

## Fastener Distributor Index – December 2018

Written by R.W. Baird analyst David J. Manthey, CFA 1/7/19



### Key Takeaway:

The seasonally-adjusted FDI for December was 56.5, retreating slightly for the second consecutive month (November 58.2). Selling conditions improved modestly, however, off of weaker November trends, as the seasonally adjusted sales index registered a 58.1 reading (vs. November 51.8). Respondent commentary on the 2019 outlook remained relatively evenly split between bulls and bears, with the six-month outlook level essentially unchanged m/m. The Forward-Looking Indicator rebounded some at 54.1, improving vs. a two-year low of 52.5 in last month's survey, albeit still solidly below average levels over the last two years (59.8).

### Fastener Distribution Trends: December 2018

<b>FASTENER DISTRIBUTION AT A GLANCE</b>										
<b>December 2018</b>										
	----- Index Values -----									
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Directbn	Rate of Change
PMI (Manufacturing Sector)	54.1	59.3	57.7	59.8	61.3	58.1	60.2	58.7	Growing	Slower
FDI (Fastener Sector)	55.6	56.9	62.0	52.8	61.7	65.8	62.5	59.4	Growing	Slower
<b>FDI (Seasonally Adjusted)</b>	<b>56.5</b>	<b>58.2</b>	<b>62.2</b>	<b>55.8</b>	<b>62.5</b>	<b>69.2</b>	<b>62.3</b>	<b>56.6</b>	Growing	Slower
Sales (SA)	58.1	51.8	73.4	46.5	74.7	89.6	74.2	61.2	Growing	Faster
Forward- Looking (SA)	54.1	52.5	57.0	54.7	63.4	60.1	62.0	58.8	Growing	Faster
<b>(Other Metrics; NSA)</b>										
Employment	66.1	64.5	67.3	61.1	67.2	64.7	68.5	60.7	Growing	Faster
Supplier Deliveries	59.7	69.7	61.5	63.0	70.3	83.8	77.8	73.2	Growing	Slower
Respondent Inventories	62.9	64.5	57.7	59.3	59.4	55.9	50.0	57.1	Growing	Slower
Customer Inventories	43.5	47.4	40.4	46.3	32.8	39.7	33.3	37.5	Declining	Faster
Pricing month-to-month	71.0	76.3	75.0	70.4	76.6	82.4	83.3	75.0	Growing	Slower
Pricing year-to-year	91.9	90.8	88.5	92.6	92.2	89.7	90.7	87.5	Growing	Faster
			Higher			Same				
6-Month Outlook - December			35%			48%			16%	
<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>										

Source: Baird, FCH Sourcing Network, Institute for Supply Management

**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 Distributor 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)**.

#### **Key Points:**

**FDI retreats slightly again in December.** The seasonally adjusted December FDI (56.5) ticked down vs. November's 58.2 reading, consistent with a deceleration in the FLI last month to the lowest reading recorded in two years. Sales trends did improve some sequentially, however, with 42% of respondents indicating sales were "better" relative to seasonal expectations vs. just 34% of respondents last month. Nevertheless, this was still noticeably below the average number of respondents who indicated sales were better than expected this year (55%). The resulting seasonally-adjusted sales index was 58.1 as compared to 51.8 in November. Pricing continues to aid top-line trends, with 84% seeing pricing gains y/y (unchanged vs. November). The resulting FDI pricing index of 91.8 was relatively consistent m/m. Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (74% of responses), while 19% believe customers' inventories are too low. This compares to 84% in line and 11% too low last month.

**December FLI rebounds off of two-year low.** The seasonally adjusted FLI increased m/m coming in at 54.1 vs. November's two-year low of 52.5. This reflected modest gains across all four FLI components (employment, respondent inventories, customer inventories, and the six-month outlook). While the December FLI recovered some m/m, the 54.1 reading remains well below the two-year average FLI reading of 59.8. As such, while the FLI suggests market conditions are likely to remain in growth mode, we continue to believe stabilization or further moderation from here remains more likely than acceleration.

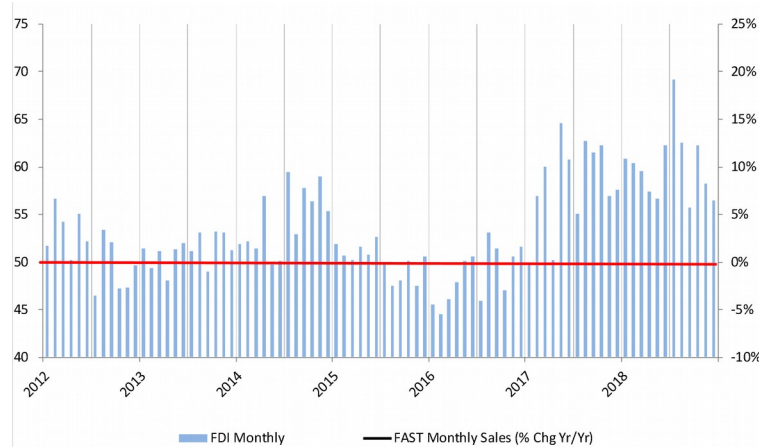
**Manufacturing employment picks up.** Hiring sentiment was a touch more bullish among survey respondents this month. 32% of respondents saw higher employment levels in December relative to seasonal expectations vs. 29% in November, while 68% saw employment as in line (November 71%). The resulting FDI Employment Index was 66.1 vs. 64.5 last month. More broadly, the US jobs report was significantly better than expected with 312,000 jobs added (~176,000 expected). The unemployment rate rose 0.2% to 3.9% as a result of a higher labor force participation rate. December's largest gains were in healthcare, food services and drinking places, construction, manufacturing, and retail trade. Manufacturing employment continued to trend upward (+32,000 jobs in December), with increases in durable goods, fabricated metal products, and computer and electronic products. Total manufacturing jobs added in 2018 was 284,000, increasing vs. the 207,000 added last year. Average hours per work week for manufacturing employees increased by 0.1 hours to 40.9 hours.

**Respondent commentary mixed.** Qualitative commentary was roughly evenly split between bulls and bears this month, as some characterized December trends as better than or in line with expectations, while others focused on signs that additional slowing may be in store in 2019. For example, one respondent commented, "Sales were down for December and our backlog is now down too, but I expect that to be a temporary seasonal situation based on the unaffected number of RFQ's flowing through our hands." Another participant said, "December was down from November but that's typical for that time

of year... Expecting great things for 2019.” Others were less optimistic, saying “Mixed signals out there seems to [indicate] slow growth for 2019,” and “I think the first quarter will closely match last year, then be down y/y for each month the rest of the year.” The six-month outlook continues to point to stable to higher activity levels anticipated by fastener distributors over the next six months, with 35% of respondents expecting higher activity levels, 48% expecting similar activity, and just 16% 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%.

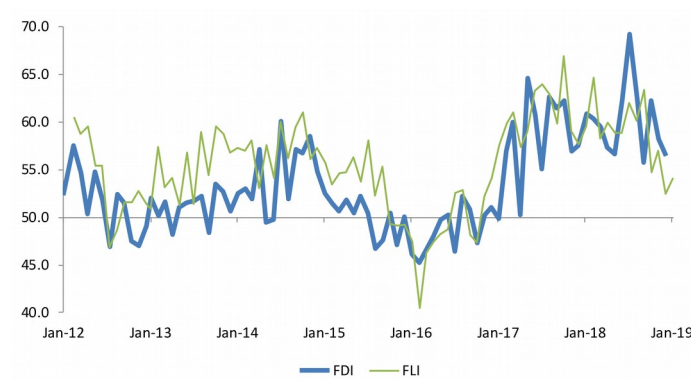
**Fastenal** reported 12.3% November daily sales growth, which was modestly above our +12.0% estimate, but reflecting sequential daily sales growth just slightly below average historical m/m trends. Underlying “core” growth (excluding foreign exchange) of 12.7% was equal to October, and represented the 18<sup>th</sup> straight month of double-digit growth. Fastener growth was up slightly m/m at +10.4% y/y (+10.1% in October). December daily sales growth will be reported with 4Q18 earnings on 1/17/19. Based on FDI data and other research inputs, we largely expect continued solid top-line trends across public industrial distributors in 2019, with Fastenal y/y daily sales growth expected to remain in or near the double digits.

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



Source: Baird, FCH Sourcing Network, Company reports

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



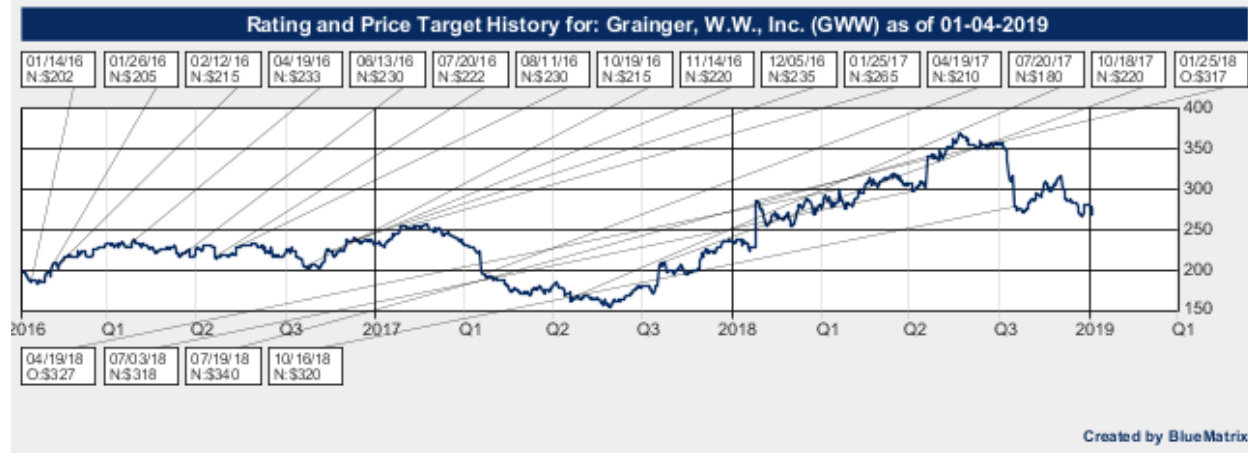
Source: Baird, FCH Sourcing Network

## Appendix – Important Disclosures and Analyst Certification

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All stock prices below are as of 1/7/2019.

Fastenal Company (FAST-\$52.29-Neutral)  
 W.W. Grainger Inc. (GWW-\$278.91-Neutral)  
 MSC Industrial Direct Co. Inc (MSM-\$77.21-Neutral)  
 (See recent research reports for more information)



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