

Fastener Distributor Index – September 2017

Written by R.W. Baird analyst David J. Manthey, CFA 10/16/17



Key Takeaway:

The seasonally adjusted FDI for September 2017 was 61.5 – down just slightly vs. August’s 62.7 reading and remaining well in expansionary territory overall. Selling conditions stayed strong as the seasonally adjusted sales index came in at 77.3, which was essentially unchanged m/m (77.1 in August). Qualitative commentary on market conditions was mostly positive as several respondents noted strong demand and generally favorable end-market conditions. The FDI Forward-Looking Indicator also remains very positive, registering a seasonally adjusted record of 66.9, up nicely vs. last month (August 59.9) and marking a YTD high.

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)**.

September FDI stays strong. The seasonally adjusted September FDI (61.5) was relatively stable m/m (August 62.7), with sales trends remaining very strong. In the September survey, 57% of respondents indicated sales were “better” relative to seasonal expectations, moderating vs. August levels of 70% but still well above 2016 average levels (31%). Relative to historical seasonal readings in the month of September, this month’s seasonally adjusted sales index of 77.3 suggests selling conditions remain very healthy overall. Pricing was again a solid tailwind for the third consecutive month as 71% of distributors saw prices rise y/y. This produced an FDI y/y pricing index of 83.9 – surpassing last month’s 78.8 reading and reaching levels not seen in over two years. As it relates to customer inventories, a majority of respondents continue to view inventory levels as relatively in line with expectations (54% of responses), while 36% see inventory levels as too low. This compares to August results of 79% and 21%, respectively.

FDI Forward-Looking Indicator accelerates. 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. September’s seasonally adjusted Forward-Looking Indicator accelerated nicely to 66.9 vs. 59.9 in August, marking a YTD high. The Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 61.6 year-to-date in 2017. Given solidly expansionary FDI and Forward-Looking Indicator readings, market conditions appear likely to remain in growth mode in the coming months.

Manufacturing employment a bit weaker m/m. Hiring sentiment decelerated slightly among survey respondents this month. 25% of respondents indicated employment was higher in September relative to seasonal expectations vs. 30% in August, while 64% saw hiring levels as in line with seasonal expectations (similar m/m). This resulted in an FDI Employment Index reading of 57.1, down slightly vs. August's 62.1 reading. Of note, hiring for several respondents may have been placed on hold amid last month's hurricanes as at least one respondent indicated operations were disrupted for several days due to the recent storms. Consistent with this, the September US jobs report came in below expectations with a net loss of 33,000 jobs (vs. +90,000 consensus expectations), with the decline largely attributed to hurricane-related disruptions. Manufacturing employment was down just modestly m/m (-1,000 jobs). Average hours per work week for manufacturing employees was unchanged at 40.7 hours.

September sentiment bullish. Survey commentary on current market conditions was again mostly positive this month. Demand remains generally quite healthy with one distributor indicating, "Demand is outpacing supply," and another saying, "Sales this year in September were better... [y/y] by 12%." Continuing recent trends, end-market conditions are also seen as generally favorable and improving – setting up for a solid end to the year and into 2018. As one respondent put it, "Mining in the US and globally is increasing. Housing... is also growing nicely. Going to be a good 2018." Although hurricane-related disruption likely led to some lost selling days for some respondents, this is seen as only a temporary headwind as the outlook generally remains solid: "We were affected by one of the hurricanes... Backlog is up, though, so we are pushing out the work!" As previously mentioned, pricing was again a solid tailwind this quarter with one respondent noting "material costs [are] rising." Lastly, the outlook over the next six months remains overall very positive, with 64% of respondents expecting higher activity levels over the next six months vs. today, up solidly vs. August (45%). In addition, zero respondents anticipate lower activity levels over the next six months – the first time since late 2013 and just the second time in survey history that has occurred.

Fastenal reported September daily sales growth of +15.3% y/y, nicely ahead of our +13.0% estimate and reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was +13.5%, the fourth consecutive month of double-digit growth. Additionally, Hurricane-related disruption was an estimated 40-50bps headwind in the month. Fasteners saw strong growth at +13.0% y/y (up vs. 12.2% last month), including the recent Mansco acquisition (+9.4% ex-Mansco). Based on FDI data and other research inputs, we expect a continued 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

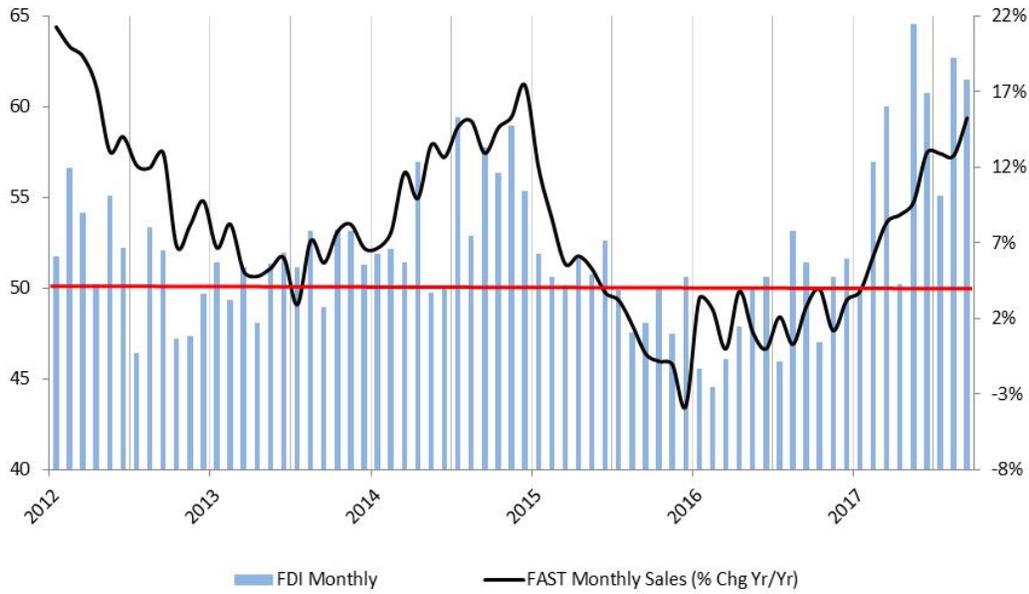
Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Fastener Distribution Trends: September 2017

FASTENER DISTRIBUTION AT A GLANCE									
September 2017									
	----- Index Values -----							Directbn	Rate of Change
	Sep	Aug	Jul	Jun	May	Apr	Mar		
PMI (Manufacturing Sector)	60.8	58.8	56.3	57.8	54.9	54.8	57.2	Growing	Faster
FDI (Fastener Sector)	57.6	61.0	52.9	60.5	66.3	53.7	61.3	Growing	Slower
FDI (Seasonally Adjusted)	61.5	62.7	55.1	60.8	64.6	50.2	60.0	Growing	Slower
Sales (SA)	77.3	77.1	69.8	86.6	79.6	43.8	74.6	Growing	Faster
Forward- Looking (SA)	66.9	59.9	62.9	64.0	63.3	58.9	57.4	Growing	Faster
(Other Metrics; NSA)									
Employment	57.1	62.1	53.3	68.0	73.6	57.4	59.8	Growing	Slower
Supplier Deliveries	69.6	65.2	65.0	64.0	72.2	66.2	61.0	Growing	Faster
Respondent Inventories	48.2	62.1	51.7	52.0	58.3	52.9	61.0	Declining	Faster
Customer Inventories	37.5	39.4	35.0	32.0	36.1	38.2	43.9	Declining	Faster
Pricing, month-to-month	73.2	72.7	65.0	52.0	59.7	60.3	63.4	Higher	Faster
Pricing, year-to-year	83.9	78.8	76.7	66.0	75.0	73.5	72.0	Higher	Faster
6-Month Outlook - September			<u>Higher</u>	<u>Same</u>	<u>Lower</u>				
			64%	36%	0%				
<p><i>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.</i></p>									

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

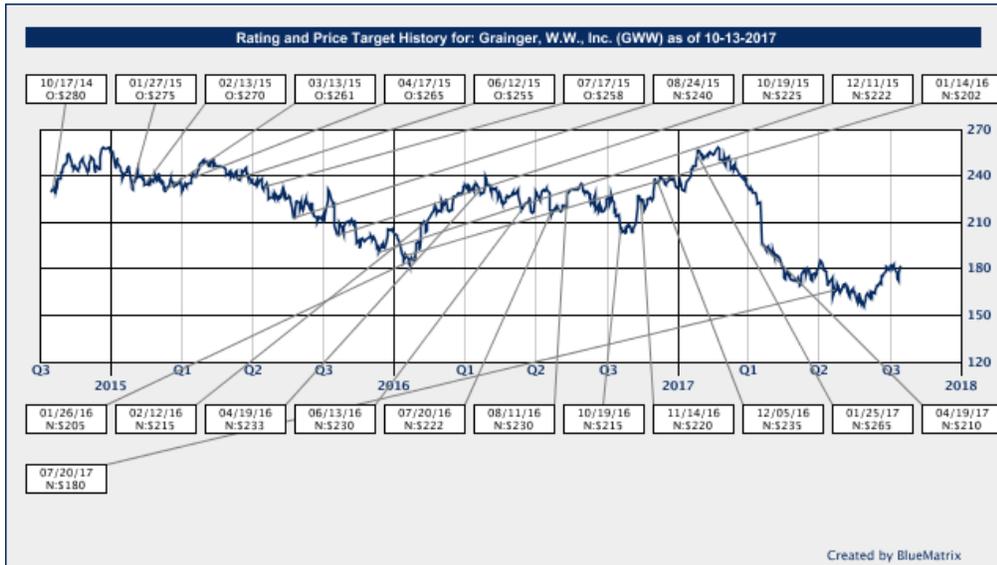
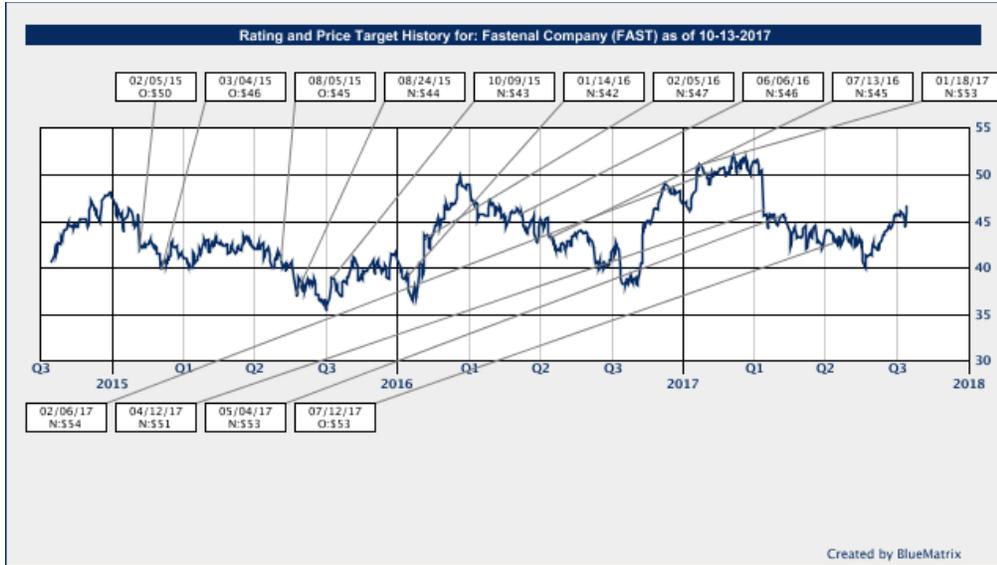
All stock prices below are as of 10/13/2017.

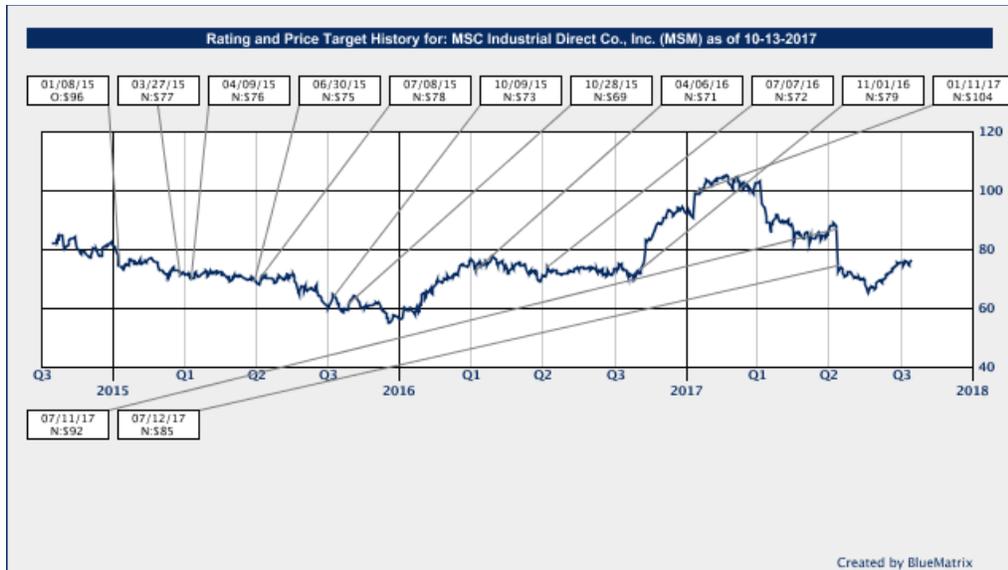
Fastenal Company (FAST- \$46.58)

W.W. Grainger Inc. (GWW- \$181.05)

MSC Industrial Direct Co. Inc (MSM- \$76.27)

(See recent research reports for more information)





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