

Fastener Distributor Index – July 2019

Written by R.W. Baird analyst David J. Manthey, CFA 8/6/19



Key Takeaway:

The seasonally-adjusted Fastener Distributor Index (FDI) for July was 52.2, recovering off of weak June results, which saw the FDI dip below 50 for the first time since early 2017. Sales trends on a seasonally-adjusted basis mirrored the improvement seen in the overall index but to a lesser degree, remaining at a contractionary reading. Respondent commentary was cautious and the six-month outlook weakened slightly. The Forward-Looking Indicator (FLI) did improve modestly, but was still sub-50 for the sixth time YTD. Overall, July results showed improvement compared to much weaker June trends, but results continued to show underlying moderation in fastener markets compared with the strong momentum seen throughout 2017/2018.

Fastener Distribution Trends: July 2019

FASTENER DISTRIBUTION AT A GLANCE										
July 2019										
	----- Index Values -----								Direction	Rate of Change
	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec		
PMI (Manufacturing Sector)	51.2	51.7	52.1	52.8	55.3	54.2	56.6	54.1	Growing	Slower
FDI (Fastener Sector)	50.9	48.8	55.9	57.8	54.4	50.9	60.2	55.6	Growing	Faster
FDI (Seasonally Adjusted)	52.2	48.3	53.8	55.8	53.0	52.5	56.5	56.5	Growing	Faster
Sales (SA)	40.4	38.5	57.4	61.3	45.3	51.3	62.2	58.1	Declining	Slower
Forward-Looking (SA)	44.9	44.4	47.7	52.1	46.9	49.6	49.8	54.1	Declining	Slower
(Other Metrics; NSA)										
Employment	55.4	56.5	57.8	55.4	56.5	51.7	57.4	66.1	Growing	Slower
Supplier Deliveries	64.3	50.0	60.9	66.2	62.9	62.1	61.1	59.7	Growing	Faster
Respondent Inventories	69.6	61.3	65.6	66.2	72.6	60.3	70.4	62.9	Growing	Faster
Customer Inventories	48.2	51.6	43.8	41.9	48.4	43.1	44.4	43.5	Declining	Faster
Pricing, month-to-month	66.1	66.1	62.5	58.1	67.7	62.1	59.3	71.0	Growing	Same
Pricing, year-to-year	80.4	82.3	89.1	82.4	85.5	81.0	83.3	91.9	Growing	Slower
6-Month Outlook - July			Higher	Same	Lower					
			21%	32%	47%					

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** with support from the **NFDA**. 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 recovers in July. The seasonally-adjusted July FDI (52.2) recovered vs. a weak June result (48.3). A slight uptick in the percentage of respondents perceiving customer inventory levels as “too low” was the primary driver of the recovery. From a sales perspective, 18% of respondents experienced sales above seasonal expectations, slightly weaker m/m (June 23%) and well below average 2018 levels (55%). That said, July is typically a weaker month for many respondents, resulting in the sales index improving modestly compared to June after the seasonal adjustment. Pricing was relatively stable on balance m/m.

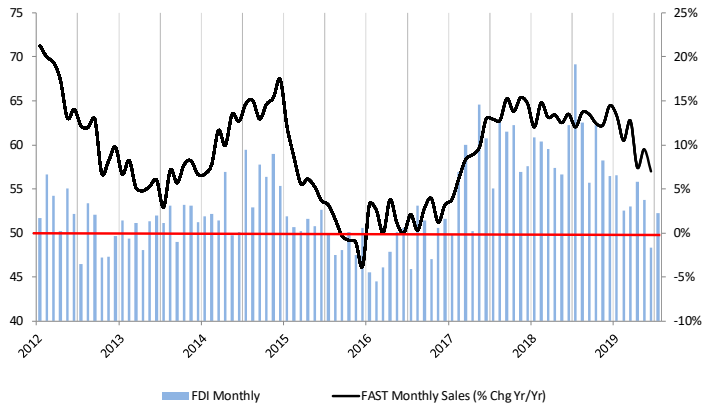
July FLI improves very slightly but still below 50. The seasonally-adjusted FLI improved ever so slightly m/m (44.9 vs. 44.4 last month), but was still the sixth sub-50 reading in seven months YTD. Of the FLI’s components (employment index, respondent inventories, customer inventories, and six-month outlook), all but customer inventories weakened sequentially. The seasonal-adjustment factor and the improvement in the customer inventory index drove the slight improvement in the FLI. The six-month outlook retrenched further with respondents still seeing contraction on balance in late 2019.

Hiring sentiment mostly unchanged. Hiring sentiment was fairly stable m/m as hiring was again in line with to above seasonal expectations for nearly all fastener distributors, consistent with June and May. The July US jobs report met expectations with a solid 164,000 jobs added economy wide vs. economist expectations of +165,000. Manufacturing employment increased slightly in July (+16,000) but remains below the pace of 2018 adds (+22,000 average).

Respondent commentary still cautious. The tone of qualitative commentary remained cautious this quarter. One respondent said, “[There] seems to be a little slow down in the fastener world.” The six-month outlook was mildly more bearish, with just 21% of respondents expecting higher activity, 32% expecting similar activity, and 47% expecting lower activity. Putting this into context, however, the percentage of respondents expecting lower activity has soared vs. the 16% in April, representing the most pessimistic reading since mid-2012.

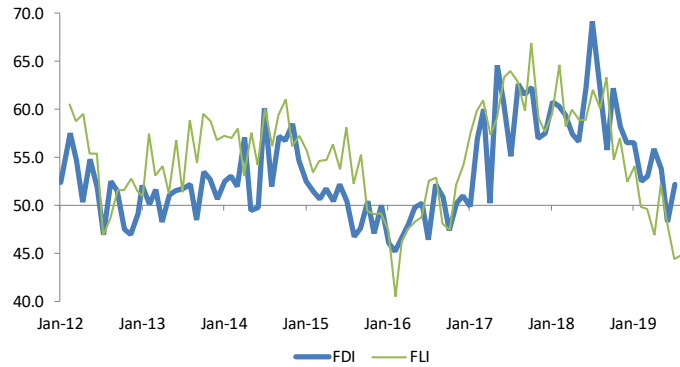
Fastenal reported +7.0% June daily sales growth, below our +10.1% estimate. Sales to manufacturing and non-residential construction customers decelerated 280bps and 630bps m/m, respectively. Underlying organic growth of +7.2% decelerated nearly 3% sequentially and was the third consecutive month of single-digit organic growth. Fastener growth was also weaker sequentially at +3.3% (May +8.1%). July daily sales growth will be reported on August 6. 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



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 8/5/2019.

Fastenal Company (FAST-\$28.68-Neutral)
 W.W. Grainger Inc. (GWW-\$269.22-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$66.02-Neutral)
 (See recent research reports for more information)



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