

Fastener Distributor Index – July 2018

Written by R.W. Baird analyst David J. Manthey, CFA 8/6/18



Key Takeaway:

The seasonally-adjusted FDI for July 2018 was 69.2, surging m/m vs. June's 62.3 reading. Selling conditions were similarly very strong and improved vs. June, with the seasonally-adjusted sales index coming in at a robust 89.6 (June 74.2). Qualitative commentary, however, was a bit more cautious, with continued concerns over tariffs and a potential slowdown looming. The six-month outlook was essentially unchanged vs. last month (and generally still positive), although the Forward-Looking Indicator moderated again to 60.1 (June 62.0).

Key Points:

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American fastener distributors, conducted with the **FCH Sourcing Network**, the **National Fastener Distributors Association**, and **Baird**. It offers insights into current fastener industry trends/outlooks. Similarly, the Forward-Looking Indicator (FLI) is based on a weighted average of four forward-looking inputs from the FDI survey. This indicator is designed to provide directional perspective on future expectations for fastener market conditions. As diffusion indexes, values above 50.0 signal strength, while readings below 50.0 signal weakness. Over time, results should be directly relevant to **Fastenal (FAST)** and broadly relevant to other industrial distributors such as **W.W. Grainger (GWW)** and **MSC Industrial (MSM)**.

July FDI surges. The seasonally-adjusted July FDI (69.2) surged vs. June's 62.3 reading, a notable acceleration for the second straight month. In the July survey, 68% of respondents indicated sales were "better" relative to seasonal expectations vs. 59% in June. This produced a record seasonally adjusted sales index of 89.6 (June 74.2), above the previous high registered in June 2017 (86.6). Pricing was higher among a large majority of respondents, with 79% seeing pricing gains y/y (and 65% m/m) vs. 81% y/y and 33% m/m in June. For perspective on the strength of recent pricing – only 20% of respondents reported higher pricing at the low point in March of 2016. The resulting FDI pricing index of 89.7 moderated ever so slightly from last month's record high. Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (74% of responses), while 24% believe customers' inventories are too low. This compares to 67% in line and 33% too low in June.

July FLI moderates. The seasonally-adjusted FLI came down slightly m/m, registering 60.1 vs. 62.0 in June, with all four forward-looking inputs in the FDI moderating. While a 60.1 reading suggests market conditions are likely to remain in growth mode, we would not be surprised to see a moderation in the FDI from here, particularly given the strength of July results.

Manufacturing employment down slightly. Hiring sentiment was a little weaker this month among survey respondents. 35% of respondents saw higher employment levels in July relative to seasonal expectations vs. 41% in June, while 59% saw employment as in line (June 56%). The resulting FDI Employment Index was 64.7 vs. 68.5 last month. The July US jobs report was similarly a bit weaker than expected with +157,000 jobs added (~190,000 expected), with the unemployment rate slipping to 3.9% (vs. June 4.0%). July's largest gains were registered in professional and business services, manufacturing, and healthcare and social assistance. Manufacturing employment continues to trend upwards (+37,000 jobs in July), with most of the gains again coming from durable goods manufacturing. Total manufacturing jobs added over the past year now stands at +327,000. Average hours per work week for manufacturing employees were unchanged at 40.9 hours.

Respondents expresses some caution in commentary. The overall tone of qualitative commentary was more cautious this month, with respondents expressing some concerns over inventory implications for the channel in light of tariffs, and a potential slowdown in activity. Specifically, one respondent indicated, "We are noticing that master distributor inventories are somewhat lower and out of stock on some sizes. We are under the impression that some larger fastener distributors are 'hoarding' sizes of parts to avoid the additional tariffs that are coming up." Another distributor expressed concern over a potential looming slowdown in activity, saying "Industry economists forecast a slow down late in the year and I feel that will be [in] Q4." Quantitatively, survey data continues to point to relatively stable momentum expected through 2018, with 47% of respondents expecting higher activity levels over the next six months and 32% expecting similar activity, although the percentage of respondents expecting higher activity has moderated substantially YTD vs. the 76% recorded in January.

Fastenal reported June daily sales growth of 13.5% y/y, nicely above our 11.0% estimate and reflecting growth across all end markets/product lines. Underlying "core" growth (excluding foreign exchange) was 13.3%, the thirteenth straight month of double-digit growth. Fasteners again saw strong growth at 13.5% y/y. July daily sales growth will be reported on 8/6/18. We view strong July FDI results as a positive read-through for FAST July daily sales, and model +12% growth y/y. This is slightly below historical m/m trends, as July growth has been below the m/m long term in every period over the last decade plus when days were equal or higher in July vs. June (21 days in each this year). Based on FDI data and other research inputs, we expect continued strong top-line trends across public industrial distributors during 2018, with Fastenal y/y daily sales growth expected to remain in the double-digits through year-end.

Risk Synopsis

Fastenal: Risks include economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

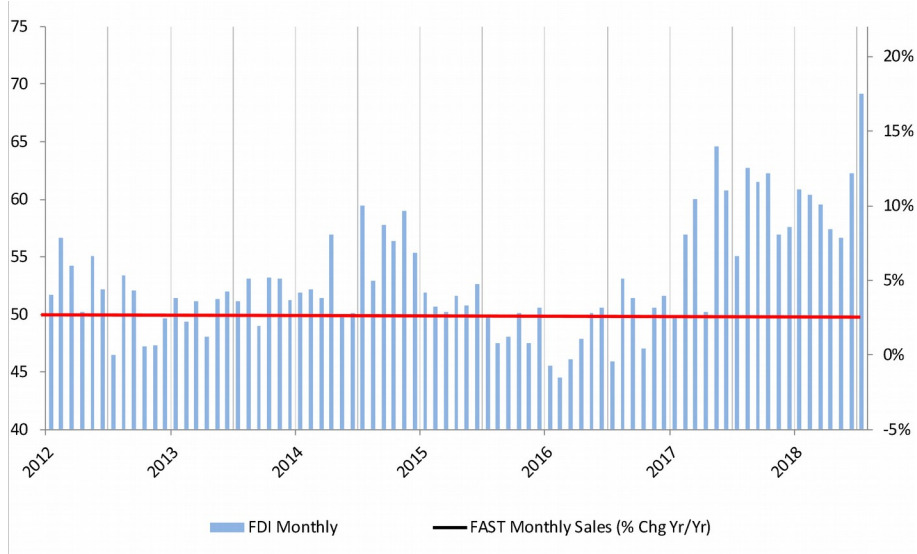
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Fastener Distribution Trends: July 2018

FASTENER DISTRIBUTION AT A GLANCE										
July 2018										
	----- Index Values -----								Directbn	Rate of Change
	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec		
PMI (Manufacturing Sector)	58.1	60.2	58.7	57.3	59.3	60.8	59.1	59.3	Growing	Slower
FDI (Fastener Sector)	65.8	62.5	59.4	59.8	61.2	58.4	64.8	56.8	Growing	Faster
FDI (Seasonally Adjusted)	69.2	62.3	56.6	57.4	59.5	60.4	60.8	57.6	Growing	Faster
Sales (SA)	89.6	74.2	61.2	63.0	70.1	74.2	72.7	68.4	Growing	Faster
Forward- Looking (SA)	60.1	62.0	58.8	58.9	59.9	58.3	64.7	59.6	Growing	Slower
(Other Metrics; NSA)										
Employment	64.7	68.5	60.7	59.4	62.5	62.2	66.7	58.6	Growing	Slower
Supplier Deliveries	83.8	77.8	73.2	71.9	69.6	64.9	66.7	68.6	Growing	Faster
Respondent Inventories	55.9	50.0	57.1	53.1	60.7	59.5	56.1	58.6	Growing	Faster
Customer Inventories	39.7	33.3	37.5	37.5	35.7	40.5	34.8	37.1	Declining	Slower
Pricing month-to-month	82.4	83.3	75.0	73.4	76.8	68.9	68.2	67.1	Growing	Slower
Pricing year-to-year	89.7	90.7	87.5	89.1	85.7	78.4	86.4	82.9	Growing	Slower
6-Month Outlook - July				Higher	Same	Lower				
				47%	32%	21%				
<p><i>FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectatbns. A reading above 50 suggests the category outperformed expectatbns, while a reading below 50 suggests the category underperformed expectatbns.</i></p>										

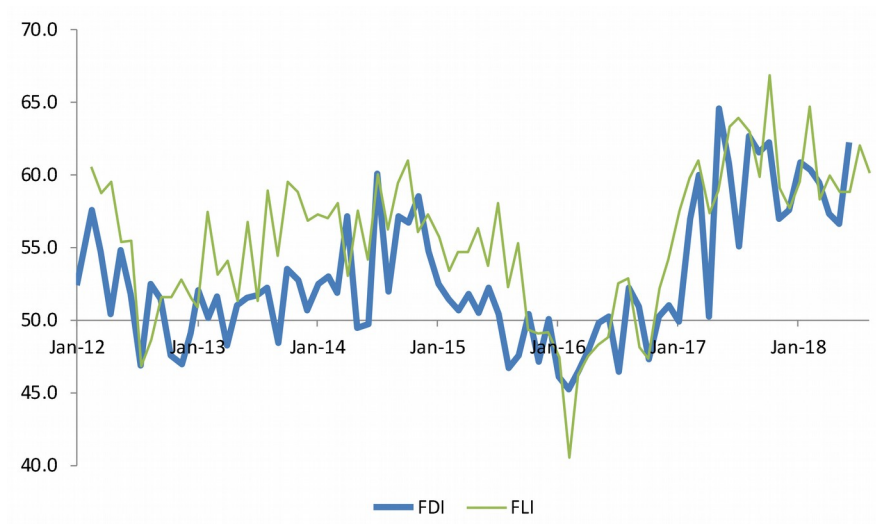
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)



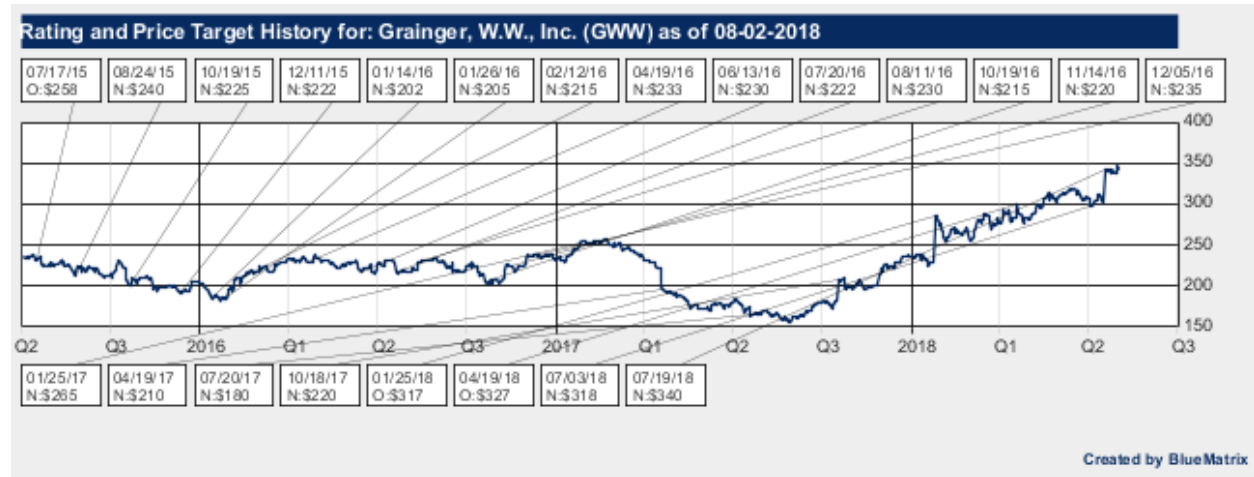
Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 8/3/2018.

Fastenal Company (FAST-\$56.25-Neutral)
 W.W. Grainger Inc. (GWW-\$340.18-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$83.32-Neutral)
 (See recent research reports for more information)





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