

Fastener Distributor Index – Report #131 November 2022

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 12/7/22



Key Takeaway:

The November seasonally adjusted Fastener Distributor Index (FDI) rebounded sharply vs. last month, coming in at **54.9** (vs. October 44.3). This broke the streak of two consecutive sub-50 (contractionary) readings, indicating market conditions improved vs. last month. Consistent with this, demand commentary was a bit more positive than recent months. Additionally, supply chain constraints continued to ease, with noticeable improvement in ocean freight times commented on by multiple respondents. That said, the Forward-Looking Indicator (FLI) registered another sub-50 index value, reading **42.0**, suggesting the bounce in the FDI could prove to be short lived. Overall, fastener market conditions improved in November relative to October, although conditions clearly remain choppy/uncertain.

Fastener Distribution Trends: November 2022

FASTENER DISTRIBUTION AT A GLANCE											
November 2022											
	----- Index Values -----										
	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Direction	Rate of Change
ISM PMI (Manufacturing)	49.0	50.2	50.9	52.8	52.8	53.0	56.1	55.4	57.1	Declining	Faster
FDI	54.9	44.3	47.6	52.6	46.1	53.8	52.7	52.6	57.2	Growing	Faster
FLI	42.0	42.2	47.5	47.4	58.1	51.5	55.4	55.1	65.4	Declining	Faster
(Other Metrics)											
Sales	59.8	27.9	43.9	51.9	43.2	65.5	56.3	60.5	75.2	Growing	Faster
Employment	57.9	53.6	47.8	53.4	62.5	59.1	62.9	53.1	62.1	Growing	Faster
Supplier Deliveries	47.4	46.4	54.3	55.2	52.1	65.2	69.4	68.8	69.7	Declining	Slower
Respondent Inventories	72.4	69.6	58.7	72.4	66.7	63.6	62.9	59.4	50.0	Growing	Faster
Customer Inventories	55.3	48.2	39.1	46.6	27.1	28.8	27.4	29.7	21.2	Growing	Faster
Pricing, month-to-month	52.6	53.6	52.2	65.5	68.8	68.2	77.4	78.1	83.3	Growing	Slower
Pricing, year-to-year	78.9	87.5	87.0	91.4	91.7	90.9	95.2	95.3	95.5	Growing	Slower
6-Month Outlook - November						Higher Same Lower					
						18% 37% 45%					
<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** 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 sees nice sequential improvement. The seasonally adjusted November FDI (54.9) improved nicely, albeit off a stretch of two very weak months. The sales index was much improved with 68% of respondents indicating sales were either in line with or better than expectations vs. just 46% in October and 52% in September. Pricing was slightly softer vs. last month, which respondents attributed to easing container/overseas freight costs. Overall, November marked a return to improving market conditions after mostly deteriorating conditions throughout the late summer/early fall.

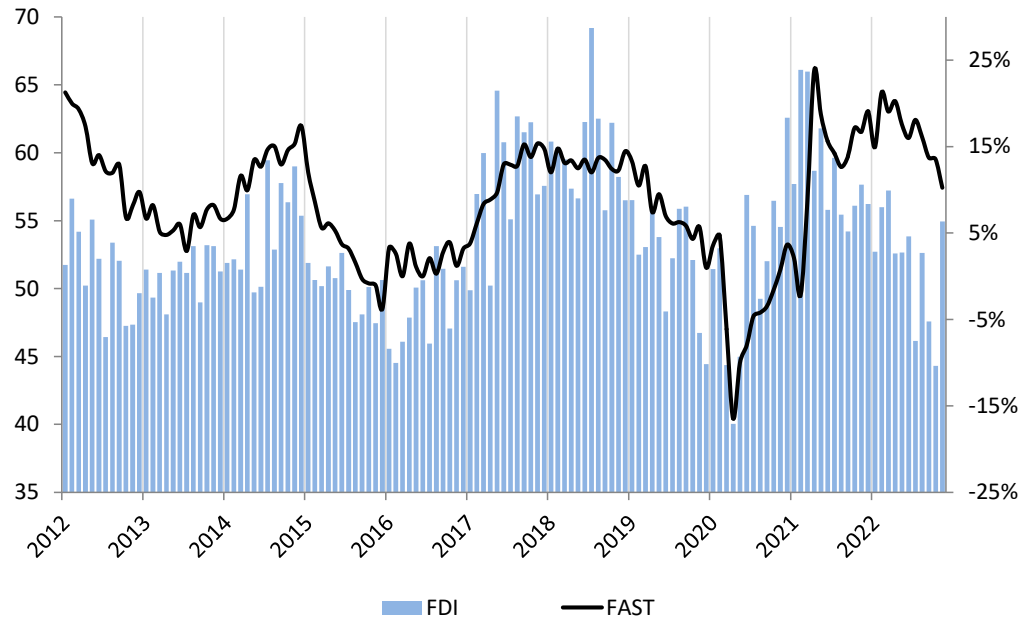
FLI suggests improvement may be short lived, however. Respondents seem to anticipate the improvement to be a short-lived bounce off the bottom. The FLI registered a weak 42.0 reading, which was relatively stable m/m but signals additional deterioration is expected ahead (sub-50 reading). A slightly better employment index and improved six-month outlook were offset by higher respondent and customer inventory levels, leaving the FLI relatively unchanged vs. last month. Just 18% of respondents anticipate activity levels will be higher six months from now vs. today, which was slightly better vs. last month (11%) but still relatively modest compared to the 47% average over the past two years. Conversely, 45% expect lower activity levels (October was 46%) vs. an average of just ~13% over the past two years. We view this as an indicator that many respondents see a recession as likely in 2023. Lastly, 37% expect similar trends. Key outlook themes from participants included slowing customer buying, slowing inbound orders, and distributor de-stocking.

FDI employment index improves. The FDI employment index came in at 57.9 for November, improving from 53.6 last month. Employment levels continue to be seen as generally at appropriate levels (68% of responses), while just 24% said employment levels were too high and 8% said they were too low. The November jobs report was similarly better than expected. 263,000 jobs were added vs. economist expectations for +200,000. A cooling labor market remains key towards the Federal Reserve slowing/pausing interest rate hikes, but to this point the labor market remains persistently strong.

Outlook improves slightly but remains downbeat. Forward-looking commentary again skewed cautious on the whole. Respondents are seeing slowing inbound order rates/customer activity levels: *“Seeing some customer buying activity slow, but could be the seasonal adjustment or slowing mfg.”* Another respondent said, *“Incoming orders slowed way down, inventory at record levels as customers continue to push orders out.”* Inventory de-stocking from distributors is also playing a role in lower demand: *“November showed us that our distributor customers are starting to pull back for end-of-year inventories. We are being told that they will pick back up at the end of the year. Overall, business is still strong and looking to be a good upcoming year.”* Supply chain constraints continue to ease, however: *“Lead times from Taiwan have peaked and are starting to come down. Ocean transit time has improved by approximately two weeks compared to the first half of the year.”* Echoing this, another respondent said, *“The supply chain is catching up but will go back to crap if the rail strike happens. The decrease in pricing is almost all related to the fact container costs have dropped significantly.”*

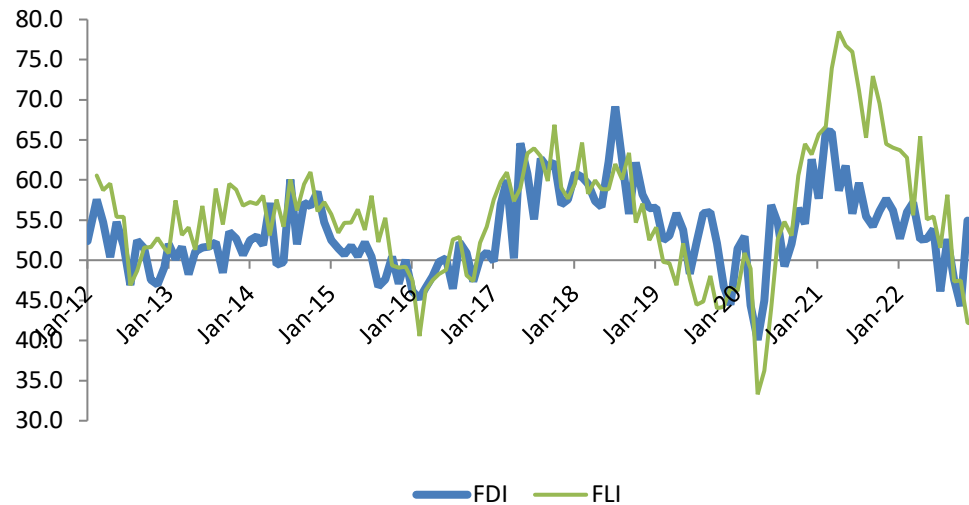
Fastenal’s 10.2% overall November daily sales growth was above our 8.6% estimate but slightly below normal seasonality. Fastener sales grew by 8.7% y/y – moderating vs. 12.2% last month. Additionally for FAST, safety was +9.6% and other non-fasteners were +12.0%. Looking ahead to December, we model overall daily sales +8.5% y/y, which is slightly better than normal seasonality. In 2023, we model weaker-than-seasonally-normal sales as we assume underlying demand conditions continue to soften exiting 2022 before outright recession begins in 2023.

Fastener Distributor Index (FDI); Seasonally Adjusted



*FAST March 2020 – December 2021 Monthly Sales Presented as ex. Safety Products
 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.

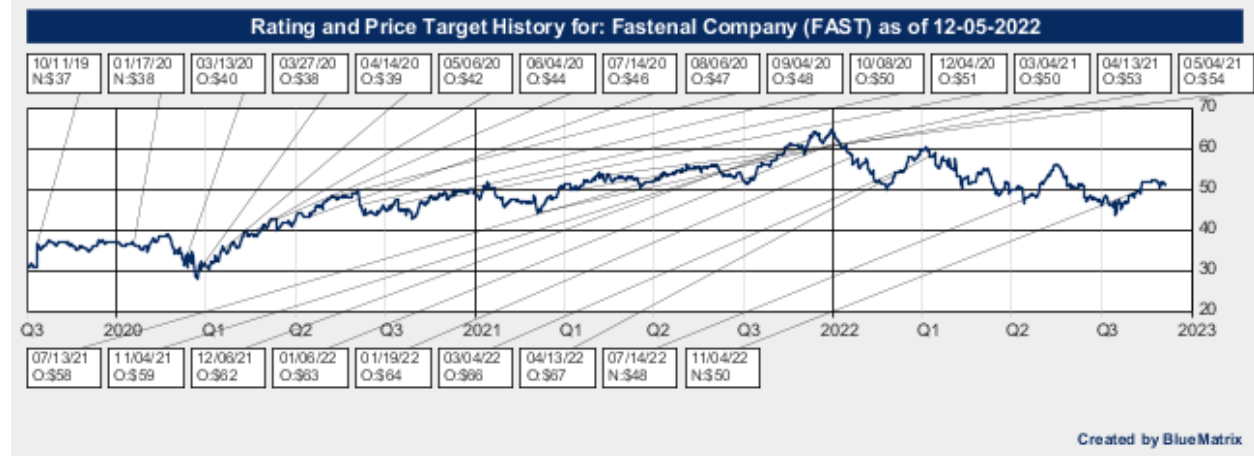
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 12/6/2022.

Fastenal Company (FAST-\$50.14-Neutral)
 W.W. Grainger Inc. (GWW-\$580.34 -Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$83.70-Outperform)
 (See recent research reports for more information)



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