

Closing Price <b>\$ 3.00</b>	Market Cap <b>\$ 57 Million</b>	Beta <b>N/A</b>	2016 P/E <b>7.8x</b>	Target <b>\$6.00</b>	Fusion Ranking <b>Buy</b>
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## Summary of Buy Recommendation

### Equity Classifications

Sector:	<b>Industrial</b>
Group:	<b>Ind. Technology</b>
Capitalization:	<b>Micro</b>
Style:	<b>Value</b>
Dividend:	<b>Non-Payer</b>

### Fusion Trading Signal Status

Short Term Buy

Long-Term Buy

INSA shares warrant a Buy rating for both the short and long term, as recent deals are creating tremendous value not being realized in the marketplace.

### Additional Metrics

52 Week Range:	\$ 3.72 / \$ 1.25
Debt/Cap:	29%
EPS 2014E	\$0.12
EPS 2015E	\$0.30
EPS 2016E	\$0.40

**Business Description:** After completion of recent acquisitions, Invisa now manufactures coated fabrics for a variety of end uses in the US and Europe, including automotive, industrial and consumer applications. Management plans to change the company name to Uniroyal Engineered Products, and should host its first annual meeting in the next couple of months.

### Key Points

**With Emergence of its Recent Earnings Reports, Story Has Been De-Risked.** The mergers with privately held Uniroyal Engineered Products, and subsequently Wardle Storeys, have been completed and the company has now reported two quarters which were better than our expectations, with strong sales growth on automotive penetration, despite currency.

**Opportunity for Additional Deals.** The company's balance sheet and cash flow generation allows for additional deal opportunities to enhance shareholder value. Management has a proven track record of value enhancing deals, as UEP has successfully merged operations with Wardle Stories, diversifying its business from the US to Europe.

**Brand Story Intact to Differentiate Product Offerings.** The business lines of the company have been differentiated by long term leading brand names in both consumer and industrial markets. The Naugahyde and Uniroyal brands in particular have had decades of successful brand penetration in their key markets, and with a now much more expanded geographical footprint that should allow for further sales and market share gains.

**Stock Could Double From Here.** The stock valuation is half of what it should be, in our view, despite the release of 2014 and 1Q numbers which suggest our estimates are increasingly conservative. The stock is less than 8x such estimates, despite what now looks like a healthy double digit growth rate. Likely multiple expansion should get the stock to our \$6/share target.



## Recent Strong Results

The company has followed up its 10-K filing with another strong quarter, with sales growth of 13%, well ahead of peers, as management has been able to ramp the mix of automotive platforms toward newer high margin business and away from mature legacy platforms. This also suggest market share gains as well, at both OEM and Tier 1 customers. Margins should continue to increase, and although heavy investment in sales and marketing results in a lag in margins getting to the target this year, it increases our confidence in continued double digit sales growth, and even stronger profit growth, particularly as G&A expense growth is currently at a much slower pace in the recent earnings results. We also see strong bottom line leverage from rapidly declining interest expense, which in the 1Q was down an impressive 15% due to lower rates

## Company Dynamics

INSA management has been quite busy with financial management and deal dynamics following the merger of Invisa with Uniroyal Engineered Products, and the merger of equals between UEP and Wardle Storeys. With the merger into publicly held Invisa, these previously private entities are now part of a publicly reporting company, with about half of its sales into higher end automotive applications. Wardle had been about 80% automotive prior to the merger, bringing up the total, but management has restructured the business toward a higher end mix in both auto and non-auto applications.

We believe this series of mergers on extremely attractive terms has created tremendous value that clearly does not appear to be represented by the current share price. After analyzing the last two earnings reports, the trends, run rate and swing factors we discuss below make a very compelling case for rapid earnings growth for INSA.



## Strong Business Lines

The combined company has become #1 in the US market with technology-driven share gains. The key businesses are based on vinyl coated fabrics, marketed under a number of brand names, including the flagship Naugahyde umbrella of brands. The products serve a wide variety of applications as alternatives to leather, cloth and other fabric coverings. There are more than 600 SKUs of different textures, patterns and colors with protective finishes, which have adhesive back coatings. Unlike leather, coated fabrics can be embossed, patterned and printed, with stain resistance and easy processability. Beside the key automotive business, key applications include furniture, non-automotive transportation, commercial and hospitality seating, healthcare facilities and athletic equipment. Key technologies that make these products versatile are lamination and thermoforming to a variety of substrates, and Naugahyde offers flame and smoke resistance. BeautyGard topcoats offer antibacterial and antifungal resistance for surfaces that require repeated cleaning in the healthcare and hospitality industries. Key here is that the company's intensive R&D effort can develop products specifically for a customer's performance needs.

Sales are heavily concentrated in automotive and other transportation applications. Key non-automotive transportation applications include heavy and medium duty trucks, industrial and agricultural tractors and bulldozers, ATV's, personal watercraft, RVs, vans, motor homes, trains and buses. The company also sells through distributors to smaller transportation and industrial markets.

## Leading Automotive Player in Oligopoly

The newly combined company has about 45% of its revenues to the automotive sector, and offers a unique materials play on the solid growth currently in the global automotive marketplace. Coated Fabric yards are growing notably faster than auto builds, and the total addressable market is now in excess of \$600 MM. The Naugahyde brand has been the workhorse for coated fabrics used in automotive interiors. The branding strategy has led to significant market share gains, and can now be leveraged into Wardle's European footprint. Key automotive applications include seating, door panels, headrests, armrests, security shades and other components. Superior performance and weight characteristics are leading to higher content per car. And INSA is now only one of three players domestically in the space, which should in our view should give the company oligopolistic pricing power. It is also the leader in Europe with only three other competitors. We also note there is high visibility to forward revenue growth given the long lead time on qualifications for automotive OEM platforms.



But the story is increasingly global platforms, clearly helped by the improved geographic reach post the Wardle's merger. Key customers of the UK company include Range Rover, Fiat, Nissan and Jaguar. Both direct and through intermediaries, we believe INSA products now wind up in most of the major domestic and European automotive company platforms. In fact, the company reports that Ford accounts for nearly 25% of its automotive revenues. The combined company is also increasing its qualification efforts at Japanese OEMs, with some early success at domestic transplants. And a new entry into the German market should lead to qualifications for domestic and exports of key German customers as well. Clearly, the diversification of the OEM base de-risks the story. The company should also benefit from the trend of major OEM's moving toward global purchase decisions, which can leverage its products and technology. This was the case with Ford, which in part led to the merger. And the company's expanded product line helps it bundle products such as vinyls and composites for ease of customer development.

## **Brands & Technology Have Driven High Market Shares**

Both Uniroyal and Wardle Storeys have built high market shares in their key markets. We believe much of this success is due to a brand strategy that was in turn built by superior technology improvements. Vinyl Coated Fabrics evolved over the last century from rubber coated fabrics marketed originally under the Uniroyal name. The company employs a continuous casting process for both coated fabrics and laminated composites, which provides superior performance characteristics for thermoforming. These continuous cast formable products clearly have great production economies over a traditional cut-and-sew approach. Bringing this technology to the Wardle Storeys facilities is starting to realize significant cost savings as well. In turn, Wardle brings a unique urethane foam molding technology for similar markets. The company differentiates its products with protective topcoat finishes and adhesive back coats, and offers a unique in-house printing technology. In both facilities, the company has upgraded and expanded coatings lines, doubling throughput for many products. Bottom line, increased speed and efficiencies from this technology has led to at least 40% of automotive sales of products developed to customer specifications.



But key to margin differentiation and its focus on the higher end of the market is a number of successfully tested proprietary brands and trademarks. Under the key Naugahyde umbrella are brands such as Naugaform, NaugaSatin, NaugaSoft and NaugaSylk. Other key brands include All-America, BeautyGard, Chame, CirroFlex, Flame Blocker and Spirit Millienium. Wardle Stories contributes two successful brands in Europe in Ambla fabrics and Velbex laminates. This brand building has led to market share building as well, as has enabled a level of strong pricing power that tends to prevent any raw material or other margin pressure.

## **Non-Automotive Growth Opportunities**

The new company's larger footprint and technological innovations should allow it to penetrate existing non-automotive industrial and consumer markets further, as well as seek new applications. Using its proprietary technologies, the company is ramping up its sales effort in the consumer product, hospitality and health care sectors. Most of these sectors tend to be smaller volume but higher margin than the automotive sector. We would expect to see some acceleration of the Naugahyde brand into consumer and furniture markets, with much improved performance characteristics than in earlier generations. Companies such as Caterpillar and Deere are using the company's coatings and colored fabrics, as are other transportation sectors such as golf carts and off-road vehicles. The company intends to accelerate its sales effort toward the designer and trade channels to accelerate such on-spec purchasing.



## Competitive Dynamics

The company's share gains have helped lead to a more concentrated market, which in turn has given it greater pricing power. The merger with Wardle Storeys has obviously taken out one would-be competitor. The main Coated Fabrics competitor in the US is Omnova, a publicly reporting specialty chemicals company. OMN is an important player in polymers, coatings and adhesives, with only about 14% of its revenues in the automotive market. In Engineered Surfaces its business is split evenly between coated fabrics and laminates, with a small films business. This competitor does have some low cost plants in China and Thailand, and has the opportunity to cut costs by converting old styrene-butadiene latex plants into coatings facilities. However, this past year the company's coated fabrics sales saw some pressure with nearly a 10% drop in revenues and an operating margin that fell to less than 7%. However, we do not believe the Coated Fabrics business is a key focus of management, with some pressure in the other key businesses. There is also an activist investor pressuring for change at OMN. All of this would tend to favor INSA on a competitive basis. But it is also notable that OMN is trading at 14x earnings, leaving notable comparable upside for INSA – an equivalent multiple would put INSA at our \$6 price target.

## Wardle Storeys – Offers Synergies and a Global Footprint

INSA management has been quite busy with financial management and deal dynamics following the merger of Invisa with Uniroyal Engineered Products. The business was acquired for a very attractive price, in our estimation at less than 6X EBITDA and less than 20% of sales, Wardle offers a European automotive customer base with little overlap with Uniroyal. Wardle has become the #2 player in Europe in the space, with both polymer films and coated fabrics. Cross selling has already begun, but in addition to sales synergies, we see significant bottom line synergies realized this year. Management has aggressively reduced the cost footprint in Europe, nearly in half, and brought over its continuous cast technology, putting in over \$2 MM in investment into Wardle's plant. All of this should dramatically improve Wardle's margins, which we are starting to see in this year's results.

Key to the story is that automotive customers are moving toward global platform and purchasing decisions, and we think its leading technology will give Invisa the #1 position in the global automotive market.



## Margin Expansion Story

The various mergers have led to numerous opportunities for margin expansion in the key business lines. We expect synergies from the Wardle merger, with well over \$1 MM in estimated costs coming out of the expense line this past year. Margins were very low when they company was purchased, and we think the low hanging fruit should show a significant swing to this year's numbers. There were also a number of legacy old contracts at lower margins rolling off in 2014 and 2015. With non-automotive margins nearly double that of the auto OEM market, we expect the mix to improve as the company's sales efforts increasingly move into industrial and consumer non-automotive markets.

There is also increasingly a raw material benefit story as well. On a secular basis, the combined company now has increased buying power with vendors, and the vinyl market is somewhat fragmented anyway, giving INSA some real purchasing leverage. The aggressive cost reduction at Wardle Storeys should also allow for more significant flow through of raw material benefits.

And on a cyclical basis (some would argue also secular) petrochemical-based raw material costs are dropping rapidly with oil prices, in particular vinyl monomer, coatings and adhesives for the back coats. So we see a significant improvement coming in 2015 gross margins, perhaps approaching 23% by the end of the year. Bottom line, the company's branded strategy tends to allow for better pricing power on the way up, and potential margin expansion on a secular basis as raw material costs decline.

All in, as sales grow, we could see incremental margins reaching as high as 50%, with fixed costs coming down as these margin benefits take hold. So longer term, we think reported overall margins can continue to improve, perhaps reaching as high as 25%.



## Financial Growth to Drive Shareholder Value

A combination of reinvigorated sales growth, synergies, market share gains and margin expansion should provide superior financial growth. The proforma new INSA should generate considerable free cash flow, which should make the relatively clean balance sheet even cleaner. With only about \$2 MM in capital spending required, we estimate the company could be debt free within two years if it so chooses. However, as noted above we don't think management will so choose, as it is likely to remain very active on the deal front.

We believe management will be looking for tuck-in deals and geographic expansion opportunities perhaps in Asia as the next logical geography. This team has a history of very accretive deals, and we fully expect the bottom line to grow much faster than the revenue line, especially from the current low base. To this end, INSA should benefit from roughly \$17 MM in NOL tax benefits, so on our projections, we do not expect a tax hit until 2018.

It does not appear burdensome to grow the top line at least 5% this year. But most notable is a dramatic bottom line swing in the first 'clean' year post the mergers. Part of this is the easy comp with a high level of restructuring and one-time costs, which according to the 10-K is about one-third of the bottom line swing in 2015. Elimination of redundancies at the UK plant and expenses for new retiree insurance policies have one-time associated expenses that should not recur this year. But we also expect margin expansion from the factors discussed above, and believe incremental margins from new product sales could be as high as 50%.

Further, as the expected 2015 metrics are achieved, the market is likely to start discounting further growth in 2016. Based on post-merger automotive platform penetration on new industrial and consumer sales, we think that 2016 could see 10-15% top line growth, and conservatively keeping the gross margin flat with debt declining could drive the bottom line up by over 30% in 2016 to roughly \$10 MM in net income, or about \$0.40 per diluted share.



## Stock Valuation Could Double Once Again

Bottom line, if our projections are achieved, we think the growth rate, high technology component and comparable advanced materials companies could warrant a valuation of at least 1.2x revenues, 10x EBITDA, and at least 15x net earnings. Triangulating these valuation metrics would put the stock at roughly \$6/share, based on our projections. As the year progresses and targets are achieved, we believe the shares could start to discount 2016 projections for this year and next. If the market agrees with our outlook, the stock valuation should reach \$6/share by the end of this year.

So at a valuation of about \$3/share, we think the shares could nearly double once again from here. Part of the current discount could be attributed to the inefficiency of the small market capitalization and its lack of history in the public marketplace. But as coverage of the stock increases and the market analyzes the last two strong earnings reports, we think such concerns can be alleviated in short order. Such de-risking of the story should lead to outsize shareholder returns to the \$6 level.

## More Deals Could Bring Valuation Even Higher

Our estimates and \$6 price target are based on the recent deals announced and now successfully integrated. But as noted above, we believe management will be very active on the deal front, with lots of opportunities in the fragmented coated fabrics and related industries. Management has proven its ability to successfully integrate deals in an accretive manner. Obviously if estimates rise further, we think the stock can rise further. And perhaps even faster than estimates as de-risking and improved confidence should lead to further multiple expansion as well.



## Financial Projections

In the table on the next page, we illustrate our projections for proforma income growth. For the reported 2013 numbers, we have removed the 'gain on bargain purchase' for that year for cleaner comparison purposes. We also note that 2014 is not a full 'clean' year, as it includes some residual effects of the post-merger restructuring of combining the companies. The 10-K spelled some of the non-recurring costs out, so we have removed them from our numbers for comparison purposes. As a result, we would focus on 2015, now underway, as the base year 'cleaner' numbers to grow from.

We believe INSA has the ability to grow earnings at a rapid rate, much faster than the top line. The preferred dividend grows quite slowly, so we expect that net income can nearly double from a post-deal 'normalized' proforma 2014 level of roughly \$5 MM in only two years to a profit of more than \$10 MM in 2016. On a bottom line basis, we see fully diluted 'normalized' earnings power of as much as \$0.50/share achievable within three years. And this could become significantly higher if management does successfully complete additional accretive deals.

**PROFORMA CONDENSED COMBINED INCOME STATEMENT**

(in thousands)

	<u>2013</u>	<u>2014</u>	<u>2015E</u>	<u>2016E</u>
NET SALES	\$94,767	\$98,323	\$108,000	\$115,000
COST OF GOODS SOLD	77,560	79,004	84,000	87,500
Gross Profit	17,207	19,319	26,000	27,500
OPERATING EXPENSES	10,446	14,657	15,800	15,000
Operating Profit	6,761	6,800	9,200	12,500
OTHER INCOME (EXPENSE):				
Interest & debt expense	(1,283)	(1,553)	(1,600)	(1,500)
Other income	<u>109</u>	<u>190</u>	<u>100</u>	<u>100</u>
Net Other Income	(1,174)	(1,362)	(1,500)	(1,400)
INCOME BEFORE TAX PROVISION	5,587	3,300	7,700	11,100
Tax Provision	175	(1,341)	(780)	625
NET INCOME	5,412	4,641	8,480	10,475
Preferred stock dividend (proforma)	2,825	475	2,800	2,900
NET INCOME, Common Shareholders	2,587	4,166	5,680	7,575
EPS:				
Basic	\$0.18	\$0.30	\$0.40	\$0.53
Diluted	\$0.14	\$0.22	\$0.30	\$0.40
SHARES OUTSTANDING:				
Basic	14,181			
Diluted	18,938			



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