

HIGHLIGHTED COVERAGE

Fastenal
FAST - \$46.49 - Hold

W.W. Grainger
GWW - \$232.48 - Hold

MSC Industrial Direct
MSM - \$75.68 - Hold

BB&TCM Fastener Distributor Index (FDI): April Higher vs. Weak Early 2016

KEY TAKEAWAY

April's seasonally adjusted FDI reading (47.9) proved modestly higher versus the weaker January-March timeframe, as results benefitted from a sequential uptick in sales bias among survey participants. Longer-term industry sentiment also improved for respondents versus the early year period, as 53% now expect better conditions in six months (37% in March). While the early improvement is encouraging, we continue to temper our expectations for more material near-term expansion among fastener distributors. Anecdotes (both public and private) still reflect cautionary industry themes (commodity dislocation, currency headwinds, mixed industrial production, etc.), and a sharp recent increase in steel pricing could also pressure near-term demand, in our view. We will continue to watch closely for added signs of more tangible strengthening.

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**).

April sales better versus early FY'16. The April FDI (47.9) continues to imply a pressured overall environment for fastener distribution, although results on the aggregate were better versus the January-March readings. Of the items measured (sales, employment, delivery times, inventories, customer inventories), we believe top-line sentiment remains the most compelling indicator in the Index. 63% of April participants noted similar or better sequential sales growth (59% in March). We believe the results are directionally consistent with April results from Fastenal (+1.7% sequentially), which reported -0.8% and +1.5% monthly DSR growth in February/March, respectively. Regarding customer inventories, 21% of participants viewed current levels as "too high." We note that during the headier growth period of 2013-2014, this metric averaged 4%.

Pricing also sees nascent expansion. The sequential point-of-sale pricing index for April (53.9) jumped into expansion territory for the first time since June 2015, as 18% of respondents saw an uptick versus March (5%). According to participant commentary, higher global steel pricing (+16% in April) drove price increases for select suppliers (*FactSet*). We believe the overall environment for pricing remains notably soft given material demand pressure and minimal inflation. Last quarter, Fastenal reported fastener price deflation of 1.5%-2%. Select distributors continue to offset weaker pricing through supplier and freight discounts.

Labor adds minimal. Employment (51.3) remained largely unchanged, as 87% of participants noted unchanged or reduced hiring versus the preceding month. On an absolute basis, Fastenal decreased total headcount by 91 in April, the fifth consecutive month of contraction. In Q1'16, the company reiterated its hiring freeze, excluding necessary vending/IT administration adds.

Six-month outlook modestly encouraging. The six-month outlook for April respondents also proved higher, as 53% of survey participants now expect increased activity later this year (only 37% last month). We believe the early improvement in currency/commodity pricing, coupled with a modestly higher April PMI (50.8, the second consecutive 50+ reading) could at least partially explain the better sentiment (*ISM*). Looking ahead, Grainger reports April sales on 5/13.

Overall, we remain cautious. Despite the improved six-month outlook, select survey commentary points to added uncertainty near-term. As one participant noted, "*Summer slow down is coming...dust off the warehouse BBQ grill.*" Perhaps more to the point, another noted, "*Even with 30 years under my 'fastener belt', I continue to be shocked at how unpredictable this market is.*" We couldn't agree more.

Additional Discussion

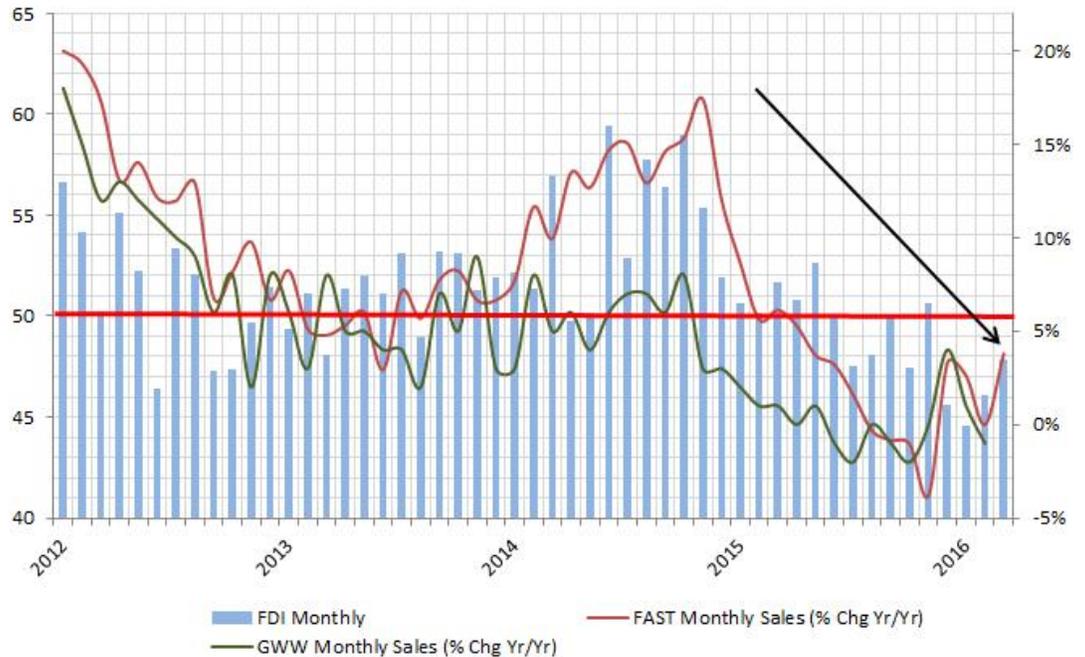
Fastener Distribution Trends; April 2016

FASTENER DISTRIBUTION AT A GLANCE									
April 2016									
	----- Index Values -----						Mar.-->Apr.		
	Apr.	Mar.	Feb.	Jan.	Dec.	Nov.	Change	Direction	
PMI (Manufacturing Sector)	50.8	51.8	49.5	48.2	48.0	48.4	(1.0)	Growing	
FDI (Fastener Sector)	51.3	47.6	44.0	50.4	49.4	46.2	3.8	Growing	
FDI (Seasonally Adjusted)	47.9	46.1	44.5	45.6	50.6	47.5	1.8	Declining	
Sales (SA)	38.2	38.6	36.7	36.6	50.4	37.0	(0.4)	Declining	
(Other Metrics; NSA)									
Employment	51.3	52.4	44.8	46.4	48.8	50.0	(1.1)	Growing	
Supplier Deliveries	56.6	53.7	51.7	55.4	55.0	59.1	2.9	Slowing	
Respondent Inventories	71.1	69.5	69.0	69.6	68.8	68.2	1.5	Too High	
Customer Inventories	50.0	41.5	44.8	50.0	50.0	45.5	8.5	Too Low	
Pricing, month-to-month	53.9	40.2	43.1	48.2	45.0	42.4	13.7	Higher	
Pricing, year-to-year	47.4	36.6	43.1	41.1	50.0	48.5	10.8	Lower	
<u>Higher</u> <u>Same</u> <u>Lower</u>									
6-Month Outlook - Apr.	53%	34%	13%						

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 May 9, 2016):

All companies under coverage:

Buy (1)	43.19%
Hold (2)	53.33%
Underweight/Sell (3)	3.48%
Not Rated (NR)	0.00%

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Not Rated (NR)	0.00%

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B: Buy **H:** Hold **UW:** Underweight **NR:** Not Rated **NA:** Not Applicable **NM:** Not Meaningful **SP:** Suspended

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