

Fastener Distributor Index – August 2017

Written by R.W. Baird analyst David J. Manthey, CFA 9/8/17



Key Takeaway:

The seasonally adjusted FDI for August 2017 was 62.7 – accelerating from July’s 55.1 reading and remaining well in expansionary territory. Selling conditions improved m/m, with the seasonally adjusted sales index coming in at 77.1 vs. July’s 69.8. Qualitative commentary on market conditions was universally positive as several respondents noted a recovery across all end markets, as well as tailwinds from higher pricing. The FDI Forward-Looking Indicator also remains well in expansionary territory, registering a seasonally adjusted 59.9, but decelerating modestly vs. last month (July 62.9).

Key Points:

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American 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, 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)**.

August FDI up nicely vs. July. The seasonally adjusted August FDI (62.7) accelerated from July’s 55.1 reading, driven mainly by improved sales trends. In the August survey, 70% of respondents indicated sales were “better” relative to seasonal expectations, well above July levels (47%). Relative to historical seasonal readings in the month of August, this month’s seasonally adjusted sales index of 77.1 suggests selling conditions remain very healthy overall. Pricing was again a solid tailwind for the second consecutive month as 61% of distributors saw higher prices y/y. This resulted in an FDI pricing index of 78.8 – the highest reading in over two years. As it relates to customer inventories, most respondents continue to view inventory levels as relatively in line with expectations (79% of responses), while 21% indicated inventory levels are too low. This compares to July results of 70% and 30%, respectively.

FDI Forwarding-Looking Indicator remains solidly in growth mode. The FDI Forward-Looking Indicator 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. August’s seasonally adjusted Forward-Looking Indicator ticked down modestly to 59.9 vs. 62.9 in July. The Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 60.9 year-to-date in 2017. Given solidly expansionary FDI and FLI readings, market conditions appear likely to remain in growth mode in the coming months.

Manufacturing employment ticks up. Consistent with improved sales momentum, hiring sentiment also picked up slightly m/m. 30% of respondents indicated employment was higher in August relative to seasonal expectations vs. 17% in July, while 64% saw hiring levels as in line with seasonal expectations (vs. 73% in July). This resulted in an FDI Employment Index reading of 62.1, up vs. July's 53.3 reading and continuing a pattern of strong YTD results (61.8 average YTD vs. 48.9 in 2016). The August US jobs report, meanwhile, came in slightly below expectations, but nicely positive (+156,000 adds vs. +180,000 consensus). Manufacturing employment, however, saw a nice m/m gain at +36,000 jobs. Average hours per work week for manufacturing employees was down slightly at 40.7 hours (vs. 40.9 in July).

August sentiment bullish. Survey commentary on current market conditions was universally positive this month vs. more mixed commentary in July. Several respondents noted improving end-market conditions driving strong top-line growth. One distributor said, "Recovery in all sectors of our business is improving," while highlighting mining as particularly strong. Another respondent indicated a significant uptick in demand is already being seen from disaster recovery efforts: "Hurricane Harvey is creating a lot of business!" As previously mentioned, pricing was also a solid tailwind this quarter. One respondent commented on this, saying "Pricing is up sharply from overseas. So are lead times. Quote replies [are] also taking longer. Obviously, business is up." Lastly, the outlook for the remainder of the year remains positive, with 45% of respondents expecting higher activity levels over the next six months vs. today, though this is down slightly vs. July (57%).

Fastenal reported August daily sales growth of +12.8% y/y, nicely ahead of our +11.0% estimate and reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was +11.3%, the third consecutive month of double-digit growth. Additionally, Hurricane Harvey disruption was an estimated 40-50bps headwind in the month. Fasteners saw strong growth at +12.2% y/y (up vs. 11.3% last month), including the recent Mansco acquisition (+8.4% ex-Mansco). Based on FDI data and other research inputs, we continue to expect a substantial uptick in growth among the public industrial distributors this year, with Fastenal daily sales growth expected to average double-digit y/y growth rates for the remainder of 2017.

FAST Risk Synopsis

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 Risk Synopsis

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

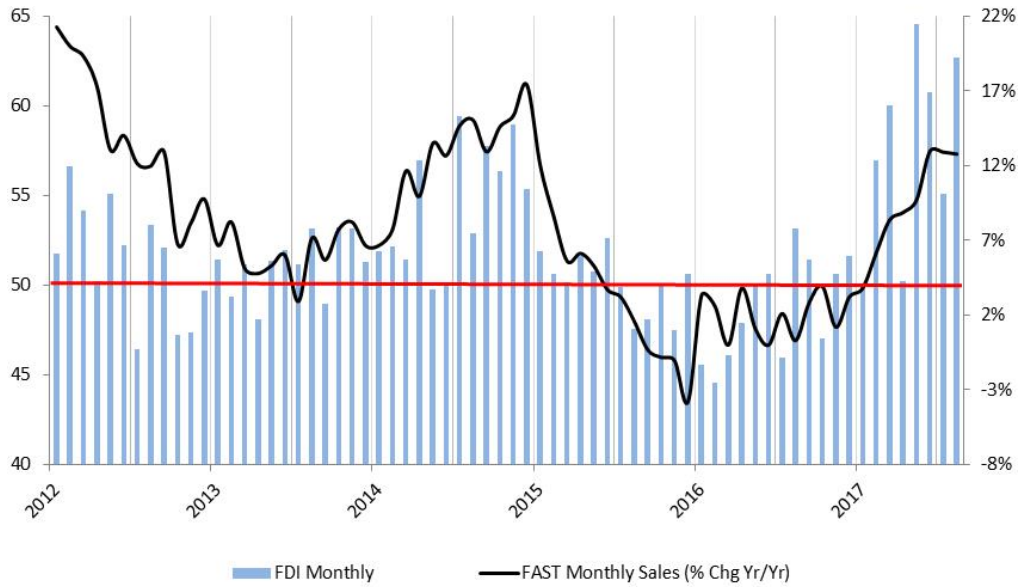
Fastener Distribution Trends: August 2017

FASTENER DISTRIBUTION AT A GLANCE									
August 2017									
	----- Index Values -----							Direction	Rate of Change
	Aug	Jul	Jun	May	Apr	Mar	Feb		
PMI (Manufacturing Sector)	58.8	56.3	57.8	54.9	54.8	57.2	57.7	Growing	Faster
FDI (Fastener Sector)	61.0	52.9	60.5	66.3	53.7	61.3	55.4	Growing	Faster
FDI (Seasonally Adjusted)	62.7	55.1	60.8	64.6	50.2	60.0	57.0	Growing	Faster
Sales (SA)	77.1	69.8	86.6	79.6	43.8	74.6	62.7	Growing	Faster
Forward- Looking (SA)	59.9	62.9	64.0	63.3	58.9	57.4	61.0	Growing	Slower
(Other Metrics; NSA)									
Employment	62.1	53.3	68.0	73.6	57.4	59.8	62.9	Growing	Faster
Supplier Deliveries	65.2	65.0	64.0	72.2	66.2	61.0	61.4	Growing	Faster
Respondent Inventories	62.1	51.7	52.0	58.3	52.9	61.0	58.6	Growing	Faster
Customer Inventories	39.4	35.0	32.0	36.1	38.2	43.9	40.0	Declining	Slower
Pricing, month-to-month	72.7	65.0	52.0	59.7	60.3	63.4	60.0	Higher	Faster
Pricing, year-to-year	78.8	76.7	66.0	75.0	73.5	72.0	70.0	Higher	Faster
6-Month Outlook - August				Higher 45%	Same 45%	Lower 9%			

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.

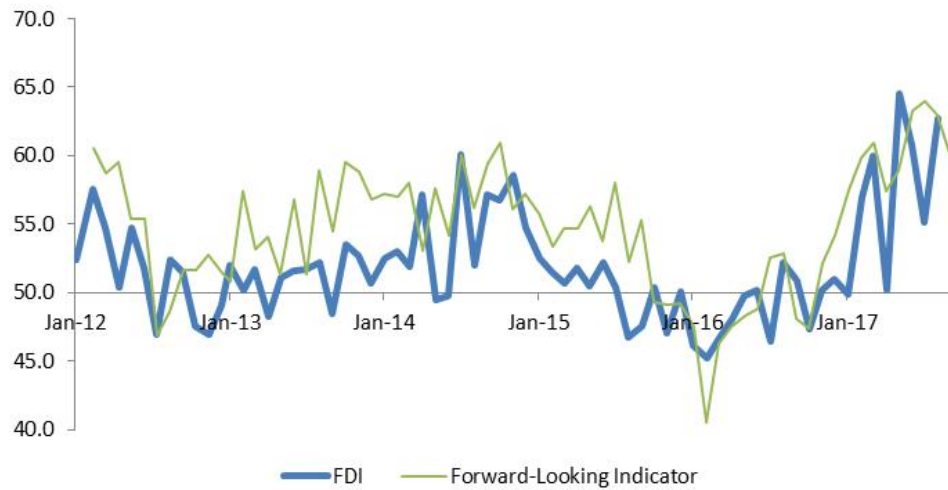
Source: Robert W. Baird & Co., [FCH Sourcing Network](#), Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

FDI vs. Forward-Looking Indicator (Seasonally Adjusted)



Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

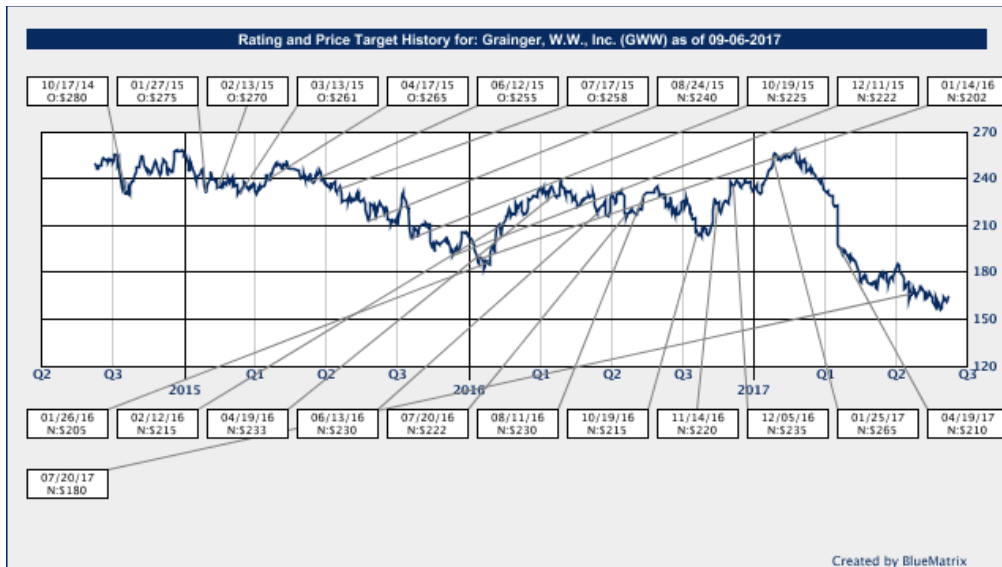
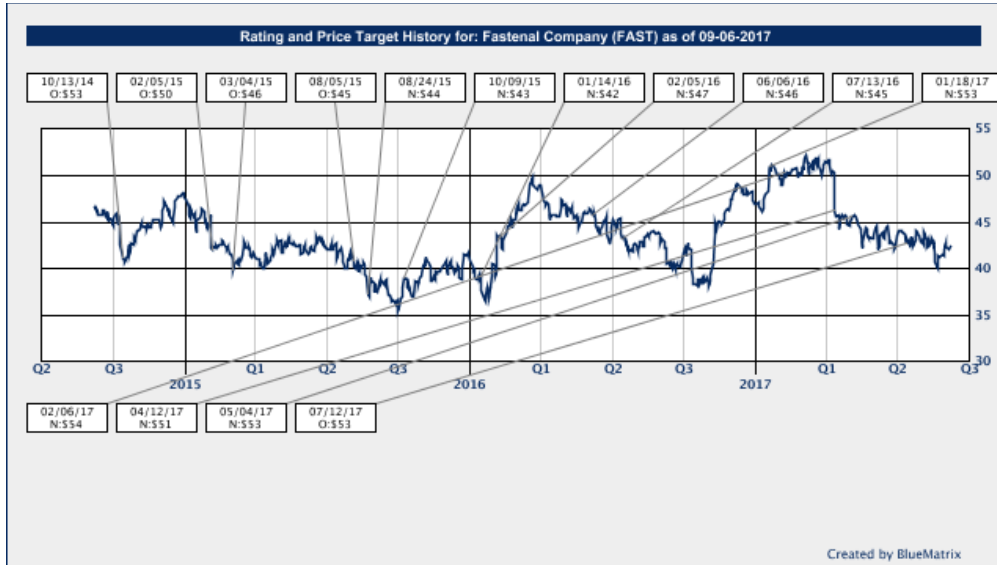
All stock prices below are as of 9/7/2017.

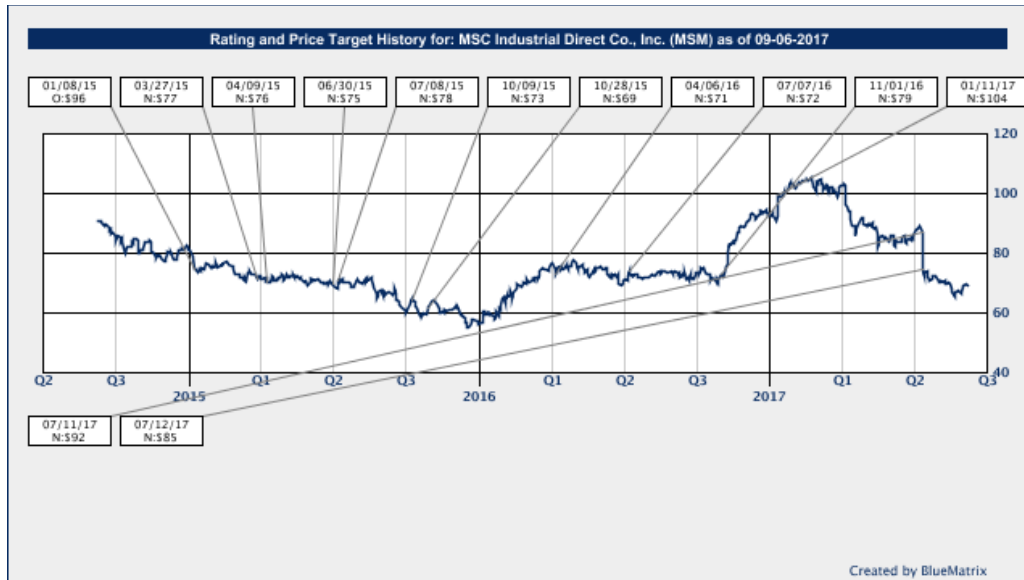
Fastenal Company (FAST- \$41.87)

W.W. Grainger Inc. (GWW- \$161.62)

MSC Industrial Direct Co. Inc (MSM- \$68.03)

(See recent research reports for more information)





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