

HIGHLIGHTED COVERAGE
Fastenal
 FAST - \$43.53 - Hold

W.W. Grainger
 GWW - \$208.48 - Hold

MSC Industrial Direct
 MSM - \$65.74 - Hold

BB&TCM Fastener Distributor Index (FDI); January Reflects Added Demand Pressure
KEY TAKEAWAY

For January, the seasonally adjusted FDI (45.6) returned to negative territory, better reflecting what we believe remains a notably strained environment for both distributors and manufacturers. Sales growth among survey participants further waned, with just 36% of respondents citing stronger results during the period. Perhaps even more disconcerting, 82% now expect unchanged (or worse) conditions six months from now. Soft employment, lower pricing, and inflated respondent inventories further underpin our overall caution for distributors near-term. To the positive, Fastenal reported nascent daily sales growth for January, and the company cited early improvement among its top 100 customers. We will continue watching closely for added signs of stabilization among our group of private distributors surveyed. As for the major public players, we remain cautious barring a return to more sustained monthly sales expansion.

KEY POINTS

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm fastener distributors, conducted with the **FCH Sourcing Network** and the **National Fastener Distributors Association**. It offers insights into current industry trends/ outlooks. As a diffusion index, figures above 50 signal strength, while readings below 50 signal weakness. It should be directly relevant to **Fastenal** and broadly relevant to other distributors (**W.W. Grainger**, **MSC Industrial**).

January FDI 45.6, tough start to 2016. The January FDI (45.6) implies another downturn in overall conditions among our survey participants. Of the items measured (sales, employment, delivery times, inventories, customer inventories), we believe weaker top-line sentiment remains the most compelling indicator in the Index. Only 36% of respondents reported sequential sales improvement for January (35% last month). Additionally, the employment component of the FDI (46.4) ticked lower in January, as 89% of participants noted unchanged or reduced hiring conditions versus the preceding month.

Inventories still inflated according to participants. The FDI also implies a clear shift in both customer and respondent inventory levels over the prior six month period. Among participants, 21% now view customer inventory levels as "too high" (5% last August), despite ongoing destocking efforts by many distributors. We believe the steep incline reflects added end market demand pressure, and note that "too high" responses averaged just 4% during the headier growth period of 2013-2014.

Pricing still tepid. Point-of-sale pricing for January was unchanged versus December for 75% of survey participants (14% lower). We believe the overall environment for price increases remains notably soft given material demand pressure (declining commodity prices, forex, weaker industrial production) and minimal inflation. Additionally, we view the survey results as largely consistent with recent yr/yr price adjustments from Grainger (-1% in Q4'15) and Fastenal (-2% on fasteners). MSC has proven to be an outlier here, with modest price realization partially attributed to nascent traction on supplier discounts and renewed freight initiatives.

But Fastenal reported a positive January, right? Well, yes. Fastenal's reported DSR of +3.3% marked the company's first positive sales print since last August. However, after adjusting for one fewer day in the month, daily sales totaled a negative 1.6% yr/yr. To the positive, approximately 60% of the company's top 100 customers cited sales expansion in January, up from 50% in December.

Overall: we're optimistic but cautious. While the early returns from Fastenal are modestly positive, in our view (and comps are getting easier), overwhelming anecdotal commentary points to continued pressure for fastener-centric distributors in FY'16. We believe lower energy spending is at the root of weaker sales, with currency woes further compounding the slowdown. We expect continued manufacturing strain in early FY'16, and note that less than one-quarter of survey participants expect materially improved activity six-months from now. Overall, we remain cautious.

Additional Discussion

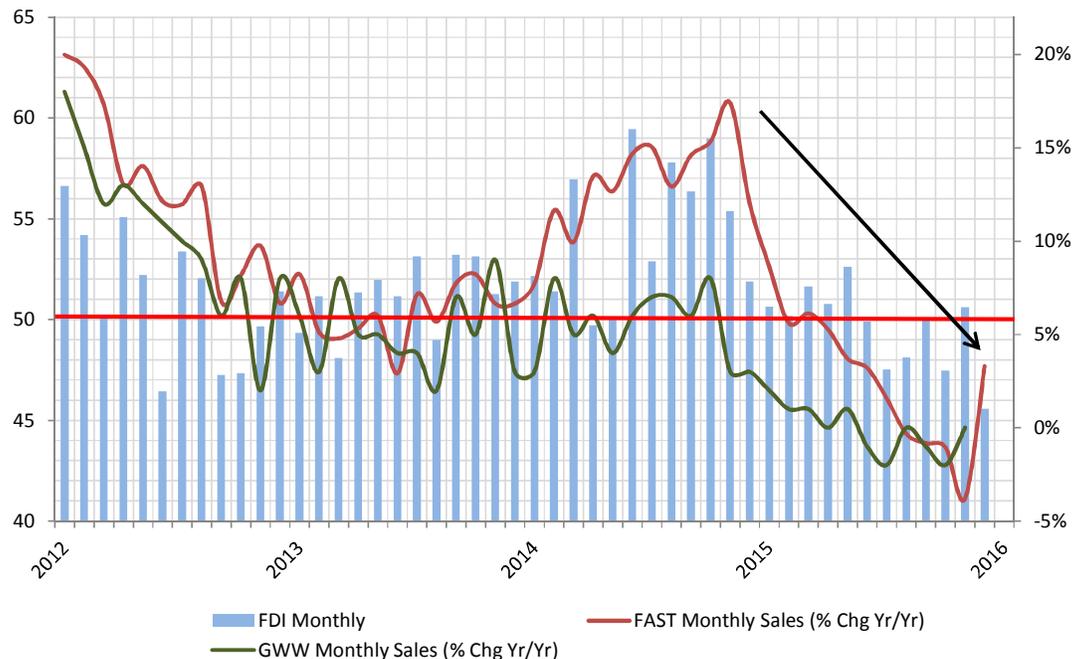
Fastener Distribution Trends; January 2015

FASTENER DISTRIBUTION AT A GLANCE									
January 2015									
	----- Index Values -----						Dec.-->Jan.		
	Jan.	Dec.	Nov.	Oct.	Sep.	Aug.	Change	Direction	
PMI (Manufacturing Sector)	48.2	48.0	48.4	49.4	50.0	51.0	0.2	Declining	
FDI (Fastener Sector)	50.4	49.4	46.2	49.6	44.6	45.5	1.1	Growing	
FDI (Seasonally Adjusted)	45.6	50.6	47.5	50.1	48.1	47.5	(5.0)	Declining	
Sales (SA)	36.6	50.4	37.0	48.3	34.9	45.8	(13.8)	Declining	
(Other Metrics; NSA)									
Employment	46.4	48.8	50.0	53.1	48.7	52.3	(2.3)	Declining	
Supplier Deliveries	55.4	55.0	59.1	51.6	56.4	56.8	0.4	Slowing	
Respondent Inventories	69.6	68.8	68.2	65.6	67.9	70.5	0.9	Too High	
Customer Inventories	50.0	50.0	45.5	42.2	43.6	29.5	0.0	Too Low	
Pricing, month-to-month	48.2	45.0	42.4	43.8	44.9	45.5	3.2	Lower	
Pricing, year-to-year	41.1	50.0	48.5	53.1	51.3	54.5	(8.9)	Lower	
<u>Higher</u> <u>Same</u> <u>Lower</u>									
6-Month Outlook - Jan.	18%	39%	43%						

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: BB&TCM, FCH Sourcing Network, Institute for Supply Management

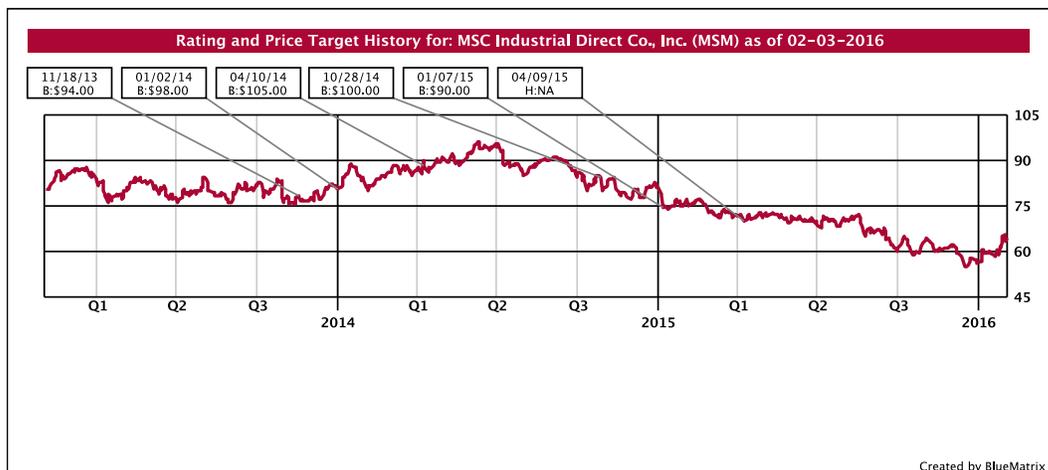
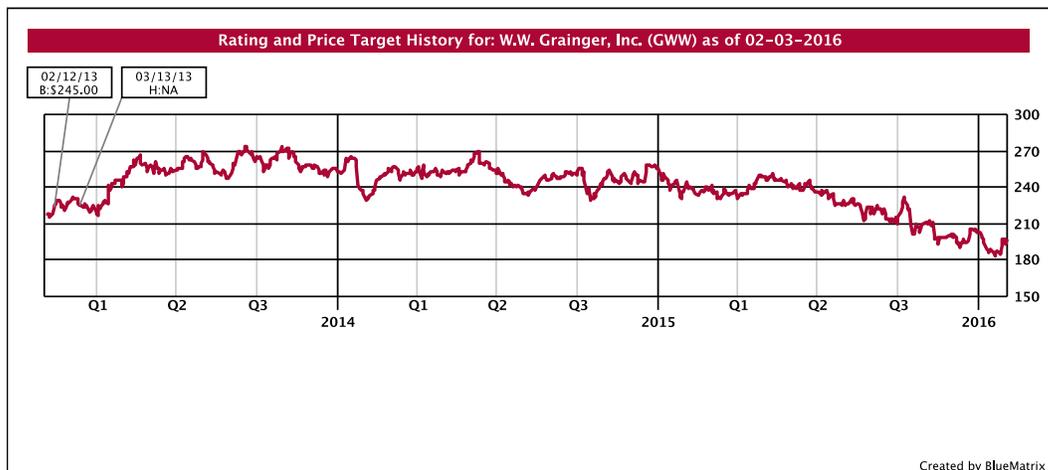
Fastener Distributor Index (FDI); Seasonally Adjusted



Source: BB&TCM, FCH Sourcing Network, company reports

IMPORTANT DISCLOSURES

Price Chart



BB&T Capital Markets rating distribution by percentage (as of February 5, 2016):

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
Buy (1)	45.03%	Buy (1)	28.57%
Hold (2)	52.34%	Hold (2)	17.32%
Underweight/Sell (3)	2.63%	Underweight/Sell (3)	22.22%
Not Rated (NR)	0.00%	Not Rated (NR)	0.00%

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The definition of each rating is as follows:

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