

Fastener Distributor Index – October 2019

Written by R.W. Baird analyst David J. Manthey, CFA 11/7/19



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for **October was 52.1**, decelerating vs. September, although this was mainly due to the seasonal adjustment factor as October is normally a strong month for respondents. Sales trends on a seasonally adjusted basis were weaker m/m, as was the employment index. The six-month outlook improved, however, and the Forward-Looking Indicator (FLI) was stable. Overall, October market conditions were a bit weaker than would be expected given normally strong seasonal trends, but underlying momentum was fairly steady with September.

Fastener Distribution Trends: October 2019

FASTENER DISTRIBUTION AT A GLANCE										
October 2019										
	----- Index Values -----									Rate of
	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Direction	Change
PMI (Manufacturing Sector)	48.3	47.8	49.1	51.2	51.7	52.1	52.8	55.3	Declining	Slower
FDI (Fastener Sector)	52.2	52.4	55.5	50.9	48.8	55.9	57.8	54.4	Growing	Slower
FDI (Seasonally Adjusted)	52.1	56.0	55.9	52.2	48.3	53.8	55.8	53.0	Growing	Slower
Sales (SA)	48.2	56.4	52.1	40.4	38.5	57.4	61.3	45.3	Declining	Faster
Forward- Looking (SA)	44.2	44.0	48.0	44.9	44.4	47.7	52.1	46.9	Declining	Slower
(Other Metrics; NSA)										
Employment	48.7	51.6	55.9	55.4	56.5	57.8	55.4	56.5	Declining	Faster
Supplier Deliveries	55.1	58.1	58.8	64.3	50.0	60.9	66.2	62.9	Growing	Slower
Respondent Inventories	69.2	69.4	64.7	69.6	61.3	65.6	66.2	72.6	Growing	Slower
Customer Inventories	52.6	53.2	52.9	48.2	51.6	43.8	41.9	48.4	Growing	Slower
Pricing, month-to-month	59.0	61.3	61.8	66.1	66.1	62.5	58.1	67.7	Growing	Slower
Pricing, year-to-year	84.6	79.0	80.9	80.4	82.3	89.1	82.4	85.5	Growing	Faster
6-Month Outlook - October				<u>Higher</u>	<u>Same</u>	<u>Lower</u>				
				28%	38%	33%				

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 Distributors Association**. The index 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 decelerates in October on seasonal-adjustment factor. The seasonally adjusted October FDI (52.1) moderated from a strong September (56.0) mainly on the seasonal-adjustment factor. Consistent with this, sales trends were slightly improved on an unadjusted basis, but the seasonal-adjustment factor drove the sales index down m/m. 38% of respondents experienced sales above seasonal expectations, slightly better m/m (September 35%) but still well below average 2018 levels (55%). Pricing was stable sequentially for a large majority of respondents. The employment index was also a slight drag on the FDI this month.

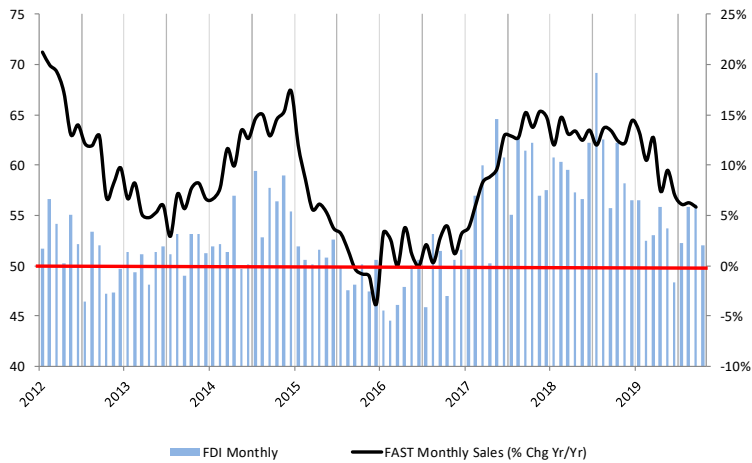
October FLI unchanged. The seasonally adjusted FLI remained stable with September at 44.2. This was the ninth sub-50 reading in ten months YTD. A more bullish six-month outlook and slight improvement in respondent inventories was entirely offset by a weaker employment index and higher customer inventories.

Hiring sentiment a bit weaker. Hiring sentiment was a bit weaker vs. September, as a very modest uptick was registered in the percentage of respondents with lower employment levels than seasonal expectations. Looking at the broader economy, the October US jobs report was better than downbeat expectations with 128,000 jobs added vs. 85,000 expected despite some noise in the numbers related to the GM strike. Nevertheless, 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 remained at 3.6%. Manufacturing employment decreased by 36,000 jobs, although this was entirely due to motor vehicles and parts employment declining by 42,000 due to the aforementioned GM strike.

Respondent commentary more positive. Feedback on the demand environment turned more positive this month. One respondent commented, "October was a phenomenal month for us, at least partially due to increased capacity. We took full advantage of the 23 business days." Another commented, "The market seems steady. Prices up from overseas but pretty steady these days." The six-month outlook showed improvement m/m but remains somewhat muted, with 33% of respondents now expecting lower activity six months from now (September 45%), 38% expecting similar activity (September 32%), and 28% expecting higher activity (September 23%).

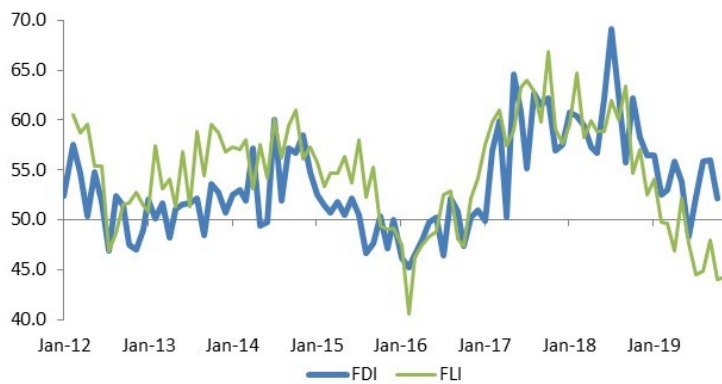
Fastenal reported +4.3% October daily sales growth, below our +5.3% estimate. Sales growth to manufacturing customers decelerated another 60bps m/m, while non-residential construction end market growth moderated 240bps sequentially. Underlying organic growth of +4.4% further moderated vs. +6.1% in September. Fastener growth was slightly improved at +3.4% (September +2.4%). 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.

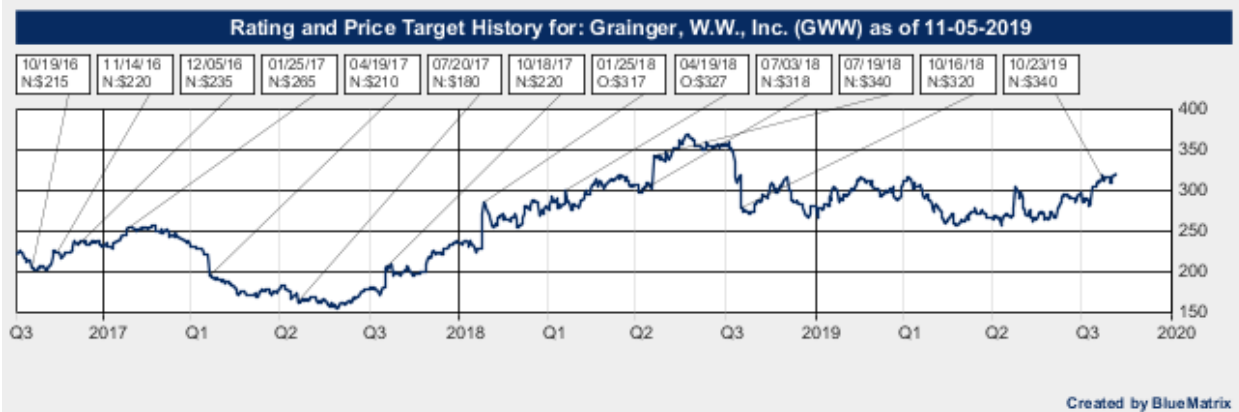
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 11/6/2019.

Fastenal Company (FAST-\$36.78-Neutral)
 W.W. Grainger Inc. (GWW-\$319.79-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$75.77-Neutral)
 (See recent research reports for more information)



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