

## Fastener Distributor Index – April 2017

Written by R.W. Baird analyst David J. Manthey, CFA 5/5/17



### Key Takeaway:

The seasonally-adjusted FDI for April 2017 was 50.2, remaining in expansionary territory but declining materially from March's record-high 60.0 reading. April's result was consistent with a slight down-tick in last month's Forward-Looking Indicator, which foreshadowed a weaker FDI this month. Recent sales momentum slipped in April, with the seasonally-adjusted sales index coming in at 43.8 (the lowest result since October 2016). Commentary on market conditions indicates growth remains solid, though perhaps slightly below heightened expectations. The six-month outlook remains favorable, with several distributors noting strong backlogs and customer activity starting to pick up. Forward indicators are also positive, with the FDI Forward-Looking Indicator registering a seasonally-adjusted 58.9 – down from a peak 61.0 in February, but a slight uptick vs. 57.4 last month.

### 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, figures above 50 signal strength, while readings below 50 signal weakness. Over time, results should be directly relevant to **Fastenal (FAST)** and broadly relevant to other industrial distributors (**W.W. Grainger [GWW]**, **MSC Industrial [MSM]**).

**April FDI ticks down.** The seasonally adjusted April FDI (50.2) decreased from March's record-high 60.0 reading, consistent with March's less bullish Forward-Looking Indicator. Top-line sentiment was notably less positive than March and YTD results, with 32% of distributors indicating sales were better relative to seasonal expectations in April vs. the March level of 68% and YTD average of 58%. This resulted in a seasonally-adjusted sales index of just 43.8, representing the lowest result seen since October 2016. Respondents continue to indicate customer inventory levels are roughly in line with expectations, as only 6% of respondents indicated inventories are too high, while 29% indicated inventories are too low. This compares to March results of 10% and 22%, respectively.

**FDI Forwarding-Looking Indicator ticks back up.** 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. April's seasonally-adjusted Forward-Looking Indicator had a value of 58.9 vs. 57.4 in March. The Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 59.3 year-to-date in 2017. Based on an expansionary Forward-Looking Indicator, significant reset in the April FDI, and still mostly supportive end markets, we would not be surprised to see a moderate rebound in the FDI next month.

**Manufacturing employment outlook ticks down slightly.** Survey respondents indicated a slight deceleration in hiring vs. March, with 21% of respondents indicating hiring picked up in April (vs. 24% in March, 29% in February, and 21% in January). Nevertheless, April represents the fifth consecutive month of above-50 readings for the FDI employment index following four consecutive sub-50 readings – suggesting employment has stabilized/improved of late. March’s US jobs report, meanwhile, came in below expectations (+98,000 adds vs. +180,000 consensus), though domestic manufacturing employment saw a slight gain (+11,000 jobs added vs. February, *US BLS*). The average workweek for manufacturing employees edged down slightly m/m at 40.6 hours.

**April sentiment mostly positive.** Commentary on current market conditions was again mostly positive, with various distributors noting strong backlog and customer trends. One respondent commented, “Our backlog doubled in April. It was a good month for us;” while another indicated “most of our customers say they have a lot of jobs on the board and that it is going to get very busy.” Consistent with a slight deceleration in the FDI reading, April results were mostly characterized as solid, though perhaps falling short of heightened expectations following a very strong March. One distributor indicated, “I rated the activity the same as the previous month, but it is still considerable growth over last year,” while another noted a deceleration near the end of the month. Overall, optimism continues despite April growth that largely fell short of heightened expectations following an exceptionally strong March.

**Fastenal** reported slightly lower-than-expected April daily sales growth of 8.9% y/y, reflecting growth in all end markets/product lines. Stripping out acquisitions, foreign exchange, and days issues, underlying “core” growth was closer to 9.5% -- accelerating vs. comparable growth of approximately 6% and 7% in February and March, respectively. Fastener growth was up a solid 6% y/y, including the recent Mansco acquisition. This report exceeded expectations and represents strong accelerating trends – a divergence from the April FDI. Based on FDI data and other inputs, we have been expecting a substantial uptick in growth among the public industrial distributors this year, with Fastenal daily sales growth now expected to average double-digit growth rates for the remainder of 2017.

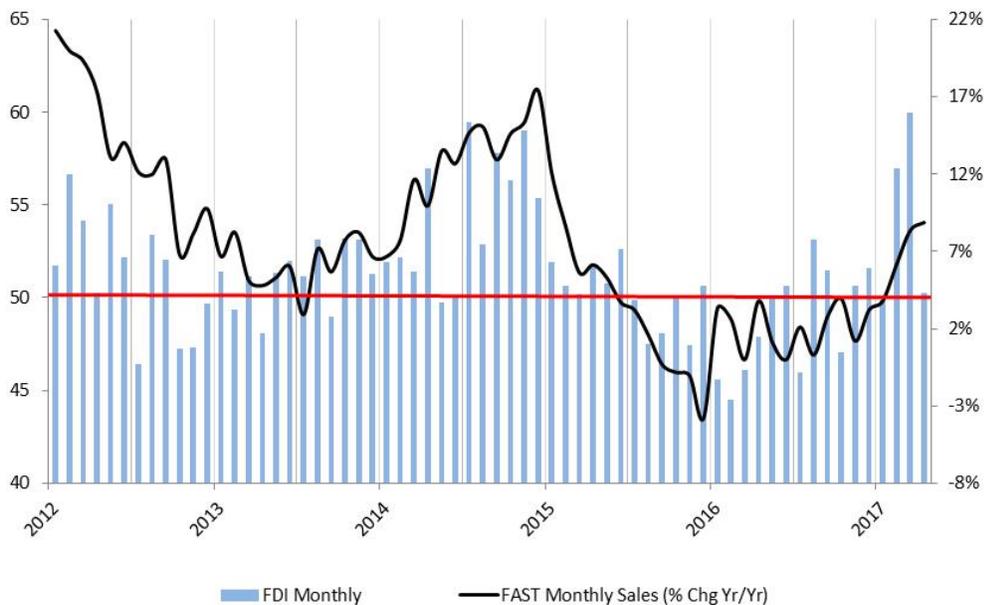
### Fastener Distribution Trends: April 2017

FASTENER DISTRIBUTION AT A GLANCE										
April 2017										
	----- Index Values -----							Apr.--> Mar.		
	April	Mar.	Feb.	Jan.	Dec.	Nov.	Oct.	Change	Direction	
PMI (Manufacturing Sector)	54.8	57.2	57.7	56.0	54.5	53.2	51.9	(2.4)	Growing	
FDI (Fastener Sector)	53.7	61.3	55.4	54.5	50.3	49.3	46.6	(7.6)	Growing	
<b>FDI (Seasonally Adjusted)</b>	<b>50.2</b>	<b>60.0</b>	<b>57.0</b>	<b>49.9</b>	<b>51.6</b>	<b>50.6</b>	<b>47.1</b>	<b>(9.8)</b>	<b>Growing</b>	
Sales (SA)	43.8	74.6	62.7	51.6	60.6	64.5	38.3	(30.8)	Growing	
Forward- Looking (SA)	58.9	57.4	61.0	59.8	57.6	54.2	52.2	1.6	Growing	
(Other Metrics; NSA)										
Employment	57.4	59.8	62.9	57.6	51.3	45.7	47.0	(2.4)	Growing	
Supplier Deliveries	66.2	61.0	61.4	56.1	56.4	55.7	54.5	5.2	Growing	
Respondent Inventories	52.9	61.0	58.6	59.1	59.0	65.7	63.6	(8.0)	Growing	
Customer Inventories	38.2	43.9	40.0	36.4	41.0	42.9	43.9	(5.7)	Declining	
Pricing, month-to-month	60.3	63.4	60.0	62.1	56.4	61.4	50.0	(3.1)	Higher	
Pricing, year-to-year	73.5	72.0	70.0	68.2	60.3	61.4	56.1	1.6	Higher	
6-Month Outlook - Apr					Higher	Same	Lower			
					59%	38%	3%			

*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.*

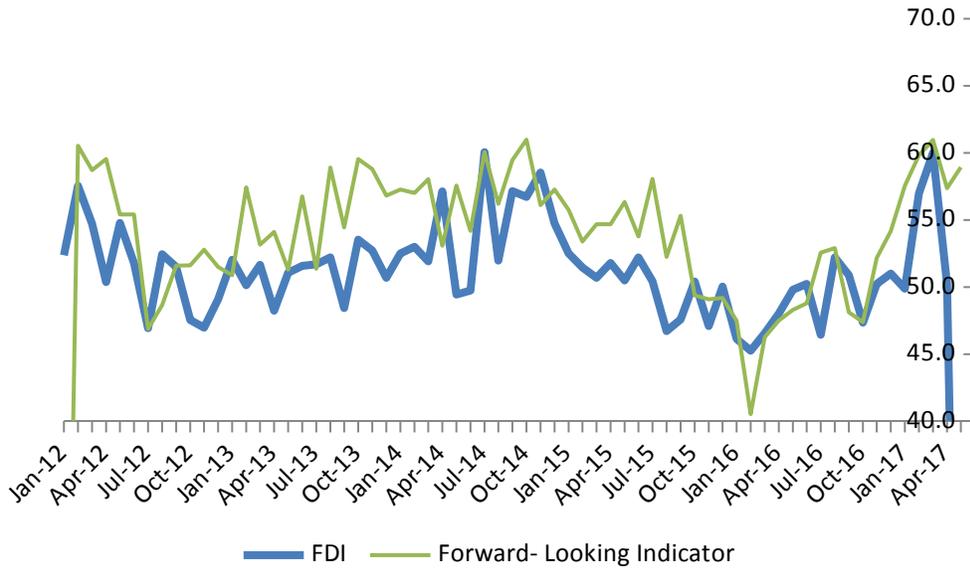
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

### 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

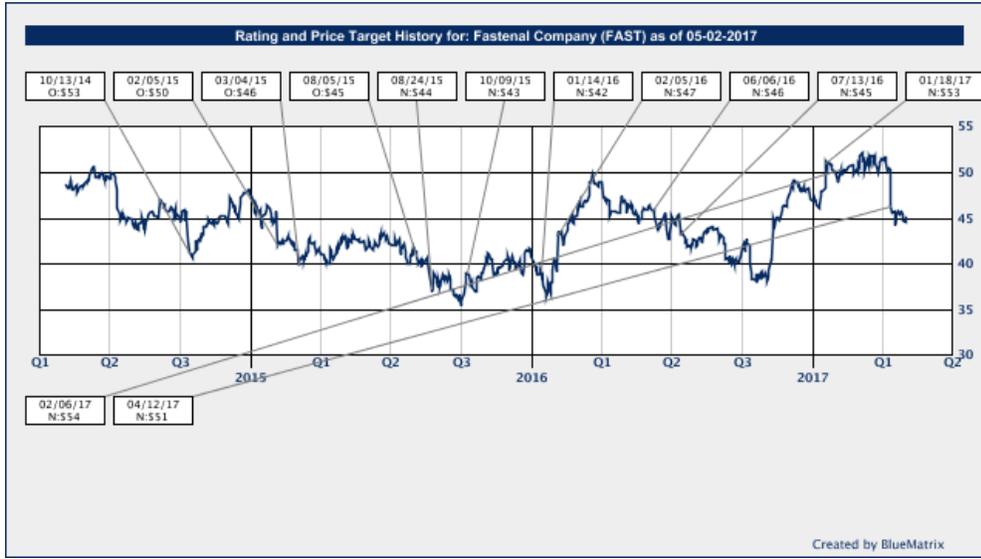
All stock prices below are the 5/3/17 closing price.

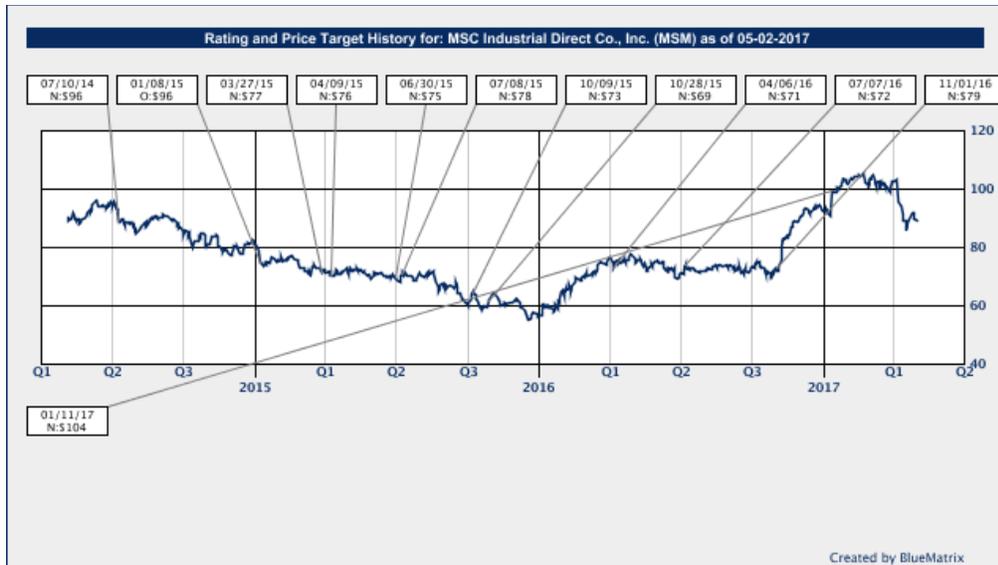
Fastenal Company (FAST- \$45.25)

WW Grainger Inc. (GWW- \$192.02)

MSC Industrial Direct Co. Inc (MSM- \$89.47)

(See recent research reports for more information)





Robert W. Baird & Co. Incorporated makes a market in the securities of FAST, GWW, and MSM.

Robert W. Baird & Co. Incorporated and/or its affiliates expect to receive or intend to seek investment-banking related compensation from the company or companies mentioned in this report within the next three months.

Robert W. Baird & Co. Incorporated may not be licensed to execute transactions in all foreign listed securities directly. Transactions in foreign listed securities may be prohibited for residents of the United States. Please contact a Baird representative for more information.

**Investment Ratings:** **Outperform (O)** - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months. **Neutral (N)** - Expected to perform in line with the broader U.S. equity market over the next 12 months. **Underperform (U)** - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

**Risk Ratings:** **L - Lower Risk** - Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings. **A - Average Risk** - Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. **H - Higher Risk** - Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. **S - Speculative Risk** - High-growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

**Valuation, Ratings and Risks.** The recommendation and price target contained within this report are based on a time horizon of 12 months but there is no guarantee the objective will be achieved within the specified time horizon. Price targets are determined by a subjective review of fundamental and/or quantitative factors of the issuer, its industry, and the security type. A variety of methods may be used to determine the value of a security including, but not limited to, discounted cash flow, earnings multiples, peer group comparisons, and sum of the parts. Overall market risk, interest rate risk, and general economic risks impact all securities. Specific information regarding the price target and recommendation is provided in the text of our most recent research report.

**Distribution of Investment Ratings.** As of April 28, 2017, Baird U.S. Equity Research covered 708 companies, with 53% rated Outperform/Buy, 46% rated Neutral/Hold and 1% rated Underperform/Sell. Within these rating categories, 10% of Outperform/Buy-rated, 5% of Neutral/Hold-rated and 9% of Underperform/Sell rated companies have compensated Baird for investment banking services in the past 12 months and/or Baird managed or co-managed a public offering of securities for these companies in the past 12 months.

**Analyst Compensation.** Analyst compensation is based on: 1) the correlation between the analyst's recommendations and stock price performance; 2) ratings and direct feedback from our investing clients, our

institutional and retail sales force (as applicable) and from independent rating services; 3) the analyst's productivity, including the quality of the analyst's research and the analyst's contribution to the growth and development of our overall research effort and 4) compliance with all of Robert W. Baird's internal policies and procedures. This compensation criteria and actual compensation is reviewed and approved on an annual basis by Baird's Research Oversight Committee.

Analyst compensation is derived from all revenue sources of the firm, including revenues from investment banking. Baird does not compensate research analysts based on specific investment banking transactions.

A complete listing of all companies covered by Baird U.S. Equity Research and applicable research disclosures can be accessed at <http://www.rwbaird.com/research-insights/research/coverage/research-disclosure.aspx>. You can also call 800-792-2473 or write: Robert W. Baird & Co., Equity Research, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.

### **Analyst Certification**

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

### **Disclaimers**

#### **Baird prohibits analysts from owning stock in companies they cover.**

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

#### **ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST**

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available.

Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

### **Copyright 2017 Robert W. Baird & Co. Incorporated**

### **Other Disclosures**

The information and rating included in this report represent the Analyst's long-term (12 month) view as described above. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst's understanding of the individual client's objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the analyst considers relevant to the client. As such, these perspectives and strategies may differ from the analyst's views contained in this report.

Robert W. Baird & Co. Incorporated and/or its affiliates (Baird) may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird's standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the Analyst's ratings and recommendations contained in more broadly disseminated standard research reports.

Baird Research Analysts may provide incremental data points or views regarding covered companies in the form of Research Posts and Flash Reports. All Posts and Flash Reports are available to clients via [www.BairdOnline.com](http://www.BairdOnline.com), but not all are sent directly to clients. Baird Associates may, at their discretion, choose whether to send these Posts and Flash Reports to Baird clients after they are posted online. Such decisions are based on, among other things, client interest, coverage, stock ownership and indicated email preferences. The incremental content and/or analysis contained in these pieces may be useful to investors as part of a broader

investment thesis, but is not sufficient to warrant a change in the Research Analyst's published opinion, including rating, estimates and price targets. Access to [www.BairdOnline.com](http://www.BairdOnline.com) is available to all Baird Clients. Contact your Baird representative if you would like access to [www.BairdOnline.com](http://www.BairdOnline.com).

**United Kingdom ("UK") disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited ("RWBL") holds an MiFID passport.**

The contents of this report may contain an "investment recommendation," as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. Please note, this report may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months which is available at <https://baird.bluematrix.com/sellside/MAR.action>.

This material is distributed in the UK and the European Economic Area ("EEA") by RWBL, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority ("FCA").

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. The views contained in this report (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated, and (ii) may differ from the views of another individual of Robert W. Baird Limited.

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated.

Robert W. Baird Group and or one of its affiliates may at any time have a long or short position in the company/companies mentioned in this report. Where the Group holds a long or short position exceeding 0.5% of the total issued share capital of the issuer, this will be disclosed separately by your RWBL representative upon request.

This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

Robert W. Baird & Co. Incorporated and RWBL have in place organizational and administrative arrangements for the disclosure and avoidance of conflicts of interest with respect to research recommendations. Robert W. Baird Group and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. An outline of the general approach taken by Robert W. Baird Limited in relation to conflicts of interest is available from your RWBL representative upon request. Baird's policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Analysts certify on a quarterly basis that such research reports accurately reflect their personal views.

This material is not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

RWBL is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.

**Dividend Yield.** As used in this report, the term "dividend yield" refers, on a percentage basis, to the historical distributions made by the issuer relative to its current market price. Such distributions are not guaranteed, may be modified at the issuer's discretion, may exceed operating cash flow, subsidized by borrowed funds or include a return of investment principal.

\*\*\*\*\*