

Fastener Distributor Index – September 2019

Written by R.W. Baird analyst David J. Manthey, CFA 10/4/19



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for September was 56.0, essentially unchanged vs. August. Sales trends on a seasonally adjusted basis improved slightly, offset by a deceleration in the employment index. The six-month outlook deteriorated, however, and the Forward-Looking Indicator (FLI) decreased to the lowest reading since January 2016. Overall, while September market conditions were relatively stable, we expect further deterioration in demand near term given the weak FLI reading.

Fastener Distribution Trends: September 2019

FASTENER DISTRIBUTION AT A GLANCE										
September 2019										
	----- Index Values -----								Direction	Rate of Change
	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb		
PMI (Manufacturing Sector)	47.8	49.1	51.2	51.7	52.1	52.8	55.3	54.2	Declining	Faster
FDI (Fastener Sector)	52.4	55.5	50.9	48.8	55.9	57.8	54.4	50.9	Growing	Slower
FDI (Seasonally Adjusted)	56.0	55.9	52.2	48.3	53.8	55.8	53.0	52.5	Growing	Faster
Sales (SA)	56.4	52.1	40.4	38.5	57.4	61.3	45.3	51.3	Growing	Faster
Forward- Looking (SA)	44.0	48.0	44.9	44.4	47.7	52.1	46.9	49.6	Declining	Faster
(Other Metrics; NSA)										
Employment	51.6	55.9	55.4	56.5	57.8	55.4	56.5	51.7	Growing	Slower
Supplier Deliveries	58.1	58.8	64.3	50.0	60.9	66.2	62.9	62.1	Growing	Slower
Respondent Inventories	69.4	64.7	69.6	61.3	65.6	66.2	72.6	60.3	Growing	Faster
Customer Inventories	53.2	52.9	48.2	51.6	43.8	41.9	48.4	43.1	Growing	Faster
Pricing, month-to-month	61.3	61.8	66.1	66.1	62.5	58.1	67.7	62.1	Growing	Slower
Pricing, year-to-year	79.0	80.9	80.4	82.3	89.1	82.4	85.5	81.0	Growing	Slower
				<u>Higher</u> <u>Same</u> <u>Lower</u>						
6-Month Outlook - September				23%	32%	45%				

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 **National Fastener Distributor's Association**. 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 unchanged in September. The seasonally adjusted September FDI (**56.0**) was flattish m/m (August 55.9). Better sales trends were offset by a weaker employment reading. From a sales perspective, 35% of respondents experienced sales above seasonal expectations, similar m/m (August 41%) but well below average 2018 levels (55%). Pricing was stable sequentially for a large majority of respondents.

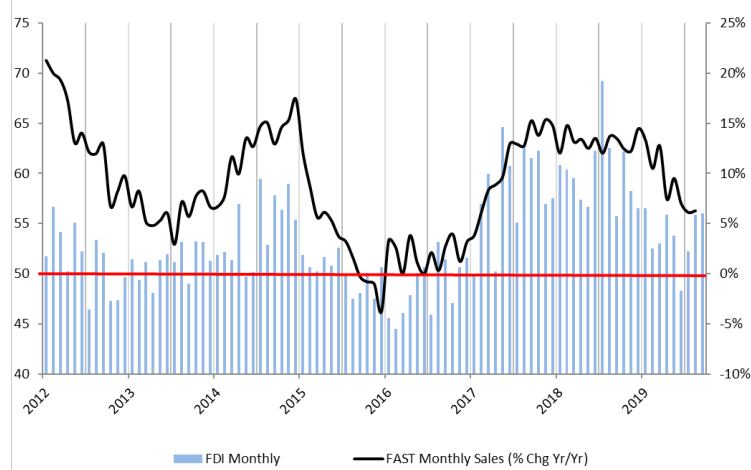
September FLI drops meaningfully. After two consecutive months of modest improvement, the seasonally adjusted FLI reversed course this month, dropping to **44.0** (48.0 last month), which is the lowest reading in the FLI since January 2016 and the eighth sub-50 reading in nine months YTD. For context, following the January 2016 FLI low, the FDI averaged just 49.0 over the remainder of 2016. All four components of the FLI (employment index, respondent inventories, customer inventories, and six-month outlook) turned more bearish m/m.

Hiring sentiment a bit weaker. Hiring sentiment was a bit weaker vs. August, as an uptick was registered in the percentage of respondents with lower employment levels than seasonal expectations. Similarly, the September US jobs report was light of economist expectations with 136,000 jobs added economy wide vs. expectations of +150,000. The rate of adds has slowed considerably since the end of 2018, when the economy was adding an average of 223,000 jobs per month. The unemployment rate dipped to 3.5%, the lowest rate since December 1969. Manufacturing employment was essentially unchanged and remains below the pace of 2018 adds (+22,000 average).

Respondent commentary mixed. Feedback on the demand environment was mixed this month. One respondent commented, "Nothing in the economic sources used in the industry that indicate a change to the slower growth rate until 2nd half 2020." Another commented on destocking occurring at some master importer branches noting, "We are seeing some of the master importer distributors not stocking as much at one location. While they may have it, we are always having to bring in parts from their various branches, adding to the COGS with additional freight." The six-month outlook deteriorated m/m, with 45% of respondents now expecting lower activity six months from now (August 32%), 32% expecting similar activity (August 41%), and 23% expecting higher activity (August 26%).

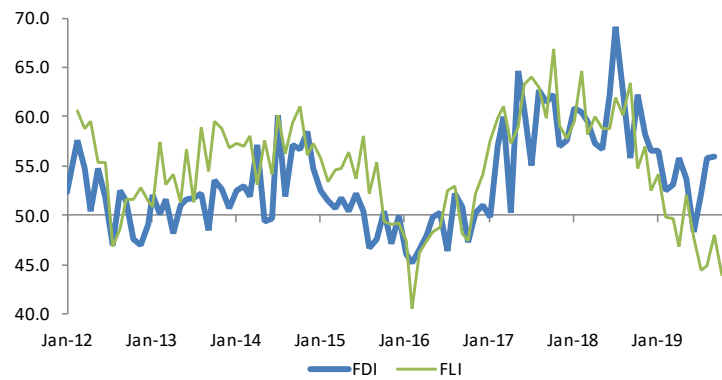
Fastenal reported +6.3% August daily sales growth, slightly below our +7.0% estimate. Sales to manufacturing customers accelerated 90bps m/m, while non-residential construction end market growth weakened 20bps further. Underlying organic growth of +6.5% was up slightly vs. July (+6.2%). Consistent with the improvement in the FDI this month, fastener growth improved sequentially at +4.6% (July +1.8%). September daily sales growth will be reported on October 11 with 2Q19 earnings. 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 10/4/2019.

Fastenal Company (FAST-\$31.58-Neutral)
 W.W. Grainger Inc. (GWW-\$291.14-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$69.92-Neutral)
 (See recent research reports for more information)



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