

## Fastener Distributor Index – March 2017

Written by R.W. Baird analyst David J. Manthey, CFA 4/5/17



### Key Takeaway:

The seasonally adjusted FDI for March 2017 was 60.0, increasing from February's 57.0 reading and representing the strongest seasonally adjusted result ever seen in the 5+ year history of the FDI Survey. Seasonally adjusted March sales saw recent strong momentum continue, with 93% of respondents noting flat or better selling conditions versus the preceding month. Although not universal, commentary on current market conditions was mostly positive, as several respondents noted strong y/y and m/m sales growth, as well as favorable end-market dynamics. A slightly more cautious six-month outlook was expressed this month, though optimism nevertheless remains much higher than 2016 pre-election average levels, as many distributors continue to be encouraged by the potential for "inflationary, pro-growth" fiscal policy and increased infrastructure spending driven by the Trump Administration. While an encouraging sign, we would note the FDI was sub-50 as recently as January and uncertainty remains ahead of any potential new policy implementation. Forward indicators are positive, with the FDI Forward-Looking Indicator registering a seasonally adjusted 57.4 – decelerating slightly from last month's strong 61.0 result. While still well above 50 (signaling good potential for future growth), the March Forward-Looking Indicator also may foreshadow a pause/retrenchment in the FDI's upward trajectory in the next month or two.

### 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** and the **National Fastener Distributors Association**. It offers insights into current industry trends/outlooks. As a diffusion index, figures above 50 signal strength, while readings below 50 signal weakness. Over time, results should be directly relevant to **Fastenal [FAST]** and broadly relevant to other distributors (**W.W. Grainger [GWW]**, **MSC Industrial [MSM]**).

**March FDI rises to a record.** The seasonally adjusted March FDI (60.0) increased over February's strong 57.0 reading, achieving the highest reading seen in the FDI Survey's 5+ year history. Top-line sentiment remained positive for March, with 93% of respondents indicating better or unchanged sales, up vs. February's 69% reading. This level includes 68% of respondents who indicated sales were better than expected in March vs. February (highest since January 2013), and another 24% of respondents who indicated sales were roughly flat. Respondents continue to indicate customer inventory levels are roughly in line with expectations, as only 10% of respondents indicated inventories are too high while 22% indicated inventories are too low. This compares to February results of 9% and 29%, respectively.

**FDI Forwarding-Looking Indicator stays strong.** The FDI Forward-Looking Indicator 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 a diffusion index, values above 50 signal strength, while values below 50 signal weakness. This month's seasonally adjusted Forward-Looking Indicator had a value of 57.4 vs. 61.0 in February. For context, the Forward-Looking Indicator averaged 49.7 during 2016, but had increased sequentially in each of the past five quarters before peaking at 61.0 last month and ticking down to 57.4 this month. While still well above 50 (signaling good potential for future growth), the March Forward-Looking Indicator also may foreshadow a pause/retrenchment in the FDI's upward trajectory in the next month or two.

**Manufacturing employment outlook ticks down slightly.** Survey respondents indicated a slight deceleration in hiring vs. February, with 24% of respondents indicating hiring picked up in March (vs. 29% in February, 21% in January, and 10% in December). Nevertheless, March represents the fourth consecutive month of above-50 readings for the FDI employment index following four consecutive sub-50 readings – suggesting employment has mostly stabilized or slightly improved of late. Consistent with this, February's US jobs report came in above expectations (+235,000 adds vs. +190,000 consensus), along with a gain in employment among domestic manufacturers (+28,000 jobs added vs. January, *US BLS*). The average workweek for manufacturers was unchanged m/m at 40.8 hours.

**March sentiment mostly positive.** Although not universal, various respondents expressed optimism that market conditions could show improvement in 2017, with several distributors noting favorable end market dynamics and strong YTD results. Consistent with the FDI reading, March results were mostly characterized as strong, with one distributor characterizing it as “an incredibly good month.” Referencing current favorable end-market dynamics, one respondent said, “While certain sectors are flat, some, like construction and some export opportunities, are opening up big time.” Price increases from suppliers related to commodity price inflation have also continued, with one distributor noting, “Continuing to get steel price increases from both overseas and domestically.” Overall, optimism continues, though some respondents are still somewhat cautious, with one distributor saying, “I believe we will see some improvement compared to 2016 overall, but the activity will remain ‘choppy.’”

**Fastenal**, meanwhile, reported better-than-expected February daily sales growth of +6.1% y/y, reflecting growth in all end markets/product lines. Fastener growth was +1.5%, encouragingly the first positive y/y reading in fasteners since early 2015. Overall, this is very consistent with recent strong FDI and Forward-Looking Indicator results, all pointing to improving industrial trends and suggesting market conditions could be strengthening. Based on FDI data and other factors, we expect a substantial uptick in growth among the public industrial distributors this year, with Fastenal daily sales growth approaching double-digits y/y.

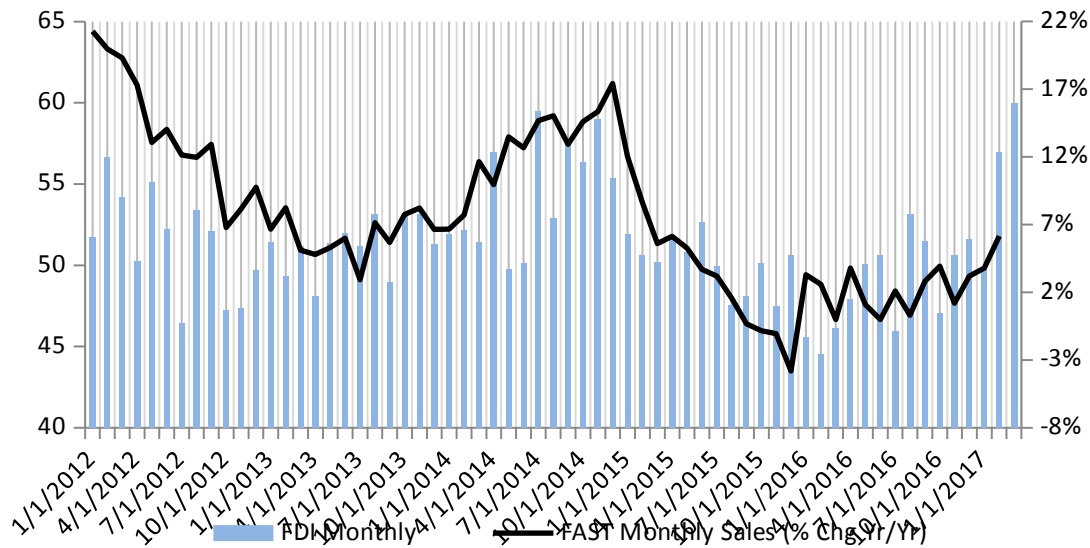
## Fastener Distribution Trends: March 2017

FASTENER DISTRIBUTION AT A GLANCE										
March 2017										
	----- Index Values -----							Mar.--> Feb.		
	Mar.	Feb.	Jan.	Dec.	Nov.	Oct.	Sep.	Change	Directon	
PMI (Manufacturing Sector)	57.2	57.7	56.0	54.5	53.2	51.9	51.5	(0.5)	Growing	
FDI (Fastener Sector)	61.3	55.4	54.5	50.3	49.3	46.6	47.7	5.9	Growing	
<b>FDI (Seasonally Adjusted)</b>	<b>60.0</b>	<b>57.0</b>	<b>49.9</b>	<b>51.6</b>	<b>50.6</b>	<b>47.1</b>	<b>51.5</b>	<b>3.0</b>	<b>Growing</b>	
Sales (SA)	74.6	62.7	51.6	60.6	64.5	38.3	48.1	11.9	Growing	
Forward- Looking (SA)	57.4	61.0	59.8	57.6	54.2	52.2	47.4	(3.6)	Growing	
(Other Metrics; NSA)										
Employment	59.8	62.9	57.6	51.3	45.7	47.0	46.9	(3.1)	Growing	
Supplier Deliveries	61.0	61.4	56.1	56.4	55.7	54.5	54.7	(0.5)	Growing	
Respondent Inventories	61.0	58.6	59.1	59.0	65.7	63.6	71.9	2.4	Growing	
Customer Inventories	43.9	40.0	36.4	41.0	42.9	43.9	48.4	3.9	Declining	
Pricing, month-to-month	63.4	60.0	62.1	56.4	61.4	50.0	53.1	3.4	Higher	
Pricing, year-to-year	72.0	70.0	68.2	60.3	61.4	56.1	45.3	2.0	Higher	
Higher Same Lower										
6-Month Outlook - Mar				66%	27%	7%				

FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.

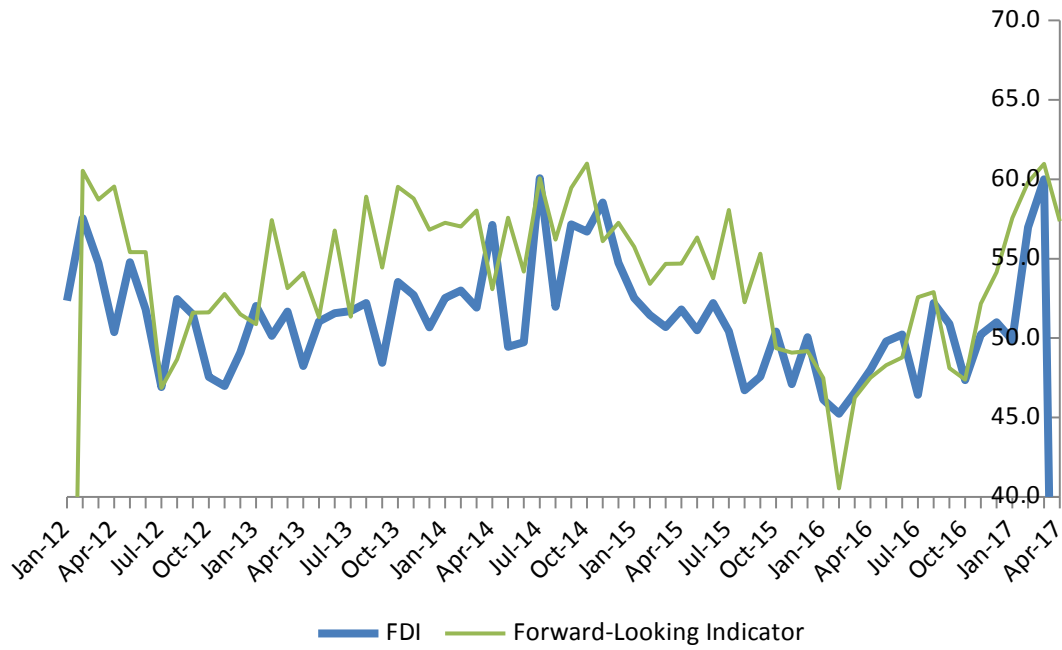
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

## Fastener Distributor Index (FDI); Seasonally Adjusted



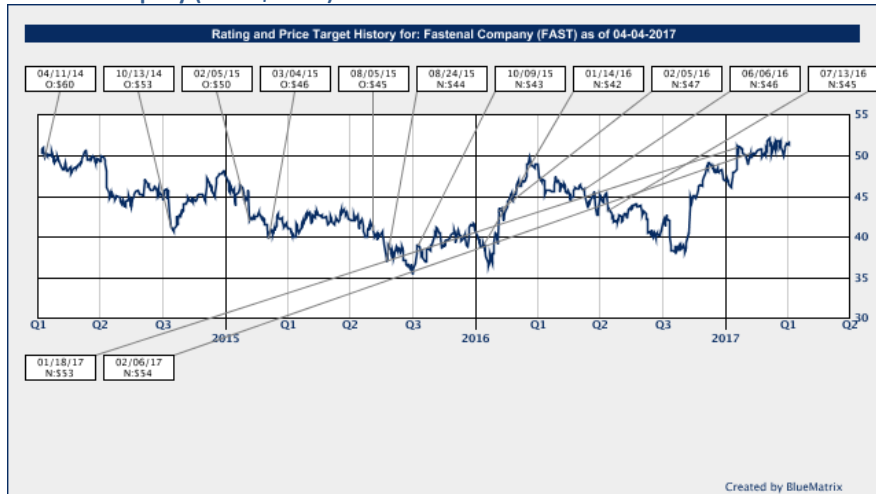
Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

**FDI vs. Forward- Looking Indicator (Seasonally Adjusted)**

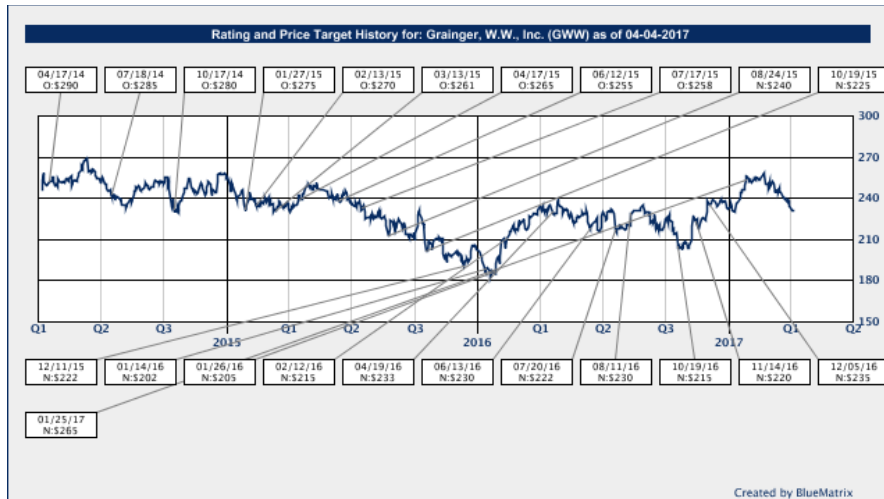


**Appendix – Important Disclosures and Analyst Certification**

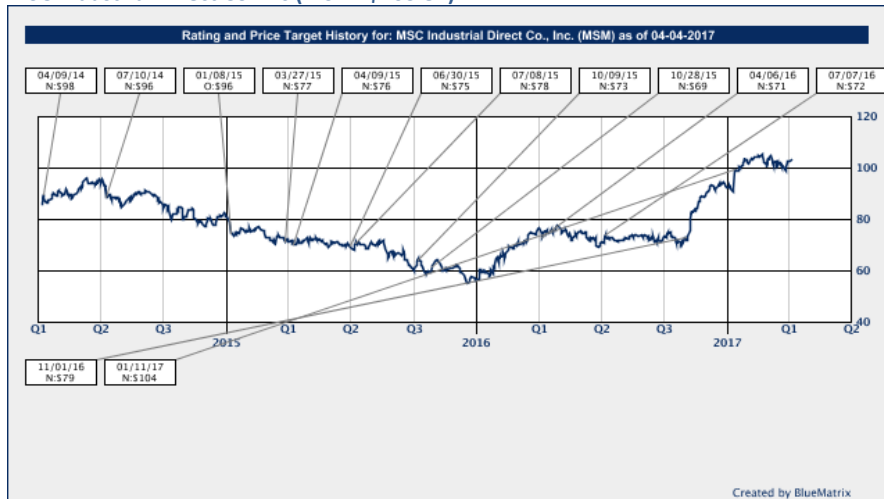
**Fastenal Company (FAST- \$52.68)**



**WW Grainger Inc. (GWW- \$233.29)**



### MSC Industrial Direct Co. Inc (MSM- \$103.87)



## Appendix – Important Disclosures and Analyst Certification

Robert W. Baird & Co. Incorporated makes a market in the securities of FAST, GWW, and MSM.

Robert W. Baird & Co. Incorporated and/or its affiliates expect to receive or intend to seek investment-banking related compensation from the company or companies mentioned in this report within the next three months.

Robert W. Baird & Co. Incorporated may not be licensed to execute transactions in all foreign listed securities directly. Transactions in foreign listed securities may be prohibited for residents of the United States. Please contact a Baird representative for more information.

**Investment Ratings: Outperform (O)** - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months. **Neutral (N)** - Expected to perform in line with the broader U.S. equity market over the next 12 months. **Underperform (U)** - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

**Risk Ratings: L - Lower Risk** - Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include:

stable earnings, conservative balance sheets, and an established history of revenue and earnings. **A - Average Risk** - Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. **H - Higher Risk** - Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. **S - Speculative Risk** - High-growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

**Valuation, Ratings and Risks.** The recommendation and price target contained within this report are based on a time horizon of 12 months but there is no guarantee the objective will be achieved within the specified time horizon. Price targets are determined by a subjective review of fundamental and/or quantitative factors of the issuer, its industry, and the security type. A variety of methods may be used to determine the value of a security including, but not limited to, discounted cash flow, earnings multiples, peer group comparisons, and sum of the parts. Overall market risk, interest rate risk, and general economic risks impact all securities. Specific information regarding the price target and recommendation is provided in the text of our most recent research report.

**Distribution of Investment Ratings.** As of March 31, 2017, Baird U.S. Equity Research covered 706 companies, with 52% rated Outperform/Buy, 46% rated Neutral/Hold and 2% rated Underperform/Sell. Within these rating categories, 11% of Outperform/Buy-rated, 5% of Neutral/Hold-rated and 9% of Underperform/Sell rated companies have compensated Baird for investment banking services in the past 12 months and/or Baird managed or co-managed a public offering of securities for these companies in the past 12 months.

**Analyst Compensation.** Analyst compensation is based on: 1) the correlation between the analyst's recommendations and stock price performance; 2) ratings and direct feedback from our investing clients, our institutional and retail sales force (as applicable) and from independent rating services; 3) the analyst's productivity, including the quality of the analyst's research and the analyst's contribution to the growth and development of our overall research effort and 4) compliance with all of Robert W. Baird's internal policies and procedures. This compensation criteria and actual compensation is reviewed and approved on an annual basis by Baird's Research Oversight Committee.

Analyst compensation is derived from all revenue sources of the firm, including revenues from investment banking. Baird does not compensate research analysts based on specific investment banking transactions.

A complete listing of all companies covered by Baird U.S. Equity Research and applicable research disclosures can be accessed at <http://www.rwbaird.com/research-insights/research/coverage/research-disclosure.aspx>. You can also call 800-792-2473 or write: Robert W. Baird & Co., Equity Research, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.

### **Analyst Certification**

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

### **Disclaimers**

## **Baird prohibits analysts from owning stock in companies they cover.**

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

## **ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST**

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available.

Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

## **Copyright 2017 Robert W. Baird & Co. Incorporated**

### **Other Disclosures**

The information and rating included in this report represent the Analyst's long-term (12 month) view as described above. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst's understanding of the individual client's objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the analyst considers relevant to the client. As such, these perspectives and strategies may differ from the analyst's views contained in this report.

Robert W. Baird & Co. Incorporated and/or its affiliates (Baird) may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird's standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the Analyst's ratings and recommendations contained in more broadly disseminated standard research reports.

Baird Research Analysts may provide incremental data points or views regarding covered companies in the form of Research Posts and Flash Reports. All Posts and Flash Reports are available to clients via [www.BairdOnline.com](http://www.BairdOnline.com), but not all are sent directly to clients. Baird Associates may, at their discretion, choose whether to send these Posts and Flash Reports to Baird clients after they are posted online. Such decisions are based on, among other things, client interest, coverage, stock ownership and indicated email preferences. The incremental content and/or analysis contained in these pieces may be useful to investors as part of a broader investment thesis, but is not sufficient to warrant a change in the Research Analyst's published opinion, including rating, estimates and price targets. Access to [www.BairdOnline.com](http://www.BairdOnline.com)



is available to all Baird Clients. Contact your Baird representative if you would like access to [www.BairdOnline.com](http://www.BairdOnline.com).

**United Kingdom (“UK”) disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited (“RWBL”) holds an MiFID passport.**

The contents of this report may contain an "investment recommendation," as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. Please note, this report may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months which is available at <https://baird.bluematrix.com/sellside/MAR.action>.

This material is distributed in the UK and the European Economic Area (“EEA”) by RWBL, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority (“FCA”).

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. The views contained in this report (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated, and (ii) may differ from the views of another individual of Robert W. Baird Limited.

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated.

Robert W. Baird Group and or one of its affiliates may at any time have a long or short position in the company/companies mentioned in this report. Where the Group holds a long or short position exceeding 0.5% of the total issued share capital of the issuer, this will be disclosed separately by your RWBL representative upon request.

This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as “relevant persons”). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

Robert W. Baird & Co. Incorporated and RWBL have in place organizational and administrative arrangements for the disclosure and avoidance of conflicts of interest with respect to research recommendations. Robert W. Baird Group and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. An outline of the general approach taken by Robert W. Baird Limited in relation to conflicts of interest is available from your RWBL representative upon request. Baird’s policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Analysts certify on a quarterly basis that such research reports accurately reflect their personal views.



This material is not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

RWBL is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.

**Dividend Yield.** As used in this report, the term “dividend yield” refers, on a percentage basis, to the historical distributions made by the issuer relative to its current market price. Such distributions are not guaranteed, may be modified at the issuer’s discretion, may exceed operating cash flow, subsidized by borrowed funds or include a return of investment principal.

\*\*\*\*\*