



August 1, 2017

CURRENT PRICE: \$26.05
RATING: HOLD
PRICE TARGET: N/A
CURRENT YIELD: 0.5%

EPS Estimates - Non-GAAP

	SEP 16A	SEP 17E
1Q	\$0.36	\$0.23A
2Q	\$0.38	\$0.39A
3Q	\$0.71	\$0.36A
4Q	\$0.51	\$0.48
	\$1.96	\$1.46

Trading Data

52-WEEK PRICE RANGE: **\$42.81 - \$22.50**
 SHARES OUTSTANDING: **19.23(M)**
 MARKET CAP: **\$500.9(M)**
 AVG. DAILY TRADING VOLUME: **0.14(M)**
 S&P 500: **2,476**

Valuation Data

BOOK VALUE: **\$11.18**
 PRICE TO BOOK: **2.33x**
 DIVIDEND: **\$0.12**

INSTEEL INDUSTRIES, INC (NSDQ: IIN)

3Q17 earnings disappoint

Highlights

- 3Q17 earnings of \$0.36/share vs. \$0.71/share during 3Q16
- Earnings hurt by weather & slowed infrastructure spending
- Gross margins decrease from competition & increased cost of goods
- Potential of resumption of rising revenues going forward
- 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-\$26.05), 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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Recent Earnings

IIN reported 3Q17 diluted earnings of \$0.36/share vs. \$0.71/share during 3Q16. The decline was primarily due to lower shipment and production volumes combined with narrower spreads between selling prices and raw material costs. These resulted from heavy rainfall in parts of the US, a reduction in new project activity created largely due to a lull in public funded infrastructure spending, and competitive pricing pressures.

Net sales fell 16.2%, to \$96.9 million from \$115.6 million, and cost of sales decreased to \$80.3 million from \$88.1 million. These results caused gross profit margins to fall to 17.2% from 23.8% due to lower shipments/spreads, and higher production costs on the lower production volumes. Shipments decreased 20.8% while average selling prices rose 5.9%.

SG&A declined to \$6.22 million from \$6.85 million from lower compensation expense mainly related to reduced incentive compensation under IIN's return on capital plan. When excluding the incentive compensation plan, costs were lower by approximately \$100,000 when comparing 3Q17 to 3Q16. Given the above factors, EBIT fell to \$10.4 million from \$20.4 million.

EARNINGS CONFERENCE CALL

Management discussed 3Q17's results which "were adversely" affected by weak demand in what is normally a seasonally strong period. Shipments fell 20.8% reflecting the higher variability in demand experienced this year due to fluctuations in weather and the timing of large projects. Rainfall in the Northeast, Midwest, and Southeast US increased 36%-63% when comparing 3Q17 to 3Q16. This negative offset favorable weather patterns for IIN's customers in Texas (7% of revenues) and in the western US. However, the business deferred should benefit IIN in the coming year.

IIN also stated there was an additional deferral of orders from project delays due to a reduction in spending from publicly funded infrastructure programs. This source of revenue could increase going forward as new state and new local funding initiatives kick-in during the new fiscal year resulting in higher spending levels.

IIN's average selling prices rose sequentially when comparing 3Q17 to 2Q17 following a price increase to recover recent increases in materials costs. However, gross profit fell to \$10.9 million from \$16.7 million when comparing 3Q17 to 3Q16 and gross margins decreased to 17.2% from 23.8%. Management stated more than half of the reduction came from lower shipments, a third came from narrowing spreads, and the rest was from higher unit manufacturing cost/lower production volumes.



Based on its forecast, IIN believes 3Q's inventory on hand represents about four months' of shipments, with an average unit cost valued at below current market level, but higher than the beginning average for the quarter as well as 3Q's cost to sales. These higher costs may put pressure on 4Q's margins depending on strength of demand and IIN's ability to raise prices in the future.

Moving into 4Q17, IIN sees positive customer sentiment, healthy project pipelines, and expects activity levels to increase going forward. This is based on IIN's customers and recent construction data, including the most-recent American Institute of Architects reported ABI number remaining above the 50% growth threshold, at 54.2%.

Our Thoughts

IIN's 3Q17 results disappointed Wall Street as the company reported earnings of \$0.36/share vs. \$0.71/share during 3Q16. The decline was due to lower shipment and production volumes combined with narrower spreads between selling prices and raw material costs. Many of IIN's customers were affected by heavy rain, delaying building projects, in their respective areas, and a lull in public funded infrastructure spending, and competitive pricing pressures. As a result, IIN's shares fell over 12.5% on the day of its earnings release as momentum investors poured out of this stock.

Going forward, IIN will need to show 3Q17's earnings decline was a one-time event and not the beginning of a negative business trend. Management stated things could rebound during the next few quarters given recent customer feedback and the potential of increased infrastructure spending as new municipal budgets take effect in 2017. Given 3Q17's earnings results and management's guidance during the conference call, our 2017 earnings estimate is being reduced to \$1.46./share from \$2.03/share. We continue to rate IIN neutral until a clearer picture of the company's profitability trend materializes during the next few months.



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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INSTEEL INDUSTRIES, INC.

FY ends 9/30

(in thousands except per share amounts)

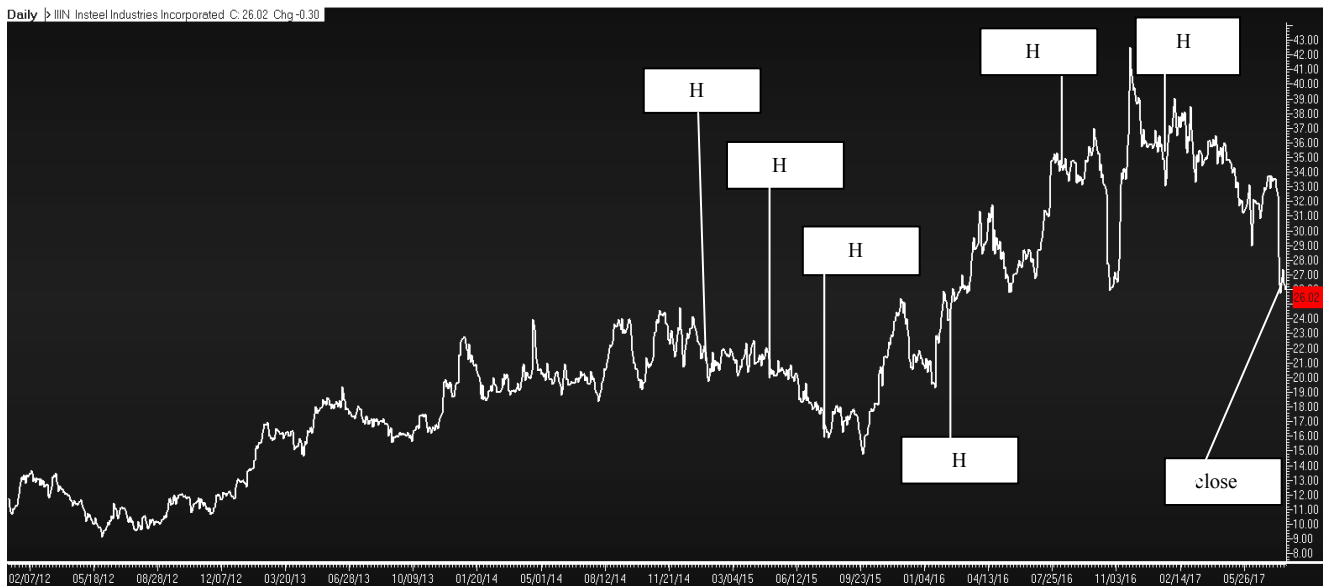
	1Q16	2Q16	3Q16	4Q16	2016	1Q17	2Q17	3Q17	4Q17e	2017e
Revenues	\$92,931	\$107,414	\$115,629	\$103,113	\$418,547	\$93,888	\$101,159	\$96,938	\$102,674	\$394,659
Cost of sales	75,968	88,799	88,082	80,510	333,359	80,878	82,865	80,262	83,166	327,171
Inventory write-downs										
Gross profit	16,423	18,615	27,547	22,603	85,188	13,010	18,294	16,676	19,508	67,488
SG&A	6,335	7,636	6,849	5,249	26,089	6,264	7,055	6,216	5,587	25,122
Acquisition costs										
Bargain Purchase gain										
Gain on debt extinguishment										
Pension settlement loss				2,539	2,539					
Restructuring charges	75	100	58	32	115	48	25	60	78	211
Other expenses/income	114	29	223	45	183	10	10	50	35	105
Income	10,277	10,850	20,417	14,738	48,666	6,726	11,204	10,350	13,878	42,113
Interest expense	-41	-40	-40	-37	-158	34	35	34	38	141
Interest income	18	32	53	63	166	52	48	75	28	203
Income taxes	3,546	3,690	6,899	4,910	19,045	2,266	3,797	3,522	4,715	14,300
Earnings from continuing Ops.	6,708	7,152	13,531	9,854	37,245	4,460	7,420	6,869	9,153	27,902
Earnings from discount. Ops										
Net Earnings	6,708	7,152	13,531	9,854	37,245	4,460	7,420	6,869	9,153	27,902
Net earnings/share	\$0.36	\$0.38	\$0.71	\$0.51	\$1.95	\$0.23	\$0.39	\$0.36	\$0.48	\$1.46
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	18,883	19,015	19,135	19,188	19,188	19,209	19,224	19,225	19,225	19,209



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Important Disclosures

Daily | IIN Insteel Industries Incorporated C:26.02 Chg:-0.30



3/07/11 \$11.74 Initiate HOLD

Ratings:

Buy: B

Hold: H

Sell: S

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- (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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