

## Fastener Distributor Index – March 2018

Written by R.W. Baird analyst David J. Manthey, CFA 4/9/18



### Key Takeaway:

The seasonally-adjusted FDI for March 2018 was 59.5, again moderating very slightly m/m (February 60.4) but remaining well in expansionary territory overall. Strong selling conditions continued in March with the seasonally-adjusted sales index coming in at 70.1, down vs. February's very strong 74.2 reading. Qualitative commentary on market conditions was mixed with some respondents commenting on the current strong demand environment and others expressing concerns around the recently announced steel tariffs. The six-month outlook nevertheless remains strong overall. The Forward-Looking Indicator ticked up slightly m/m and came in at a healthy 59.9 (vs. 58.3 in February).

### 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. 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)**.

**March FDI moderates again slightly.** The seasonally-adjusted March FDI (59.5) moderated slightly m/m vs. February's 60.4 reading. In the March survey, 64% of respondents indicated sales were "better" relative to seasonal expectations, improving vs. a seasonally slower February (51%). This produced a seasonally-adjusted sales index of 70.1 (February 74.2). Pricing was again a tailwind for a majority of respondents (71% saw higher prices y/y) amid strong end-market demand and widespread New Year supplier price increases. This resulted in an FDI pricing index of 85.7 (vs. February's 78.4 reading) – solidly above the 2017 average of 75.0. Several respondents commented on continued inflationary pressures in the channel, with steel tariffs seen as likely to lead to additional supplier price increases over the near to medium-term. Regarding customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (64% of responses), while 32% believe customers' inventories are too low, and another 4% see inventory levels as too high. This was relatively consistent with February (70% in line, 24% too low, and 5% too high).

**March FLI ticks up.** The seasonally-adjusted FLI rebounded following the moderation seen last month, coming in at 59.9 in March vs. 58.3 in February. A modestly more bullish six-month outlook primarily drove the m/m acceleration. At 59.9, the FLI remains solidly in expansionary territory and relatively consistent with average levels seen in 2017 (60.9). Given solidly expansionary FDI and FLI readings, we believe market conditions are likely to remain in growth mode in the coming months.

**Manufacturing employment stable with last month.** Hiring sentiment was essentially unchanged this month among survey respondents. 29% of respondents saw higher employment levels in March relative to seasonal expectations vs. 27% in February, while another 68% saw employment as in line (February 70%). The resulting FDI Employment Index was 62.5, also essentially unchanged m/m. The March US jobs report, meanwhile, came in slightly softer than expected at +103,000 jobs (+185,000 expected) following a very strong February report, with March's gains coming from manufacturing, health care, and mining. Manufacturing employment continues to trend upwards (+22,000 jobs in March), driven entirely by gains in durable goods industries, which brings total manufacturing jobs added over the past year to +232,000. Average hours per work week for manufacturing employees edged down very slightly at 40.9 hours (vs. February 41.0).

**March sentiment mixed.** Commentary was a bit more mixed this month as positive commentary on current demand was balanced by some respondents expressing concerns over the Trump Administration's steel tariffs and implications for pricing/margins. Reflecting the positive demand environment, one respondent indicated, "Most customers are seeing increases in usage, some significantly. Lead times from suppliers are being extended both domestically and overseas." Another described March as a "very good month for us" despite some weather-related headwinds. Others, however, expressed concern over uncertainty arising from the steel and aluminum tariffs and related margin pressures. One distributor commented, "We are seeing continuing inflation on purchased product. The tariffs put in place by the Trump administration will give suppliers another reason/excuse to raise prices. It is very difficult for us to pass on cost increases." Another commented, "As usual during periods of increasing costs, I see distributors being too slow to raise [selling] prices to reflect replacement costs." We continue to see impacts from steel tariffs as likely to be net neutral to slight positive, as most distributors have historically been able to pass on, and potentially even exceed, price increases from suppliers, while higher domestic activity levels could also be a minor positive. Despite the more mixed commentary, quantitative survey data points to continued momentum through 2018, with 64% of respondents expecting higher activity levels over the next six months (essentially unchanged m/m) and 29% expecting similar activity.

**Fastenal** reported February daily sales growth of 14.8% y/y, nicely above our 10.5% estimate and again reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was 13.0%, the ninth consecutive month of double-digit growth. Fasteners again saw strong growth at 13.1% y/y, including the Mansco acquisition (+9.5% ex-Mansco). Based on FDI data and other research inputs, we expect continued strength in public industrial distributor growth during 2018, with Fastenal daily sales growth expected to sustain in the double-digits y/y.

#### **FAST Risk Synopsis**

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 Risk Synopsis**

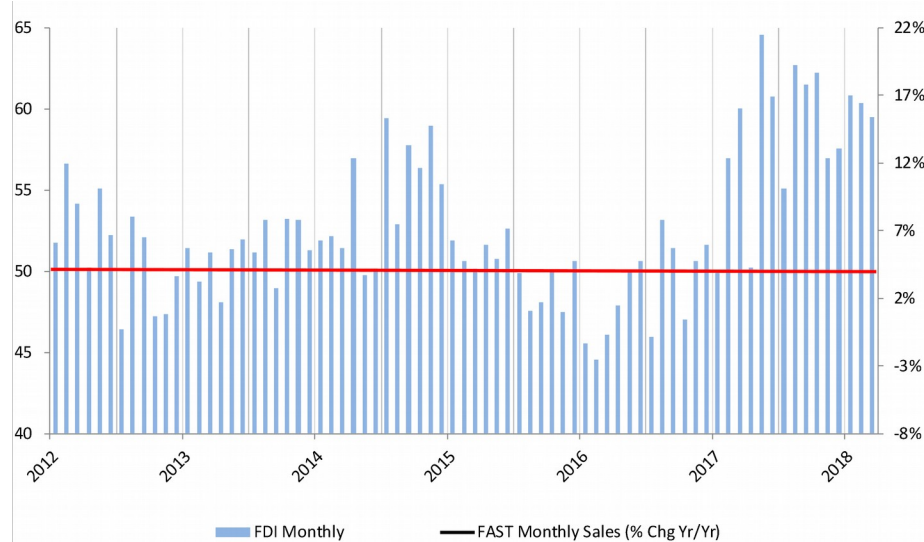
Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

## Fastener Distribution Trends: March 2018

FASTENER DISTRIBUTION AT A GLANCE										
March 2018										
	----- Index Values -----								Directiøn	Rate of Change
	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug		
PMI (Manufacturing Sector)	59.3	60.8	59.1	59.3	58.2	58.7	60.8	58.8	Growing	Slower
FDI (Fastener Sector)	61.2	58.4	64.8	56.8	55.9	61.3	57.6	61.0	Growing	Faster
<b>FDI (Seasonally Adjusted)</b>	<b>59.5</b>	<b>60.4</b>	<b>60.8</b>	<b>57.6</b>	<b>56.9</b>	<b>62.2</b>	<b>61.5</b>	<b>62.7</b>	Growing	Slower
Sales (SA)	70.1	74.2	72.7	68.4	72.8	80.1	77.3	77.1	Growing	Slower
Forward- Looking (SA)	59.9	58.3	64.7	59.6	57.7	59.1	66.9	59.9	Growing	Faster
<b>(Other Metrics; NSA)</b>										
Employment	62.5	62.2	66.7	58.6	53.1	56.7	57.1	62.1	Growing	Faster
Supplier Deliveries	69.6	64.9	66.7	68.6	68.8	65.0	69.6	65.2	Growing	Faster
Respondent Inventories	60.7	59.5	56.1	58.6	53.1	51.7	48.2	62.1	Growing	Faster
Customer Inventories	35.7	40.5	34.8	37.1	37.5	40.0	37.5	39.4	Declining	Faster
Pricing, month-to-month	76.8	68.9	68.2	67.1	64.1	63.3	73.2	72.7	Growing	Faster
Pricing, year-to-year	85.7	78.4	86.4	82.9	78.1	75.0	83.9	78.8	Growing	Faster
6-Month Outlook - March				Higher	Same	Lower				
				64%	29%	7%				
<p><i>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.</i></p>										

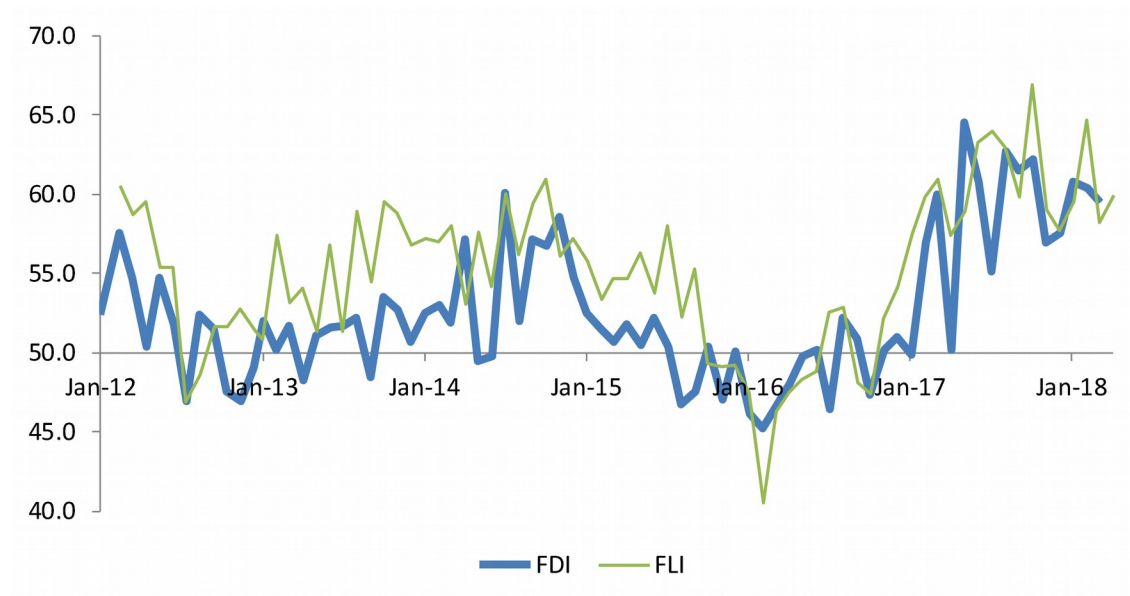
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

## 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

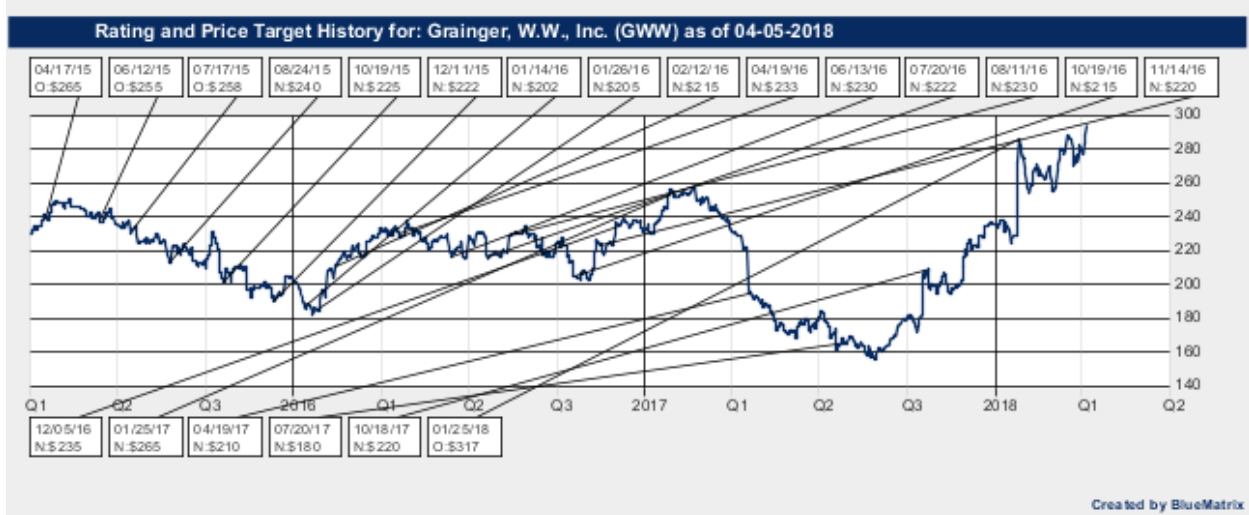
All stock prices below are as of 4/6/2018.

Fastenal Company (FAST-\$53.83-Outperform)

W.W. Grainger Inc. (GWW-\$287.25-Outperform)

MSC Industrial Direct Co. Inc (MSM-\$91.60-Neutral)

(See recent research reports for more information)





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