

Fastener Distributor Index – June 2018

Written by R.W. Baird analyst David J. Manthey, CFA 7/6/18



Key Takeaway:

The seasonally-adjusted FDI for June 2018 was 62.3, accelerating strongly m/m and reversing four straight months of modest deceleration in the FDI. Selling conditions were similarly strong and improved vs. May, with the seasonally-adjusted sales index coming in at 74.2 (May 61.2). Qualitative commentary on demand remains mostly positive, while increasingly inflationary pressures from raw material increases and tariffs were again common themes among survey participants. The six-month outlook was slightly less bullish this month but remains strong overall, and the Forward-Looking Indicator accelerated to 62.0 (May 58.8).

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**, the **National Fastener Distributors 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)**.

June FDI surges. The seasonally-adjusted June FDI (62.3) accelerated strongly vs. May's 56.6 reading, a departure from recent trends (four straight months of deceleration, albeit off of a high 60.8 January reading to start the year). In the June survey, 59% of respondents indicated sales were "better" relative to seasonal expectations vs. 54% in May. This produced a seasonally adjusted sales index of 74.2 (May 61.2). Pricing gains were again noted by a large majority of respondents, with 81% seeing higher prices y/y (and 67% m/m) vs. 75% in May. For perspective on the strength of pricing in June – only 20% of respondents reported higher pricing at the low point in March of 2016. The resulting FDI pricing index of 90.7 represents a new high for the index. Regarding customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (67% of responses), while 33% believe customers' inventories are too low. This was very consistent with May (68% in line, 29% too low, and 4% too high).

June FLI picks up. The seasonally-adjusted FLI ticked up m/m, registering 62.0 in June vs. 58.8 in May, mainly attributable to an improved employment index, which was partially offset by a modestly lower six month outlook. At 62.0, the FLI remains well into expansionary territory and is slightly above the average seen across 2017 (60.9). Given solidly-expansionary FDI and FLI readings, we believe market conditions are likely to remain in growth mode (albeit potentially moderating growth) in the coming months.

Manufacturing employment improves. Hiring sentiment again improved this month among survey respondents. 41% of respondents saw higher employment levels in June relative to seasonal expectations vs. 32% in May, while 56% saw employment as in line (May 57%). The resulting FDI Employment Index was 68.5, up nicely vs. May's 60.7 reading. The June US jobs report was similarly better than expected with +213,000 jobs added (+195,000 expected), with the unemployment rate rising slightly to 4.0%. June's largest gains were registered in professional and business services, manufacturing, and healthcare. Manufacturing employment continues to trend upwards (+36,000 jobs in June), with nearly all the gains again coming from durable goods manufacturing (including fabricated metal products +7,000). Total manufacturing jobs added over the past year now stands at +285,000. Average hours per work week for manufacturing employees increased slightly at 40.9 hours (vs. May 40.8).

June sentiment on demand mostly positive. While qualitative commentary were fewer in number this survey, one respondent indicated demand remains strong, saying "RFQ's are strong so sales will be better once we increase production so that we can decrease ship dates." Steel tariffs and global trade remain areas of concern among several respondents, echoed by one distributor who indicated "We've been told that wire coming into the states from Canada has a 25% tariff on it. That's increased our cost about 7%-8% on the finished good. I don't see this ending any time soon." Quantitatively, survey data points to mostly stable momentum expected through 2018, with 44% of respondents expecting higher activity levels over the next six months and 41% expecting similar activity, although the percentage of respondents expecting higher activity has moderated every month YTD since the 76% recorded in January.

Fastenal reported May daily sales growth of 12.5% y/y, above our 11.5% estimate and reflecting growth across all end markets/product lines. Underlying "core" growth (excluding foreign exchange) was 12.0%, the twelfth straight month of double-digit growth. Fasteners again saw strong growth at 9.1% y/y. June daily sales growth will be reported on 7/11. Based on FDI data and other research inputs, we expect continued strong top-line trends across public industrial distributors during 2018, with Fastenal y/y daily sales growth expected to remain in the double-digits through year-end.

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.

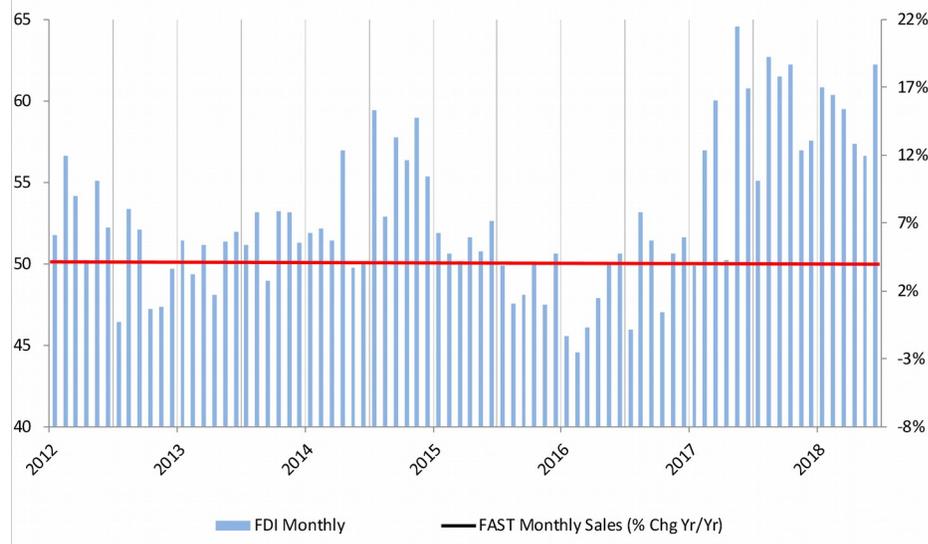
Fastener Distribution Trends: June 2018

FASTENER DISTRIBUTION AT A GLANCE										
June 2018										
	----- Index Values -----								Directiøn	Rate of Change
	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov		
PMI (Manufacturing Sector)	60.2	58.7	57.3	59.3	60.8	59.1	59.3	58.2	Growing	Faster
FDI (Fastener Sector)	62.5	59.4	59.8	61.2	58.4	64.8	56.8	55.9	Growing	Faster
FDI (Seasonally Adjusted)	62.3	56.6	57.4	59.5	60.4	60.8	57.6	56.9	Growing	Faster
Sales (SA)	74.2	61.2	63.0	70.1	74.2	72.7	68.4	72.8	Growing	Faster
Forward- Looking (SA)	62.0	58.8	58.9	59.9	58.3	64.7	59.6	57.7	Growing	Faster
(Other Metrics; NSA)										
Employment	68.5	60.7	59.4	62.5	62.2	66.7	58.6	53.1	Growing	Faster
Supplier Deliveries	77.8	73.2	71.9	69.6	64.9	66.7	68.6	68.8	Growing	Faster
Respondent Inventories	50.0	57.1	53.1	60.7	59.5	56.1	58.6	53.1	Steady	N/A
Customer Inventories	33.3	37.5	37.5	35.7	40.5	34.8	37.1	37.5	Declining	Faster
Pricing, month-to-month	83.3	75.0	73.4	76.8	68.9	68.2	67.1	64.1	Growing	Faster
Pricing, year-to-year	90.7	87.5	89.1	85.7	78.4	86.4	82.9	78.1	Growing	Faster
6-Month Outlook - June				Higher	Same	Lower				
				44%	41%	15%				

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

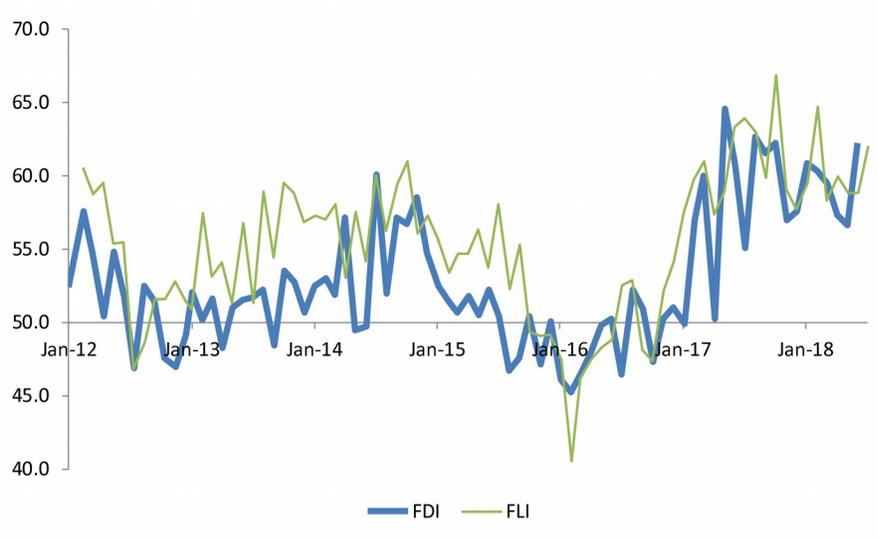
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

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 7/5/2018.

Fastenal Company (FAST-\$48.08-Neutral)
 W.W. Grainger Inc. (GWW-\$297.89-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$84.00-Neutral)
 (See recent research reports for more information)





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