

Fastener Distributor Index – November 2018

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Key Takeaway:

The seasonally adjusted FDI for November was 58.2, retreating slightly vs. October’s 62.2 reading. Selling conditions cooled off of strong October trends, with the seasonally adjusted sales index coming in at 51.8 (vs. October 73.4). Respondent commentary was mainly focused on the 2019 outlook, with some respondents anticipating a slowdown in activity and others expressing optimism regarding implications from recent trade developments. The six-month outlook improved modestly m/m, although the Forward-Looking Indicator slipped (52.5 vs. October’s 57.0 reading).

Fastener Distribution Trends: November 2018

FASTENER DISTRIBUTION AT A GLANCE											
November 2018											
	----- Index Values -----										
	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Directn	Rate of Change	
PMI (Manufacturing Sector)	59.3	57.7	59.8	61.3	58.1	60.2	58.7	57.3	Growing	Faster	
FDI (Fastener Sector)	56.9	62.0	52.8	61.7	65.8	62.5	59.4	59.8	Growing	Slower	
FDI (Seasonally Adjusted)	58.2	62.2	55.8	62.5	69.2	62.3	56.6	57.4	Growing	Slower	
Sales (SA)	51.8	73.4	46.5	74.7	89.6	74.2	61.2	63.0	Growing	Slower	
Forward- Looking (SA)	52.5	57.0	54.7	63.4	60.1	62.0	58.8	58.9	Growing	Slower	
(Other Metrics; NSA)											
Employment	64.5	67.3	61.1	67.2	64.7	68.5	60.7	59.4	Growing	Slower	
Supplier Deliveries	69.7	61.5	63.0	70.3	83.8	77.8	73.2	71.9	Growing	Faster	
Respondent Inventories	64.5	57.7	59.3	59.4	55.9	50.0	57.1	53.1	Growing	Faster	
Customer Inventories	47.4	40.4	46.3	32.8	39.7	33.3	37.5	37.5	Declining	Slower	
Pricing, month-to-month	76.3	75.0	70.4	76.6	82.4	83.3	75.0	73.4	Growing	Faster	
Pricing, year-to-year	90.8	88.5	92.6	92.2	89.7	90.7	87.5	89.1	Growing	Faster	
			<u>Higher</u>			<u>Same</u>		<u>Lower</u>			
6-Month Outlook - November			37%			45%		18%			

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: Baird, FCH Sourcing Network, Institute for Supply Management

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 Distributor 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)**.

Key Points:

November FDI decelerates on weaker sales trends. The seasonally adjusted November FDI (58.2) ticked down vs. October's 62.2 reading, albeit remaining well in expansionary territory overall. In the November survey, just 34% of respondents indicated sales were "better" relative to seasonal expectations vs. 69% in October. This produced a seasonally adjusted sales index of 51.8 (October 73.4). The six-month average seasonally unadjusted sales index hit its lowest reading since early 2017. Pricing also continues to benefit top-line trends, with 84% seeing pricing gains y/y vs. 77% in October. The resulting FDI pricing index of 90.8 was up slightly m/m. Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (84% of responses), while 11% believe customers' inventories are too low. This compares to 81% in line and 19% too low last month.

November FLI drops to lowest level since November 2016. The seasonally adjusted FLI decreased m/m, registering 52.5 in November vs. 57.0 last month. This reflected a slight decline in the FDI employment index and less bullish respondent/customer inventory levels, partially offset by an uptick in the six-month outlook. At 52.5, the FLI suggests market conditions are likely to remain in growth mode, although we continue to believe the rate of growth may be stabilizing some in light of recent moderation in both the FLI and the FDI sales index.

Manufacturing employment weakens. Hiring sentiment was a touch less bullish among survey respondents this month. 29% of respondents saw higher employment levels in November relative to seasonal expectations vs. 35% in October, while 71% saw employment as in line (October 65%). The resulting FDI Employment Index was 64.5 vs. 67.3 last month. Similarly, the US jobs report was weaker than expected with 155,000 jobs added (~198,000 expected) despite a slight downward revision to October's gains. The unemployment rate remained at a 49-year low at 3.7%. November's largest gains were registered in healthcare, manufacturing, transportation and warehousing. Manufacturing employment continued to trend upward (+27,000 jobs in October), with increases in chemicals and primary metals. As of November, total manufacturing jobs added over the past year stands at 288,000. Average hours per work week for manufacturing employees were unchanged at 40.8 hours.

Respondent commentary mixed. The overall tone of qualitative commentary remained mixed this month, with favorable feedback on implications from recent trade developments offset by some unease regarding future economic conditions. For example, one respondent commented, “The new agreement with Mexico and Canada will bring confidence. This weekend’s talks with China, delay of increased tariffs, and China’s promise to buy more from US will inject some enthusiasm into economy.” Another participant said, “No immediate signs of slowing. November is traditionally lower than October, but still 30% above last year.” Others were less enthusiastic, saying “Some economic forecasts are predicting a slight downturn in 2019.” The six-month outlook, however, continues to point to stable to higher activity levels anticipated by fastener distributors over the next six months, with 37% of respondents expecting higher activity levels, 45% expecting similar activity, and just 18% expecting lower activity. For context, the percentage of respondents expecting higher activity this year has averaged 50%, while the percentage expecting lower activity has been 14%.

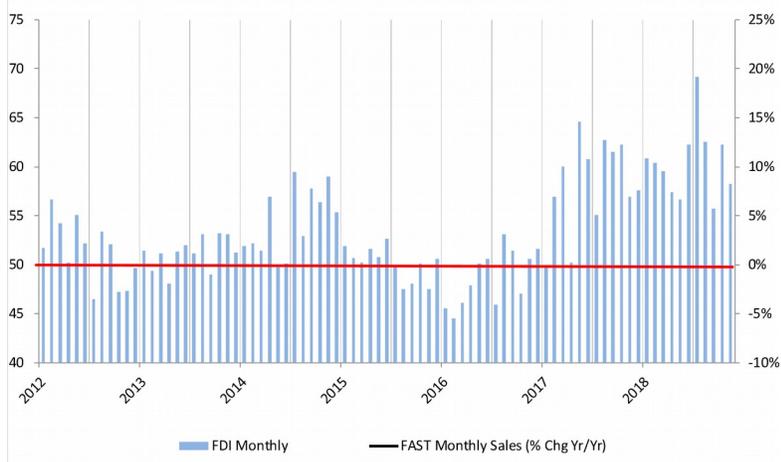
Fastenal reported 12.3% November daily sales growth, which was modestly above our +12.0% estimate, but reflecting sequential daily sales growth just slightly below average historical m/m trends. Underlying “core” growth (excluding foreign exchange) of 12.7% was equal to October, and represented the 18th straight month of double-digit growth. Fastener growth was up slightly m/m at +10.4% y/y (+10.1% in October). Based on FDI data and other research inputs, we largely expect continued solid top-line trends across public industrial distributors in 2019, with Fastenal y/y daily sales growth expected to remain in or near the double digits.

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.

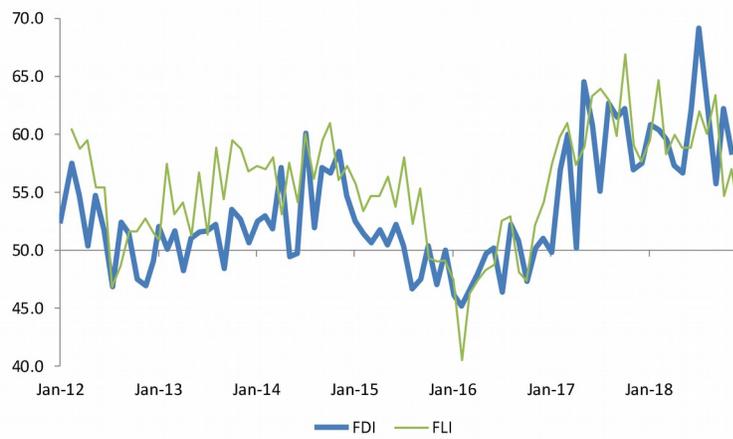
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Baird, FCH Sourcing Network, Company reports

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



Source: Baird, FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 12/7/2018.

Fastenal Company (FAST-\$56.42-Neutral)
 W.W. Grainger Inc. (GWW-\$296.42-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$83.30-Neutral)
 (See recent research reports for more information)



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