Fastener Distributor Index – Report #130 October 2022

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 11/7/22

Key Takeaway:

The October seasonally adjusted Fastener Distributor Index (FDI) declined further vs. the previous month, coming in at **44.3** (September was 47.6). This represents another contractionary reading, indicating market conditions continued to deteriorate. This was consistent with the sub-50 reading in last month's Forward-Looking Indicator (FLI). Demand commentary again skewed pessimistic, with comments ranging from "slight slowing" to "noticeable declines", and very few positive comments about demand. On the positive side, stainless steel pricing seems to be stabilizing and many respondents noted improvement in supplier lead times and overseas transit times. Looking ahead, the FLI once again registered a sub-50 index value, reading **42.4**, suggesting further declines in the FDI could be likely. Overall, similar to the overall macro backdrop, and the industrial economy specifically, fastener market demand conditions continue to soften.

Fastener Distribution Trends: October 2022

FASTENER DISTRIBUTION AT A GLANCE
October 2022

	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Direction	Rate of Change
	------------------------ Index Values								---------------------		
ISM PMI (Manufacturing)	50.2	50.9	52.8	52.8	53.0	56.1	55.4	57.1	58.6	Growing	Slower
FDI	**44.3**	**47.6**	**52.6**	**46.1**	**53.8**	**52.7**	**52.6**	**57.2**	**56.0**	Declining	Faster
FLI	**42.2**	**47.5**	**47.4**	**58.1**	**51.5**	**55.4**	**55.1**	**65.4**	**55.6**	Declining	Faster
(Other Metrics)											
Sales	27.9	43.9	51.9	43.2	65.5	56.3	60.5	75.2	79.1	Declining	Faster
Employment	53.6	47.8	53.4	62.5	59.1	62.9	53.1	62.1	48.3	Growing	Faster
Supplier Deliveries	46.4	54.3	55.2	52.1	65.2	69.4	68.8	69.7	72.4	Declining	Faster
Respondent Inventories	69.6	58.7	72.4	66.7	63.6	62.9	59.4	50.0	56.9	Growing	Faster
Customer Inventories	48.2	39.1	46.6	27.1	28.8	27.4	29.7	21.2	25.9	Declining	Slower
Pricing, month-to-month	53.6	52.2	65.5	68.8	68.2	77.4	78.1	83.3	81.0	Growing	Faster
Pricing, year-to-year	87.5	87.0	91.4	91.7	90.9	95.2	95.3	95.5	94.8	Growing	Faster
					Higher	Same	Lower				
6-Month Outlook - October					11%	43%	46%				

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** 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:

FDI continues to soften. The seasonally adjusted October FDI (44.3) registered a second consecutive month of contractionary readings as demand softened further and sentiment continued to deteriorate according to respondents. This is the third time in four months that the index was sub-50 following a 25 month streak of expansion. Sales and supplier delivery indexes were weaker m/m, offsetting improvement registered in employment and customer inventory levels. Just 14% of respondents saw sales above seasonal expectations, while 54% indicated sales were worse. Pricing was mostly stable vs. last month, as respondents indicated commodity prices (in particular stainless steel) have stabilized. Overall, we believe October saw fairly broad-based softening among respondents.

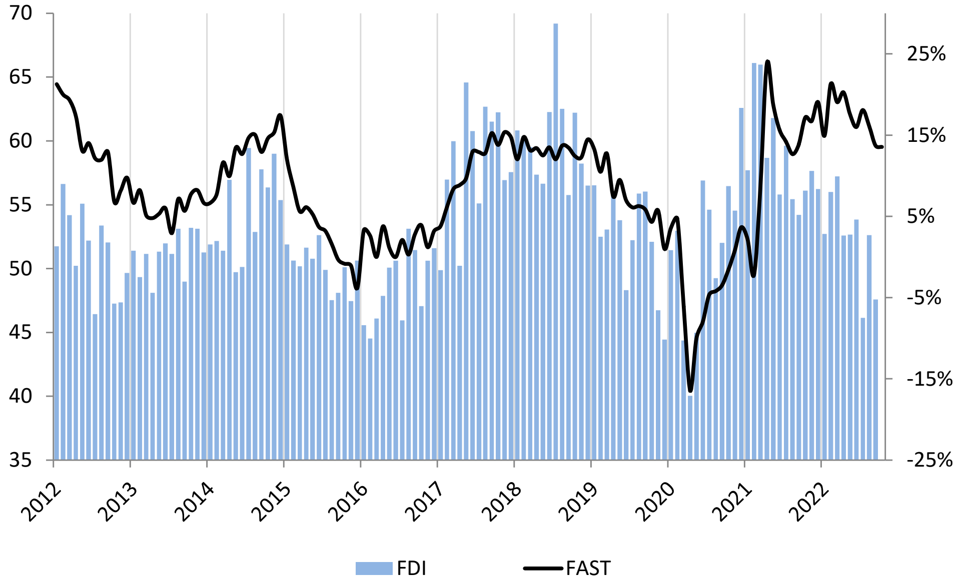
FLI suggests additional softening ahead. While October was soft, respondents anticipate further weakening in November. The FLI registered just a 42.2 reading, which was both contractionary (<50) and at an accelerating rate (decreased m/m). We believe this suggests November demand conditions could soften at a greater rate than October. Relative to last month, higher respondent and customer inventory levels m/m is read as a bearish sign for future demand as it could indicate customer de-stocking ahead. The six-month outlook was mostly unchanged, with just 11% of respondents anticipating activity levels will be higher six months from now vs. today (September was 9%). Conversely, 46% expect lower activity levels (September was 43%) vs. an average of just ~13% over the past two years. We view this as an indicator that many respondents anticipate a recession occurring in 2023. Lastly, 43% expect similar trends. Key outlook themes from participants included improving supplier lead times/overseas transit times, customer de-stocking, slowing demand, and general macroeconomic angst.

FDI employment index improves. The FDI employment index came in at 53.6 for October, improving from 47.8 last month. The vast majority of participants indicated they were at levels of employment that are seasonally normal/appropriate (64%), while 21% said employment levels were too high and 14% said they were too low. The October jobs report similarly painted a slightly better-than-expected job picture. 261,000 jobs were added vs. economist expectations for +195,000.

Outlook similar m/m but remains downbeat. Forward-looking commentary again skewed more bearish as recession fears continue to build. General economic fears are beginning to translate into reduced customer orders and careful monitoring of cost: "*Commercial customers are scaling back, anticipating slowing from their customers. Aerospace is still growing from the slowdown that COVID created, however, they seem to be watching their cost more closely.*" Another respondent said, "*Slight slowing from customers, feeling like everyone is a little hesitant and fearful of an economic slowdown.*" Inventory de-stocking is also playing a role in lower demand: "*The expected drop in sales is finally here and probably will be for the next 4-6 months until inventory levels out*." Positively, supply chains seem to be freeing up in a significant way for the first time since the onset of the pandemic: "*Some lead times getting better. Also finding transit times from overseas are getting better into the west coast!*" Echoing this, one respondent said, "*Supplier lead times are still longer than pre-COVID but coming down. Stainless steel costs seem more stable now than any time in recent memory. Automotive is down from earlier in the year but apparently there is still enough pent-up demand. Most other industrial sectors are noticeably down and regularly scheduled shipments are slowing*."

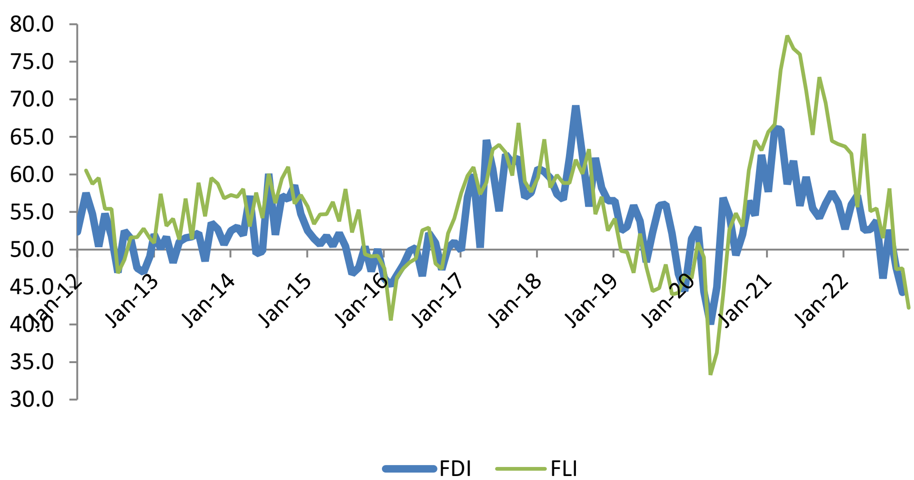
Fastenal's 13.6% overall October daily sales growth was above our 11.1% estimate and days-adjusted normal seasonality. Fastener sales grew by 12.2% y/y – moderating vs. 15.1% last month. Additionally for FAST, safety was +14.7% and other non-fasteners were +14.1%. Looking ahead to November, we model overall daily sales +8.6% y/y, which is in line with normal seasonality. In 2023, we model slightly weaker-than-seasonally-normal sales as we assume underlying demand conditions continue to soften exiting 2022 before outright recession begins in 2023.

Fastener Distributor Index (FDI); Seasonally Adjusted



**FAST March 2020 – December 2021 Monthly Sales Presented as ex. Safety Products*
Source: Baird, FCH Sourcing Network, Company reports

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



Source: Baird, FCH Sourcing Network

Risk Synopsis

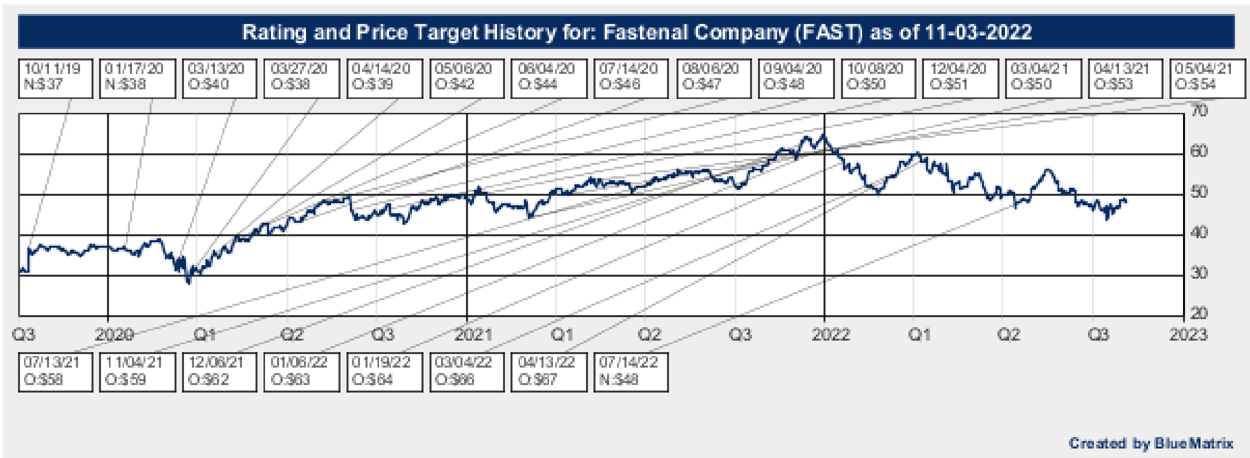
Fastenal: Risks include economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

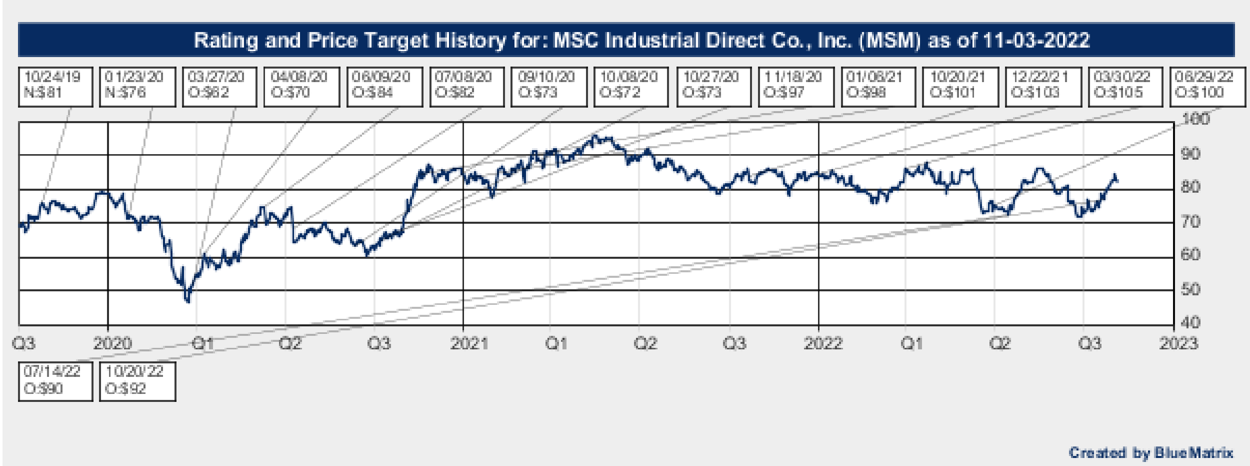
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are as of 11/4/2022.

Fastenal Company (FAST-$49.17-Neutral)
W.W. Grainger Inc. (GWW-$591.97 -Outperform)
MSC Industrial Direct Co. Inc (MSM-$82.38-Outperform)
(See recent research reports for more information)





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