

Fastener Distributor Index – January 2019

Written by R.W. Baird analyst David J. Manthey, CFA 2/7/19



Key Takeaway:

The seasonally-adjusted FDI for January was **56.5**, unchanged with December’s reading. Selling conditions improved modestly for the second straight month with the seasonally-adjusted sales index coming in at 62.2 (vs. December 58.1). The tone of respondent commentary was a bit more positive, with the overall tone around 2019 cautiously optimistic. Although the six-month outlook was steady, the Forward-Looking Indicator decelerated and dipped into slightly contractionary levels at **49.8** – the first sub-50 reading since September 2016.

Fastener Distribution Trends: January 2019

FASTENER DISTRIBUTION AT A GLANCE										
January 2019										
	----- Index Values -----									
	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	Direction	Rate of Change
PMI (Manufacturing Sector)	56.6	54.1	59.3	57.7	59.8	61.3	58.1	60.2	Growing	Faster
FDI (Fastener Sector)	60.2	55.6	56.9	62.0	52.8	61.7	65.8	62.5	Growing	Faster
FDI (Seasonally Adjusted)	56.5	56.5	58.2	62.2	55.8	62.5	69.2	62.3	Growing	Faster
Sales (SA)	62.2	58.1	51.8	73.4	46.5	74.7	89.6	74.2	Growing	Faster
Forward- Looking (SA)	49.8	54.1	52.5	57.0	54.7	63.4	60.1	62.0	Declining	Faster
(Other Metrics; NSA)										
Employment	57.4	66.1	64.5	67.3	61.1	67.2	64.7	68.5	Growing	Slower
Supplier Deliveries	61.1	59.7	69.7	61.5	63.0	70.3	83.8	77.8	Growing	Faster
Respondent Inventories	70.4	62.9	64.5	57.7	59.3	59.4	55.9	50.0	Growing	Faster
Customer Inventories	44.4	43.5	47.4	40.4	46.3	32.8	39.7	33.3	Declining	Slower
Pricing, month-to-month	59.3	71.0	76.3	75.0	70.4	76.6	82.4	83.3	Growing	Slower
Pricing, year-to-year	83.3	91.9	90.8	88.5	92.6	92.2	89.7	90.7	Growing	Slower
6-Month Outlook - January				Higher	Same	Lower				
				41%	37%	22%				
<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 steady in January. The seasonally-adjusted January FDI (56.5) was unchanged m/m and the seasonally-adjusted sales index improved modestly to 62.2 as compared to 58.1 in December. Although still higher y/y for a majority of respondents, the pricing index moderated m/m and y/y. Customer inventory levels were in line with expectations and consistent with December levels. Interestingly, respondents indicating inventory levels were “too high” was the highest since September 2016, which was also a key factor driving FLI sub-50 (more on this below).

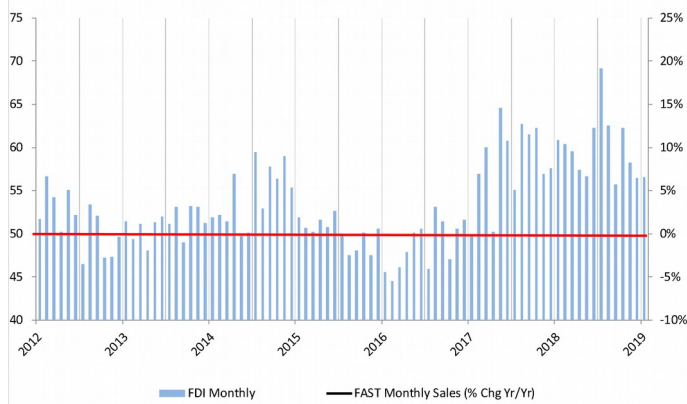
January FLI dips into contractionary territory. The seasonally-adjusted FLI decreased m/m (49.8 vs. December 54.1) into contractionary territory. This represents the first contractionary reading for the index since September 2016. The deceleration in this month’s FLI was driven by a weaker employment reading and slightly higher inventory levels among respondents, as previously mentioned. With this month’s FLI the first sub-50 reading in over two years (but very close to a neutral 50.0 reading), we are hesitant to call for an imminent downturn and still expect growth in 2019. That being said, we believe stabilization or further moderation in the rate of growth remains more likely than acceleration from here.

Hiring sentiment a bit weaker among respondents. Hiring sentiment was lower among survey respondents this month with employment levels characterized as in line or lower than seasonal expectations. The resulting FDI Employment Index moderated m/m. Conversely, the January US jobs report was significantly better than expected with 304,000 jobs added (~180,000 expected). The unemployment rate rose to 4.0% (+0.1%) in part reflecting the partial government shutdown. January’s largest gains were in leisure and hospitality, construction, health care, and transportation and warehousing. Manufacturing employment continued to trend upward (+13,000 jobs), with increases in durable goods (+20,000) partially offset by declines in non-durable goods (-7,000). Average hours per work week for manufacturing employees decreased to 40.8 hours (-0.1 m/m).

Respondent commentary a bit more favorable. Qualitative commentary skewed more positive than negative this month. Several respondents expressed cautious optimism for a potential resolution to the US-China trade dispute saying, “Stay tuned. China and the USA will soon be playing nice again.” Pending any resolution, however, tariffs have continued to have an impact on lead times and pricing; as one respondent summarized, “Tariffs from China are affecting increased costs and an influx of incoming material is delaying shipment at the ports!” Macroeconomic uncertainty appears to be leading to a cautiously optimistic (but uncertain) outlook for 2019. One respondent indicated, “Even though we have seen a slight downtrend, I am confident that positive fundamentals are still in place for now.” Another commented, “Uncertain about looking too far ahead. Economists forecast a less robust growth year, however, January was better than anticipated.” The six-month outlook points to stable to higher activity levels anticipated by fastener distributors over the next six months, with 41% of respondents expecting higher activity levels, 37% expecting similar activity, and 22% 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%.

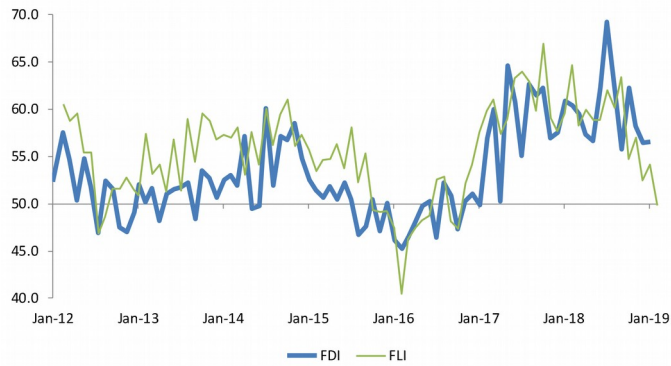
Fastenal reported 13.3% January daily sales growth, which was slightly below our +13.6% estimate due to FX. Underlying organic growth of +14.0% matched our estimate despite a 1% weather headwind and was the 20th straight month of double-digit growth. Fastener growth was up m/m at +13.3% y/y (+13.1% in December). Based on FDI data and other research inputs, we largely expect continued solid top-line trends across public industrial distributors in 2019, although we do expect moderation in volume growth at Fastenal, partially offset by higher pricing.

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

Risk Synopsis

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

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 2/5/2019.

Fastenal Company (FAST-\$61.62-Neutral)
 W.W. Grainger Inc. (GWW-\$299.99-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$83.87-Neutral)
 (See recent research reports for more information)



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