

Fastener Distributor Index – October 2020

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 11/6/20



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for October was **56.5**, improving for the second consecutive month. Nearly all components of the FDI showed m/m improvement. Looking forward, the Forward-Looking Indicator (FLI) also showed nice improvement, reaching the highest levels since January 2018 at **64.5**. Taking the FDI and FLI together, in our view, we believe this indicates October fastener market conditions showed m/m improvement at a greater rate than September.

Fastener Distribution Trends: October 2020

FASTENER DISTRIBUTION AT A GLANCE										
October 2020										
	----- Index Values -----									
	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Direction	Rate of Change
ISM PMI (Manufacturing)	59.3	55.4	56.0	54.2	52.6	43.1	41.5	49.1	Growing	Faster
FDI	56.5	52.0	49.2	54.6	56.9	45.0	40.0	44.4	Growing	Faster
FLI	64.5	60.6	53.1	54.8	52.6	43.9	36.2	33.3	Growing	Faster
(Other Metrics)										
Sales	65.1	60.8	47.6	79.2	69.9	28.9	14.0	34.6	Growing	Faster
Employment	58.3	53.7	46.1	44.3	56.6	40.0	26.8	27.0	Growing	Faster
Supplier Deliveries	63.9	57.3	60.5	57.1	57.9	67.5	76.8	68.9	Growing	Faster
Respondent Inventories	55.6	63.4	64.5	64.3	69.7	70.0	68.3	64.9	Growing	Slower
Customer Inventories	33.3	34.1	40.8	42.9	47.4	48.8	47.6	48.6	Declining	Faster
Pricing, month-to-month	58.3	56.1	52.6	58.6	52.6	47.5	59.8	50.0	Growing	Faster
Pricing, year-to-year	72.2	80.5	65.8	67.1	60.5	61.3	67.1	60.8	Growing	Slower
6-Month Outlook -October				Higher			Same		Lower	
				72%			22%		6%	
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: 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** with support from the **National Fastener Distributors Association**. 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:

October FDI shows momentum improved m/m vs. September and at a faster rate. The seasonally adjusted October FDI (**56.5**) remained well into expansionary territory and improved m/m at a faster rate than September. Nearly all FDI components saw improvement but gains were most significant across the seasonally adjusted sales index, which came in at 65.1 vs. 60.8 last month. Pricing was mostly stable with last month.

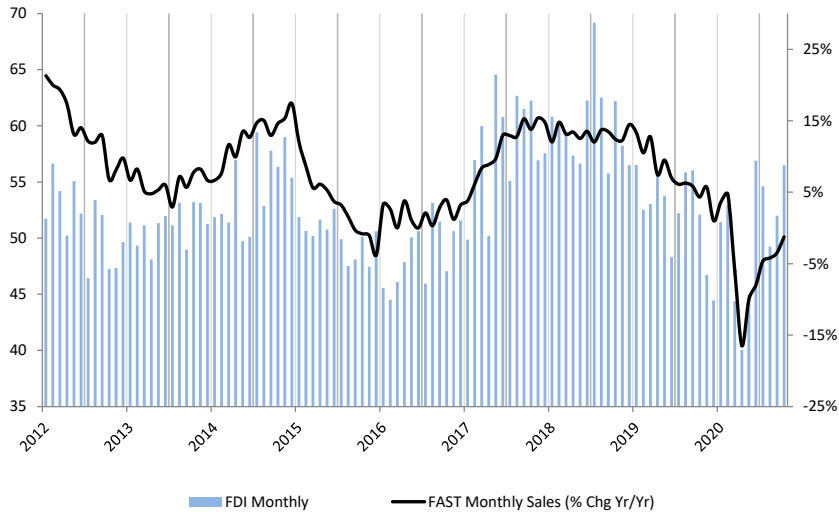
FLI continues recent upward march. The seasonally adjusted FLI was **64.5**, improving nicely from September's 60.6. This was also the highest FLI reading recorded since January 2018. We view this breakout as a positive sign going forward, as low customer inventories, coupled with a continued slightly more optimistic tone around hiring, could bode well for near-term prospects. Net, we believe the FDI should see expansionary readings in the near term, implying additional m/m improvement in market conditions ahead even as trends on a y/y basis for many respondents may remain down.

Hiring sentiment continues to moderately improve. The FDI employment index registered a 58.3 reading vs. September 53.7. Looking at the broader economy, despite a continued recovery in the labor market, the unemployment rate remains elevated (6.9% as of October). The October jobs report showed slightly better than expected jobs added (+630,000 vs. economists' consensus of ~600,000), but the economy remains down about 10 million jobs from pre-pandemic levels. This was the seventh straight month of net gains but also the fifth consecutive month of decelerating additions.

Respondent commentary mostly focused on election. The Presidential election was not surprisingly the main area of focus for respondents this month. One respondent indicated, *"The future is hinged on two things not in anyone's control: the general election and potential spikes in COVID globally,"* while another commented, *"I have a feeling this survey would be vastly different if you held it on 11/4 versus 11/2."* There were also comments that suggested demand continues to strengthen. Per one participant, *"Business is definitely improving and [our] expectation is to stay on a growth pattern but at a slower rate than what some industry economic sources are saying. What happens with COVID the next few months can be a major factor on the positive growth [we're] experiencing currently."* Attitudes about expected activity levels over the next six months compared to today remain more positive than negative on balance, however, with 72% of participants expecting higher activity levels and only 6% expecting lower.

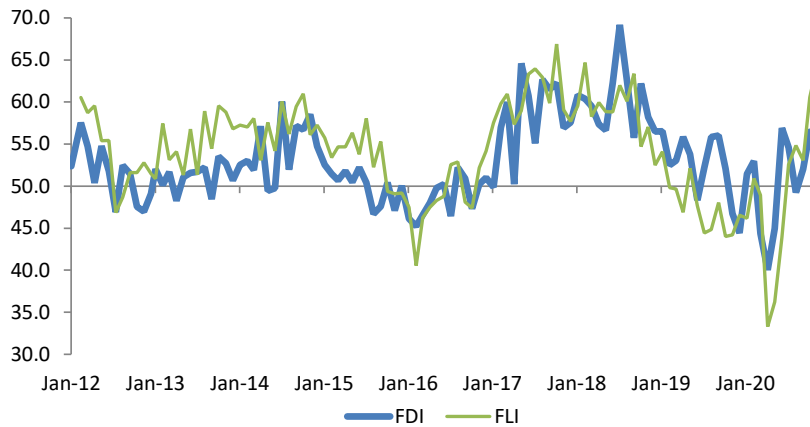
Fastenal reported 4.1% overall October daily sales growth vs. our +0.7% estimate, again boosted by significant demand for safety/PPE (+32% y/y). Excluding safety products, underlying sales were -1.6% y/y, showing continued sequential improvement relative to September's -3.5% y/y. Similar to an FDI reading that indicated improving fastener markets sequentially, FAST's fastener sales were better m/m at -4.7% (September -6.1%). Looking forward, November safety product sales will likely see continued elevated demand, although we are conservatively assuming m/m moderation (our November estimate is +10% y/y vs. October +32%). We expect underlying momentum in fastener products and other non-fastener products to be mostly steady with October. Putting it all together, we are modeling overall daily sales -0.2% y/y in November, which will be reported December 4.

Fastener Distributor Index (FDI); Seasonally Adjusted



*FAST March-September Monthly Sales Presented as ex. Safety Products; October Baird ex-safety estimate
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.

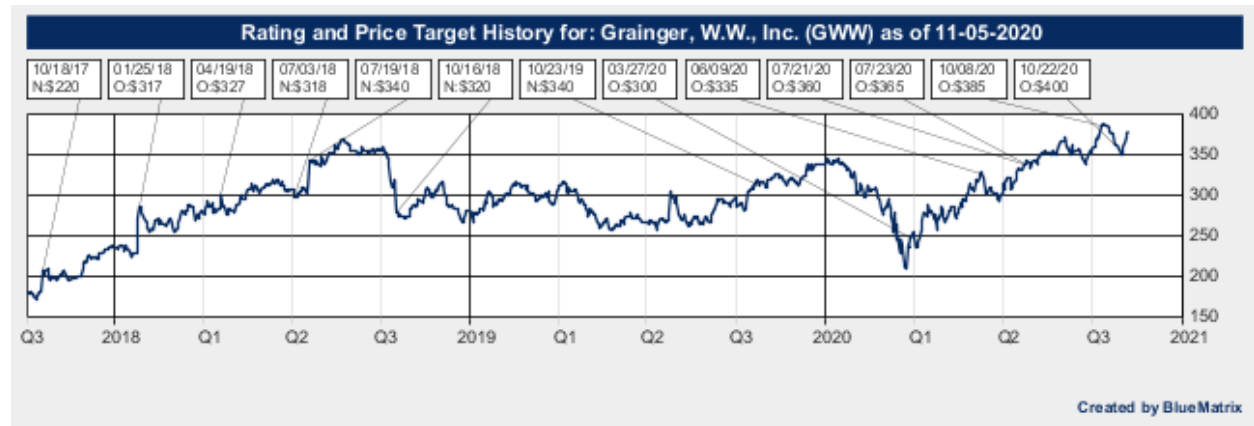
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 11/6/2020.

Fastenal Company (FAST-\$46.31-Outperform)
 W.W. Grainger Inc. (GWW-\$381.06-Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$74.42-Outperform)
 (See recent research reports for more information)



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