Key Takeaway:
The seasonally-adjusted Fastener Distributor Index (FDI) for June was 48.3, contracting over five points vs. May’s 53.8 reading. Sales trends mirrored the deceleration in the overall index to an even greater degree, as the seasonally-adjusted sales index decreased substantially into contractionary levels. Respondent commentary similarly remained cautious on balance, as both the six-month outlook and the Forward-Looking Indicator (FLI) decreased m/m. The FLI specifically was sub-50 for the fifth time YTD. Overall, results were weaker than expected for many respondents in June.

Fastener Distribution Trends: June 2019
About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American fastener distributors, conducted by the FCH Sourcing Network and Baird with support from the National Fastener Distributors Association. The FDI 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 results weaken in June. The seasonally-adjusted June FDI (48.3) decelerated vs. May (53.8). Weaker sales trends were the main driver of the contraction. Just 23% of respondents indicated sales were better than seasonal expectations, below both 2018 levels (55%) and the percentage of respondents indicating sales were weaker this month (48%). The pricing index improved m/m, although a majority of respondents still indicated stable pricing levels vs. May. Although customer inventory levels are perceived as in line by most respondents, there was a noticeable uptick in those perceiving inventory levels as too high. Respondents’ inventories decreased m/m to more in-line levels.

June FLI further retreats below 50. The seasonally-adjusted FLI contracted m/m (44.4 vs. 47.7), the fifth sub-50 reading in six months YTD. Of the FLI’s components (employment index, respondent inventories, customer inventories, and six-month outlook), all but respondent inventories weakened sequentially. The six-month outlook further retrenched with respondents still seeing contraction on balance in late 2019.

Hiring sentiment mostly unchanged. Hiring sentiment was stable in June as hiring was again in line with to above seasonal expectations for nearly all fastener distributors, consistent with May results. The June US jobs report was better than expected with 224,000 jobs added economy wide vs. economist expectations of +160,000. Manufacturing employment increased slightly in June (+17,000) following 4 consecutive months of little to no change.

Respondent commentary remains cautious. The tone of qualitative commentary remained cautious this quarter. One distributor noted that “RFQ’s are less numerous but the flow of orders has not slowed enough to drop our backlog,” while another commented, “business is softer.” Commenting on elevated inventory levels among some customers, one distributor indicated, “Customers are moving existing orders out indicating overloaded inventories and slowing demand.” Lastly, some distributors commented on political uncertainty ahead of the 2020 election as a key risk to the outlook. As a result, the six-month outlook was again less optimistic this month, with just 23% of respondents expecting higher activity levels, 32% expecting similar activity, and 45% expecting lower activity. The percentage of respondents expecting lower activity has soared vs. the 16% in April, representing the most pessimistic reading since mid-2012.

Fastenal reported 9.5% May daily sales growth, slightly below our +9.9% estimate. M/m growth benefitted from Easter dropping out, while the number of selling days were unchanged both m/m and y/y. Underlying organic growth of +9.9% accelerated ~2% sequentially but still represented the second consecutive month of single-digit organic growth. Fastener growth rebounded somewhat to +8.1% (April +5.1%). June daily sales growth will be reported with 2Q19 results on Thursday, July 11. Based on FDI data and other research inputs, we continue to expect positive, albeit moderating top-line growth across public industrial distributors in 2019, partially offset by higher pricing.
Fastener Distributor Index (FDI); Seasonally Adjusted

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

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 7/8/2019.

Fastenal Company (FAST-$31.84-Neutral)
W.W. Grainger Inc. (GWW-$266.13-Neutral)
MSC Industrial Direct Co. Inc (MSM-$72.77-Neutral)

(See recent research reports for more information)

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