Key Takeaway:

The seasonally-adjusted FDI for February was 52.5, decelerating vs. last month’s 56.5 reading and consistent with the deceleration in last month’s FLI. Sales trends were weaker m/m with the seasonally-adjusted sales index coming in at 51.3 (vs. January 62.2). Respondent commentary was notably more cautious this month as several respondents noted softening market conditions. The six-month outlook was a bit weaker as well and the Forward-Looking Indicator, while essentially unchanged sequentially, remained in contractionary territory.

Fastener Distribution Trends: February 2019

<table>
<thead>
<tr>
<th>FASTENER DISTRIBUTION AT A GLANCE</th>
<th>February 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>--------------</td>
</tr>
<tr>
<td></td>
<td>Feb</td>
</tr>
<tr>
<td>PMI (Manufacturing Sector)</td>
<td>54.2</td>
</tr>
<tr>
<td>FDI (Fastener Sector)</td>
<td>50.9</td>
</tr>
<tr>
<td>FDI (Seasonally Adjusted)</td>
<td><strong>52.5</strong></td>
</tr>
<tr>
<td>Sales (SA)</td>
<td>51.3</td>
</tr>
<tr>
<td>Forward-Looking (SA)</td>
<td>49.6</td>
</tr>
<tr>
<td>(Other Metrics; NSA)</td>
<td></td>
</tr>
<tr>
<td>Employment</td>
<td>51.7</td>
</tr>
<tr>
<td>Supplier Deliveries</td>
<td>62.1</td>
</tr>
<tr>
<td>Respondent Inventories</td>
<td>60.3</td>
</tr>
<tr>
<td>Customer Inventories</td>
<td>48.1</td>
</tr>
<tr>
<td>Pricing, month-to-month</td>
<td>62.1</td>
</tr>
<tr>
<td>Pricing, year-to-year</td>
<td>81.0</td>
</tr>
</tbody>
</table>

6-Month Outlook - February

<table>
<thead>
<tr>
<th>Higher</th>
<th>Same</th>
<th>Lower</th>
</tr>
</thead>
<tbody>
<tr>
<td>24%</td>
<td>52%</td>
<td>14%</td>
</tr>
</tbody>
</table>

FDI and Pricing are diffusion indexes. At 50, the performance of the category 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
**Key Points:**

**FDI decelerated in February.** The seasonally-adjusted February FDI (52.5) decreased m/m to the lowest reading since April 2017, consistent with a weak January FLI reading. The sales index also decelerated as only 21% of respondents saw higher than seasonally expected sales in February. Positively, pricing stabilized on a m/m and y/y basis after deceleration was seen in January. Customer inventory levels continue to be perceived as in line with expectations, while respondents’ inventories normalized from elevated levels in the channel last month.

**February FLI still in contractionary territory.** The seasonally-adjusted FLI was essentially unchanged vs. January (49.6 vs. 49.8 last month) but remained below 50 for the second straight month. While more bullish readings from respondent and customer inventories both drove slight improvements in the FLI, these were more than offset by a less bullish employment picture and a reduced six-month outlook. Looking back to the most recent time the FLI had two consecutive sub-50 readings (August/September 2016), the subsequent four FDI readings were all near or below a neutral level of 50. In light of this, we believe stabilization or further moderation in the FDI could be more likely than acceleration from here.

**Hiring sentiment again a bit weaker.** Hiring sentiment cooled some again this month as hiring was above seasonal expectations for fewer fastener distributors. The resulting FDI Employment Index moderated another 6 points sequentially. On an economy-wide basis, the January US jobs report was well above expectations with 304,000 jobs added (~180,000 expected). The unemployment rate rose to 4.0% (+0.1%) in part reflecting the partial government shutdown. January’s largest gains were registered in leisure and hospitality, construction, health care, and transportation and warehousing. Manufacturing employment continued to trend upward (+13,000 jobs), with increases in durable goods (+20,000) partially offset by declines in non-durable goods (-7,000). Average hours per work week for manufacturing employees decreased to 40.8 hours (-0.1 m/m). February’s report is expected to be released on March 8, with consensus estimates calling for +190,000 jobs.

**Respondent commentary turns more cautious.** Qualitative commentary had a more cautious tone overall this month as several respondents noted softening market conditions. One respondent summarized the environment simply stating, “Starting to slow down.” Another commented, “Volume is down, but because of cost increases implemented last year, revenue is running about equal.” Unfavorable weather conditions likely also negatively impacted results to an extent, as one participant noted “I can understand the rest of the country being flat or slight growth; [I’m] wondering how the inclement weather affected sales.” The six-month outlook mostly points to stable activity levels anticipated by fastener distributors over the next six months, with just 24% of respondents expecting higher activity levels, 62% expecting similar activity, and 14% expecting lower activity. For context, the percentage of respondents expecting higher activity throughout 2018 was 49% on average, while the percentage expecting lower activity was 14%.

**Fastenal** reported 10.5% February daily sales growth, which was consistent with our +10.4% estimate. Underlying organic growth of +11.0% matched our estimate despite a 1.3%-1.6% weather headwind, and was the 21st straight month of double-digit growth. Consistent with the deceleration seen in the February FDI and January’s weak FLI reading, fastener growth decelerated m/m to +8.7% y/y (+13.3% in January). Based on FDI data and other research inputs, we largely expect still-solid but potentially moderating top-line trends across public industrial distributors in 2019, partially offset by higher pricing.
**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.

**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).
Fastener Distributor Index (FDI); Seasonally Adjusted

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

Source: Baird, FCH Sourcing Network
Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are as of 3/6/2019.

Fastenal Company (FAST-$62.03-Neutral)
W.W. Grainger Inc. (GWW-$302.45-Neutral)
MSC Industrial Direct Co. Inc (MSM-$84.63-Neutral)
(See recent research reports for more information)
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