

Fastener Distributor Index – October 2018

Written by R.W. Baird analyst David J. Manthey, CFA 11/7/18



Key Takeaway:

The seasonally adjusted FDI for October was 62.2, recovering strongly vs. September's 55.8 reading. Selling conditions surged off of days-impacted September results, with the seasonally adjusted sales index coming in at 73.4 (vs. September 46.5). Qualitative commentary was mostly positive on current trends, but participants continue to express uncertainty regarding tariff impacts on price/cost and related demand elasticity. The six-month outlook also improved m/m and was more consistent with recent trends, with the Forward-Looking Indicator similarly picking up (57.0 vs. September 54.7).

FASTENER DISTRIBUTION AT A GLANCE										
October 2018										
	----- Index Values -----									
	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Directn	Rate of Change
PMI (Manufacturing Sector)	57.7	59.8	61.3	58.1	60.2	58.7	57.3	59.3	Growing	Slower
FDI (Fastener Sector)	62.0	52.8	61.7	65.8	62.5	59.4	59.8	61.2	Growing	Faster
FDI (Seasonally Adjusted)	62.2	55.8	62.5	69.2	62.3	56.6	57.4	59.5	Growing	Faster
Sales (SA)	73.4	46.5	74.7	89.6	74.2	61.2	63.0	70.1	Growing	Faster
Forward-Looking (SA)	57.0	54.7	63.4	60.1	62.0	58.8	58.9	59.9	Growing	Faster
(Other Metrics; NSA)										
Employment	67.3	61.1	67.2	64.7	68.5	60.7	59.4	62.5	Growing	Faster
Supplier Deliveries	61.5	63.0	70.3	83.8	77.8	73.2	71.9	69.6	Growing	Slower
Respondent Inventories	57.7	59.3	59.4	55.9	50.0	57.1	53.1	60.7	Growing	Slower
Customer Inventories	40.4	46.3	32.8	39.7	33.3	37.5	37.5	35.7	Declining	Faster
Pricing, month-to-month	75.0	70.4	76.6	82.4	83.3	75.0	73.4	76.8	Growing	Faster
Pricing, year-to-year	88.5	92.6	92.2	89.7	90.7	87.5	89.1	85.7	Growing	Slower
6-Month Outlook - October				Higher 46%	Same 23%	Lower 31%				

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**, the **National Fastener Distributors 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:

October FDI accelerates. The seasonally adjusted October FDI (62.2) rebounded nicely vs. September's days-impacted 55.8 reading, remaining well in expansionary territory overall. In the October survey, 69% of respondents indicated sales were "better" relative to seasonal expectations vs. just 22% in September. This produced a seasonally adjusted sales index of 73.4 (September 46.5), with respondents likely benefiting from the addition of four selling days m/m. Pricing also continues to aid top-line trends, with 77% seeing pricing gains y/y vs. 85% in September. The resulting FDI pricing index of 88.5 was down slightly m/m but consistent with average levels seen this year. Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (81% of responses), while 19% believe customers' inventories are too low. This compares to 70% in line and 19% too low last month.

October FLI also recovers. The seasonally adjusted FLI increased m/m, registering 57.0 vs. 54.7 in September, mainly attributable to a more bullish employment picture and improved six month outlook. At 57.0, the FLI continues to suggest market conditions are likely to remain in growth mode, although we continue to believe the rate of growth may be stabilizing some in light of recent moderation in PMI readings and recent FLI readings coming in below YTD averages.

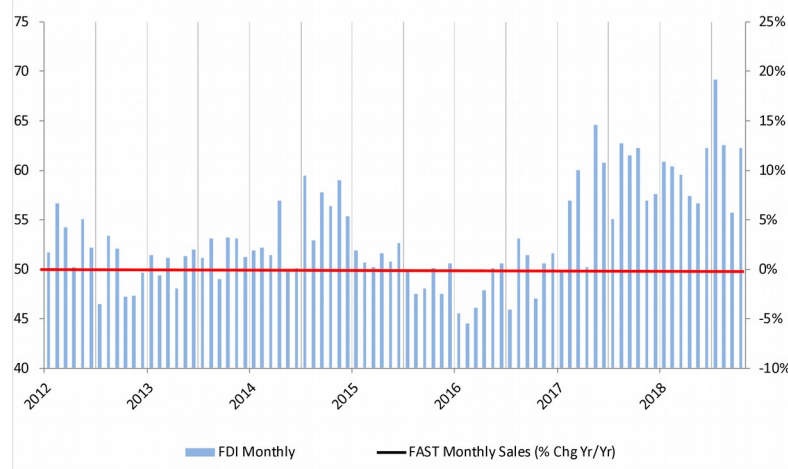
Manufacturing employment improves. Hiring sentiment was more bullish this month among survey respondents. 35% of respondents saw higher employment levels in October relative to seasonal expectations vs. 30% in September, while 65% saw employment as in line (September 63%). The resulting FDI Employment Index was 67.3 vs. 61.1 last month. Meanwhile, the October US jobs report was significantly better than expected with +250,000 jobs added (~200,000 expected), in part boosted by a slight downward revision to last month's gains. The unemployment rate remained at a 49-year low at 3.7%. October's largest gains were registered in healthcare, manufacturing, construction, and transportation and warehousing. Manufacturing employment continues to trend upwards (+32,000 jobs in October), with most of the gains again in durable goods manufacturing. As of October, total number of manufacturing jobs added over the past year stands at +296,000. Average hours per work week for manufacturing employees were just modestly lower at 40.8 hours.

Respondent commentary mixed. The overall tone of qualitative commentary was mixed this month, with favorable feedback on October trends offset by unease surrounding tariff impacts on price/cost and demand elasticity. For example, one respondent commented, "October was the second highest month ever and our most profitable month ever. Looking forward we have 10% tariffs coming in November and 25% in January... Our manufacturing customers' projections have been extremely cautious and nervous – exactly the last thing any of us in the fastener industry wants to hear." Another participant said, "Tariffs from China are killing us and causing issues with our customers who don't understand them and are resisting price increases." Perhaps in part due to this uncertainty, the six-month outlook was modestly less optimistic than YTD trends, with 46% of respondents expecting higher activity levels over the next six months, 23% expecting similar activity, and 31% expecting lower activity. For context, the percentage of respondents expecting higher activity this year has averaged 52%, while the percentage expecting lower activity has been just 13%.

Fastenal reported +12.4% October daily sales growth, which was modestly above our estimate, but reflecting sequential daily sales growth slightly below average historical m/m trends. Underlying "core" growth (excluding foreign exchange) was +12.7%, the 17th straight month of double-digit growth. Fastener growth was down slightly m/m at +10.1% y/y (+11.6% in September). Based on FDI data and other research inputs, we expect continued solid

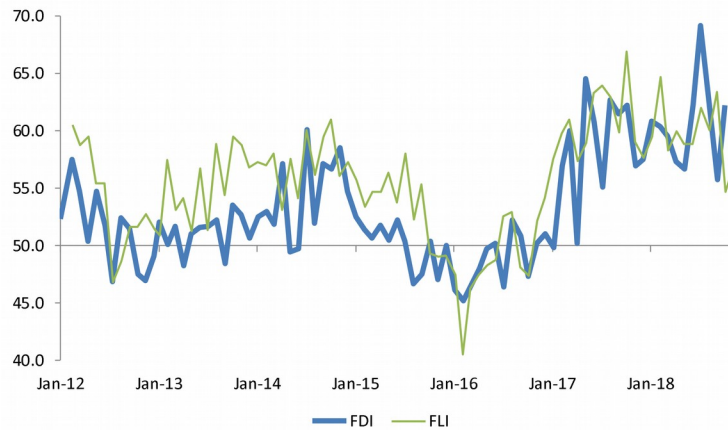
top-line trends across public industrial distributors through the remainder of 2018, with Fastenal y/y daily sales growth expected to remain in the double-digits through year-end.

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.

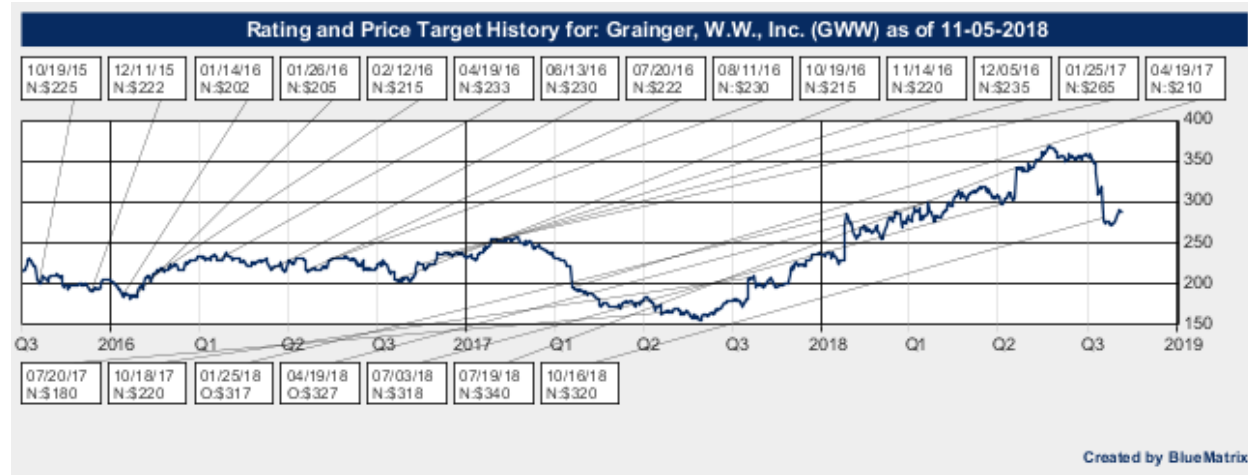
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 11/6/2018.

Fastenal Company (FAST-\$52.92-Neutral)
 W.W. Grainger Inc. (GWW-\$287.25-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$85.12-Neutral)
 (See recent research reports for more information)





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