Fastener Distributor Index – Report #129 September 2022

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FCH SOURCING NETWORK

Key Takeaway:

The September seasonally adjusted Fastener Distributor Index (FDI) retreated once again to a sub-50 reading at **47.6** as the FDI continues its recent choppy pattern of bouncing up/below the neutral level. This was consistent with the sharp contraction registered in last month's Forward-Looking Indicator (FLI), which we suggested could result in a contractionary reading for September. Demand commentary remained bearish, with many expecting further normalizing demand as customers burn through inventory. Looking forward, the Forward-Looking Indicator (FLI) remained at sub-50 levels, reading **47.5**, suggesting additional declines in the FDI could be likely next month. Overall, September was a relatively soft month for fastener distributors and we suspect further softening ahead.

Fastener Distribution Trends: September 2022

FASTENER DISTRIBUTION AT A GLANCE
September 2022

	------------------------ Index Values							---------------------		**Rate of**
	Sep	**Aug**	**Jul**	**Jun**	**May**	**Apr**	**Mar**	**Feb**	**Direction**	**Change**
ISM PMI (Manufacturing)	50.9	52.8	52.8	53.0	56.1	55.4	57.1	58.6	Growing	Slower
FDI	**47.6**	**52.6**	**46.1**	**53.8**	**52.7**	**52.6**	**57.2**	**56.0**	Declining	Faster
FLI	**47.5**	**47.4**	**58.1**	**51.5**	**55.4**	**55.1**	**65.4**	**55.6**	Declining	Slower
(Other Metrics)										
Sales	43.9	51.9	43.2	65.5	56.3	60.5	75.2	79.1	Declining	Faster
Employment	47.8	53.4	62.5	59.1	62.9	53.1	62.1	48.3	Declining	Faster
Supplier Deliveries	54.3	55.2	52.1	65.2	69.4	68.8	69.7	72.4	Growing	Slower
Respondent Inventories	58.7	72.4	66.7	63.6	62.9	59.4	50.0	56.9	Growing	Slower
Customer Inventories	39.1	46.6	27.1	28.8	27.4	29.7	21.2	25.9	Declining	Faster
Pricing, month-to-month	52.2	65.5	68.8	68.2	77.4	78.1	83.3	81.0	Growing	Slower
Pricing, year-to-year	87.0	91.4	91.7	90.9	95.2	95.3	95.5	94.8	Growing	Slower
				Higher	Same	Lower				
6-Month Outlook - September				9%	48%	43%				

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 remains choppy, back to contraction. The seasonally adjusted September FDI (47.6) dipped back below 50, suggesting market conditions worsened m/m. This was the second time in three months that the index has registered a contractionary reading following a 25 month stretch of expansion. Of the four components, the sales index saw the most significant weakening vs. last month, as only 22% of respondents saw sales above seasonal expectations. The month over month pricing index also moderated sharply, likely reflecting continued moderation in commodities and container costs. Overall, we believe September saw fairly broad-based softening among respondents.

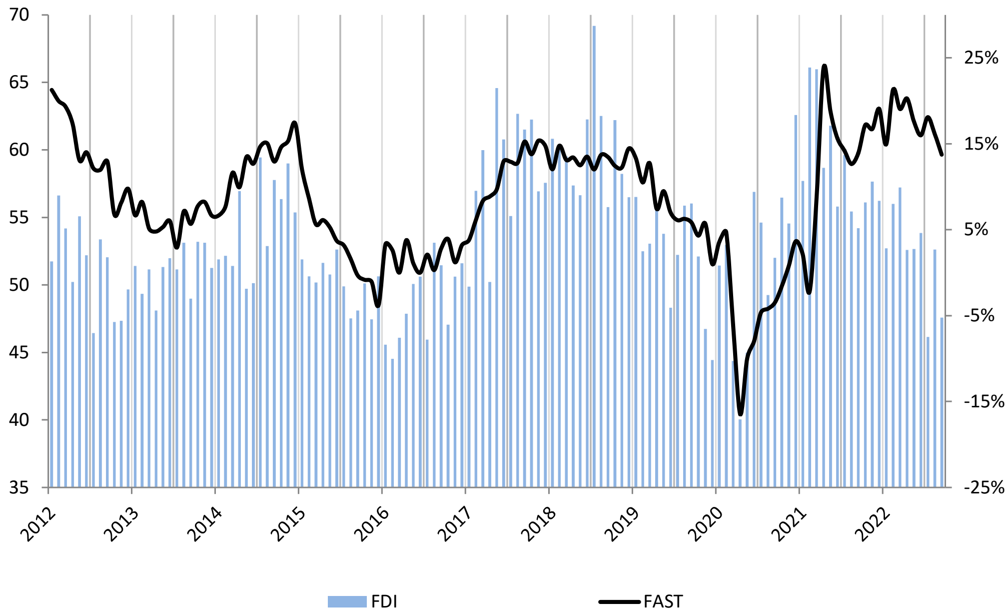
FLI suggests further weakening likely next month. While September was soft, respondents seem to anticipate further weakening in October. The FLI registered just a 47.5 reading, which was essentially unchanged vs. last month but still well into contractionary territory, which we believe suggests expectations for further weakening in demand/activity going forward. Relative to last month, employment levels softened, while the six-month outlook was significantly less positive. Regarding the outlook, just 9% of respondents anticipate activity levels will be higher six months from now vs. today. Conversely, 43% expect lower activity levels vs. an average of just ~13% over the past two years. We view this as an indicator that many respondents are anticipating a recession occurring in 2023. Lastly, 48% expect similar trends. Key outlook themes from participants included inventory de-stocking at both the customer and distributor level, normalizing order patterns following several years of supply chain chaos, and increasing bidding/quoting activity among customers in an attempt to avoid price increases.

FDI employment index ticks down. The FDI employment index came in at 47.8 for September, decreasing from 53.4 last month. The vast majority of participants indicated they were at levels of employment that is seasonally normal/appropriate (61%), although the respondents saying employment levels were too low did tick up modestly to 22% from 10% in August. The September jobs report is slated to be released this Friday (October 7th). Economists are expecting a similar deceleration in the broader economy, with consensus expectations for +250,000 jobs added vs. +315,000 jobs in August and +526,000 in July.

Outlook continues to deteriorate. Forward-looking commentary again skewed more bearish amid recession fears. Some customers are already attempting to preserve cash: "*Requests for delayed delivery dates are increased as is the aging of accounts receivable at a time when margins are thin. This is a deadly combination for cash flow especially with ever rising interest rates.*" High levels of inventory at the customer level remains a headwind to future growth in the near term, with one respondent saying, "*While if may feel like business is way off, using the last few years as the benchmark is not really an accurate comparison. Hopefully this situation will pass in the next 5-6 months as inventories level off. That is what we expect and then back to normal growth.*" Others noted softening business conditions are allowing customers more time to seek quotes to avoid price increases: "*Sales were slightly slower, however, quoting activity is up. Customers seem to have more time to quote their business out in an effort to minimize their cost increases.*" Supply chain remains a persistent headwind to meeting demand; per one respondent, "*The supply chain remains broken, vendors aren't ordering enough, prices will go up, though sales on total number of units will be static or lower*." Some see light at the end of the tunnel, however: "*Import deliveries are getting better and freight costs declining!*"

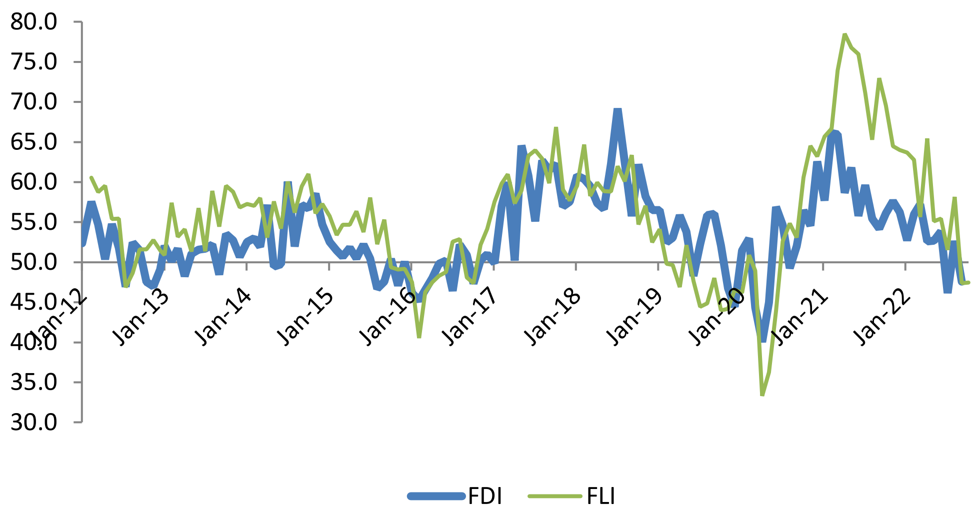
Fastenal's +16.1% overall August daily sales growth came in materially in line with our +16.5% estimate and days-adjusted normal seasonality. Fastener sales grew by +19.8% y/y (consistent with July growth). Additionally for FAST, safety was +11.7% and other non-fasteners were +14.5%. Looking ahead to September daily sales, we model overall daily sales +13.7% y/y, which is in line with normal seasonality. Over the remainder of the year, we model in-line to slightly weaker-than-seasonally-normal sales as we assume underlying demand conditions continue to soften exiting 2022 with outright recession in 2023. FAST will report September daily sales with 3Q22 results on October 13.

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

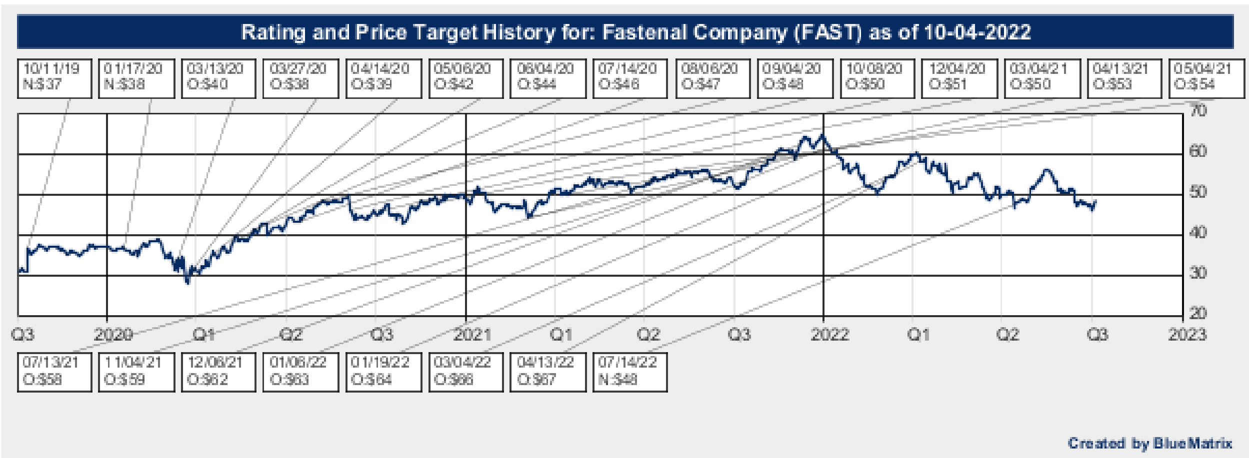
Fastenal: Risks include economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

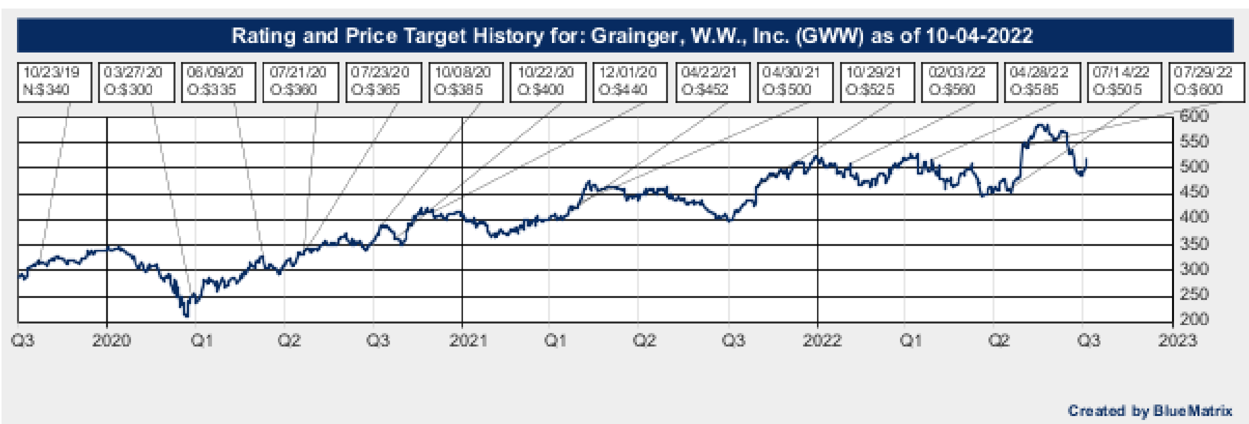
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are as of 10/5/2022.

Fastenal Company (FAST-$48.40-Neutral)
W.W. Grainger Inc. (GWW-$524.51-Outperform)
MSC Industrial Direct Co. Inc (MSM-$76.68-Outperform)
(See recent research reports for more information)





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