonresidential construction (approximately 85% infrastructure & 15% non-infrastructure) and 15% to residential construction. IIIN 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 2Q21 earnings of \$0.76/share vs. \$0.23/share during 2Q20. The improvement came from higher sales and increased gross margins created by strong customer demand. Net sales rose 21% to \$139.0 million from \$114.9 million due to a 15% increase in average selling prices and a 5.2% rise in shipments. The rise in average selling prices were the result of price increases initiated by IIIN across its broad product line during 2Q21 to cover escalating costs of raw materials used by the company.

When comparing 2Q21 to 2Q20, gross profit rose to \$30.2 million from \$15.3 million while IIIN's gross profit margins increased to 21.7% from 13.3%. Margin improvements came from a 15% increase in average selling prices and a 5.2% rise in shipments. Higher average selling prices came from price increases implemented along all of IIIN's product lines done to cover rapidly escalating production costs.

SG&A expense rose to \$10.3 million from \$9.6 million due to higher compensation costs under the company's incentive profitability plan-which were absent during 2Q20. Additionally, SG&A increased from higher legal expenses related to ongoing trade cases related to IIIN's pursuit to stop foreign dumping of products into the US markets. Restructuring charges rose to \$543,000 from \$149,000 and interest expense declined to \$24,000 from \$26,000.

RECENT EARNINGS CONFERENCE CALL

Following the 2Q21 earnings release, IIIN held a conference call to discuss results and forward expectations for the balance of the year. The improved 2Q21 earnings resulted from strong underlying demand for IIIN's reinforcing products and rising steel prices. Earnings were also aided by robust demand for its concrete products and widening spreads between selling prices and costs for raw materials. Thus, average selling prices rose 15% when comparing 2Q21 to 2Q20 and 12.7% on a sequential quarterly basis from price increases initiated during the past two quarters.

These positives more than offset "rapidly escalating raw material costs" and the supply of wire rod in the US is now becoming constrained as of the end of 2Q21. Along these lines, steel scrap, the primary input in the production of wire rod, is up over 60% during the past 6 months.

Gross profit margin, which increased to 21.7% from 13.3% , when comparing 2Q21 to 2Q20, came from rising average selling prices that outpaced higher rod costs. IIIN noted its gross profit margin rate currently is higher than historical averages, and expects it to normalize (lower) sometime in the future.

While expenses rose to \$10.3 million from \$9.6 million, the increase was partly offset by a \$2 million positive charge in the cash surrender value of life insurance policies. The tax rate for IIIN was 22.5% for 2Q21 vs. 21.2% during 2Q20 and management anticipates a forward rate of 23%.

Cash flow from operations generated \$15.3 million during 2Q21, due mainly to earnings growth combined with a minimal change in working capital, compared to \$3 million in 2Q20 when net working capital increased \$13.8 million. IIIN's 2Q21 ending inventories were valued at an average unit cost higher than 1Q21 cost of sales yet



remain favorable relative to current replacement costs. At the conclusion of 2Q21, the company had \$3/share in cash on hand and no borrowings on its \$100 million revolving credit facility.

During 3Q21, management remains optimistic due to steady customer demand, a strong order book, and scheduled shipments trending above forecast levels. 2021 highway and street construction spending appears to be on the same level during 2020 and is running 5% above the past five years' average. Going forward, IIIN has seen "favorable determinations" with respect to the PC strand trade and standard welded wire cases over the near term. Additionally, the tight supply environment for rod and the escalation of raw material costs in this area may not abate any time soon.

Throughout 2H21, IIIN expects continued strength in its customer markets driven by improved public finances at the state/local levels with expected higher spending levels in distribution and e-commerce segment of the private non-residential construction market. Also, IIIN expects to benefit from growing federal covid recovery spending and potentially from President Biden's proposed infrastructure bill. Given these factors, IIIN anticipates pricing power could be in its favor going forward. It was noted transportation costs are rising partially due to a "chronic shortage of flatbed truck capacity" (used to ship products) with expectations of passing these higher transport expenses on to customers.

Our Thoughts

IIIN had a strong earnings report as the company reported 2Q21 earnings of \$0.76/share vs. \$0.23/share during 2Q20. The improvement came from a rise in gross profit margins (21.7% vs. 13.3%), higher shipments (+5.2%), and strength throughout IIIN's construction markets. Additionally, during 2Q21 average selling prices rose 15% when comparing the two quarters, as increased customer demand, and higher production costs, allowed pricing increases which management believes will continue during 3Q21 and possibly 4Q21. Revenues increased to \$139.0 million from \$114.9 million. The overall improvement came from a rebounding post-covid US economy resulting in strong customer demand for IIIN's products.

IIIN's earnings should continue to grow throughout FY21 with the current pace of the US economic recovery and expanded gross margins. Under this scenario, we are raising our 2021 earnings estimate to \$2.23/share from \$1.77/share. However, we continue to rate IIIN a HOLD, given the stock has nearly tripled during the past year, trades near its 52-week high, high bullish stock market public sentiment, and uncertainty whether a new infrastructure bill passes through the US Congress. We expect IIIN's shares will continue to be volatile, given current stock market trading volatility. Potentially, market volatility may create attractive entry points for IIIN's shares, at lower levels, in the future.



Risks

There are no guarantees IIIN 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 IIIN's share price. Given the relatively small amount of daily trading activity in IIIN'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)

	1Q20	2Q20	3Q20	4Q20	2020	1Q21	2Q21	3Q21e	4Q21e	2021e
Revenues	\$97,569	\$114,859	\$121,959	\$138,231	\$472,618	\$119,605	\$138,999	\$140,165	\$149,679	\$548,448
Cost of sales	91,332	99,576	107,154	118,769	416,831	99,754	108,771	112,132	131,418	452,075
Inventory write-downs										
Gross profit	6,237	15,283	14,805	19,462	55,787	19,851	30,228	28,033	18,261	96,373
SG&A	5,744	9,602	6,694	9,308	31,348	8,553	10,330	10,547	9,773	39,203
Acquisition costs		187	8		195					
Bargain Purchase gain										
Gain on debt extinguishment										
Pension settlement loss										
Restructuring charges		149	808	738	1,695	657	545	412	185	1,799
Other expenses/income	25	18	1,240	29	1,254	13	75	26	57	171
Income	518	5,363	8,535	9,387	23,803	10,628	19,278	17,048	9,531	56,485
Interest expense	26	26	26	28	106	25	24	26	26	101
Interest income	226	204	22	21	473	5	5	11	22	44
Income taxes	163	1,177	1,867	1,954	5,161	2,465	4,339	3,918	2,192	12,914
Earnings from continuing Ops.	555	4,364	6,664	7,426	19,009	8,143	14,920	13,115	7,335	43,513
Earnings from discount. Ops										
Net Earnings	\$555	\$4,364	\$6,664	\$7,426	\$19,009	\$8,143	\$14,920	\$13,115	\$7,335	\$43,513
Net earnings/share	\$0.03	\$0.23	\$0.34	\$0.38	\$0.98	\$0.42	\$0.76	\$0.67	\$0.38	\$2.23
Cash dividends/share	\$0.03	\$0.03	\$0.03	\$0.03	\$0.12	\$1.53	\$0.03	\$0.03	\$0.03	\$1.62
Fully diluted shares outstanding	19,370	19,386	19,377	19,396	19,383	19,434	19,386	19,386	19,386	19,386

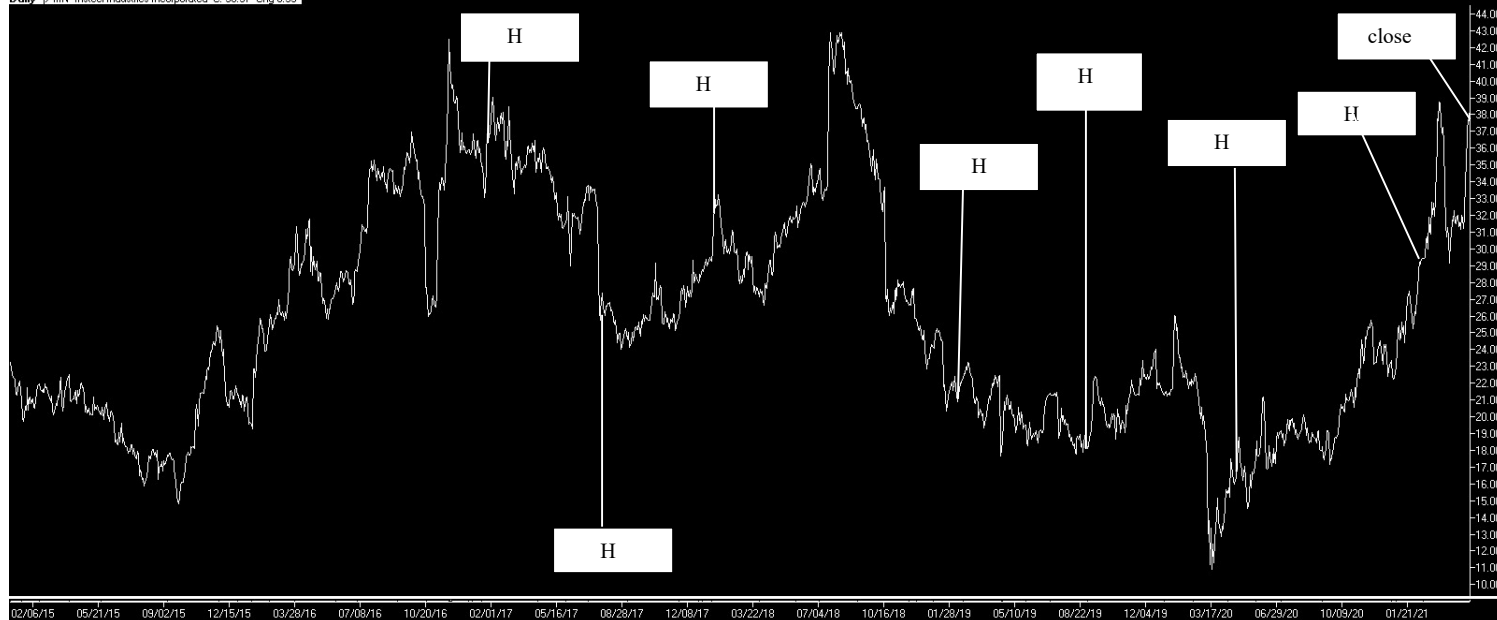


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Important Disclosures

Daily I: IIN Insteel Industries Incorporated C: 38.57 Chg 0.95



Ratings:
Buy: B
Hold: H
Sell: S

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