BB&TCM Fastener Distribution Index (FDI)- Reflects Sluggish September Sales

KEY TAKEAWAY

The FDI is a monthly survey of NorAm fastener distributors that aims to provide insight into current trends/outlooks. As a diffusion index, readings above 50 signal strength and below 50 signal weakness. For the third consecutive month, the seasonally adjusted September FDI fell below 50 (47.5), which we believe is consistent with the tough current environment for many distributors. Added contraction was driven by the lowest seasonally adjusted sales figure (32.4) yet recorded for the FDI. In addition, employment fell into contraction for the first time since April 2013. Sequential uptick in the aggregate index resulted from a normalization of customer inventories, which remained in negative territory (43.6). Pricing and supplier deliveries were largely unchanged, and the long-term outlook for industry sentiment ticked modestly lower. Overall, we believe that fastener distributors continue to face material demand pressure from lower commodity prices, forex, and weaker industrial production. We maintain our cautious outlook on the industry, but will continue to watch for signs of more material long-term improvement.

KEY POINTS

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm 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. It should be directly relevant to Fastenal and broadly relevant to other distributors (W.W. Grainger, MSC Industrial).

September sales sentiment plunges. For September, the FDI fell below 50 (47.5) for the third consecutive month. Of the items measured (sales, employment, delivery times, inventories, customer inventories), we believe weaker top-line sentiment remains the most directionally accurate indicator in the Index. 85% of total respondents reported sequentially flat or lower sales for September. In our view, the results are consistent with sluggish recent growth from Fastenal (+1.6% yr/yr in August versus a five year average of +13.2%), Grainger (-2% in August versus FY’15 guide of 0%-2%), and MSC (company estimated +2.2% in June versus +7.6% last year).

Employment also contracts. Of additional note, the September employment index (48.7) showed a contraction in overall headcount for select distribution respondents for the first time in 30 months. We believe these results are consistent with recent contraction from Fastenal, which reduced total headcount on an absolute basis in August for the first time in seven months. Additionally, Fastenal continues to consolidate select branch locations (-3% yr/yr), which we believe reflects the tepid overall demand environment.

Pricing largely stagnant. Point-of-sale pricing for September was unchanged versus August for 74% of survey participants. We believe the overall environment for price increases remains notably soft given material demand pressure (declining commodity prices, forex, weaker industrial production) and minimal inflation. Additionally, we view the survey results as largely consistent with recent price adjustments from Grainger (-1% in Q2’15).

What does this mean for public distributors? In our view, the data reflects overall weakness within the domestic economy, and 2015 has proven difficult thus far for many industrial distributors. We believe lower energy spending is at the root of weaker sales, with currency woes further compounding the slowdown. Recent conversations with private industry contacts suggest continued pressure on manufacturing demand for the latter portion of FY’15 (69% of FDI respondents expect flat-to-weaker conditions six months from now). We will continue to watch for signs of more material long-term improvement. For now, however, we expect announced earnings for Fastenal (10/13) and Grainger (10/16) to reflect ongoing weakness in the overall industrial environment.
Additional Discussion
Fastener Distribution Trends; September 2015

**FASTENER DISTRIBUTION AT A GLANCE**

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<tbody>
<tr>
<td>PMI (Manufacturing Sector)</td>
<td>50.2</td>
<td>51.1</td>
<td>52.7</td>
<td>53.5</td>
<td>52.8</td>
<td>51.5</td>
<td>(0.9)</td>
<td>Growing</td>
<td></td>
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<tr>
<td>FDI (Fastener Sector)</td>
<td>44.6</td>
<td>45.5</td>
<td>48.4</td>
<td>52.0</td>
<td>51.9</td>
<td>55.4</td>
<td>(0.9)</td>
<td>Declining</td>
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<tr>
<td>FDI (Seasonally Adjusted)</td>
<td>47.5</td>
<td>46.7</td>
<td>49.8</td>
<td>53.4</td>
<td>51.0</td>
<td>52.1</td>
<td>0.7</td>
<td>Declining</td>
<td></td>
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<tr>
<td>Sales (SA)</td>
<td>32.4</td>
<td>45.3</td>
<td>35.4</td>
<td>68.7</td>
<td>53.3</td>
<td>58.3</td>
<td>(12.9)</td>
<td>Declining</td>
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(Other Metrics; NSA)

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<tbody>
<tr>
<td>Employment</td>
<td>48.7</td>
<td>52.3</td>
<td>52.1</td>
<td>60.5</td>
<td>53.7</td>
<td>54.8</td>
<td>(3.6)</td>
<td>Declining</td>
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<td>Supplier Deliveries</td>
<td>56.4</td>
<td>56.8</td>
<td>58.3</td>
<td>57.9</td>
<td>66.7</td>
<td>57.1</td>
<td>(0.4)</td>
<td>Slowing</td>
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<tr>
<td>Respondent Inventories</td>
<td>67.9</td>
<td>70.5</td>
<td>64.6</td>
<td>55.3</td>
<td>57.4</td>
<td>50.0</td>
<td>(2.5)</td>
<td>Too High</td>
<td></td>
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<tr>
<td>Customer Inventories</td>
<td>43.6</td>
<td>29.5</td>
<td>50.0</td>
<td>34.2</td>
<td>33.3</td>
<td>40.5</td>
<td>14.0</td>
<td>Too Low</td>
<td></td>
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<tr>
<td>Pricing, month-to-month</td>
<td>44.9</td>
<td>45.5</td>
<td>45.8</td>
<td>55.3</td>
<td>50.0</td>
<td>54.8</td>
<td>(0.6)</td>
<td>Lower</td>
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<tr>
<td>Pricing, year-to-year</td>
<td>51.3</td>
<td>54.5</td>
<td>58.3</td>
<td>71.1</td>
<td>68.5</td>
<td>83.3</td>
<td>(3.3)</td>
<td>Higher</td>
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6-Month Outlook - Sept. 31% 38% 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: BB&TCM, FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted

Source: BB&TCM, FCH Sourcing Network, company reports
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AEROSPACE/DEFENSE
Government Services/Security
Brian W. Ruttenbur (571) 262-7046
Corbin M. Allen (571) 262-7051

AUTOMOTIVE AFTERMARKET & DEALERSHIPS/VEHICLE DISCRETIONARY
Automotive Aftermarket & Dealerships/Powersports, RVs, & Marine
Anthony F. Cristello (804) 205-9119

COMMERCIAL AND INDUSTRIAL
Building Materials & Construction
Adam R. Thalheimer, CFA (804) 344-8377
Paul Betz, CFA (804) 782-8746
Building Products & Furnishings
Matthew S. McCall, CFA (804) 780-3582
Reuben Garner, CFA (804) 482-7167
Chemicals & Advanced Materials
Christopher J. Kapsch (212) 822-8140
Environmental Services/Industrial Distribution
Charles E. Redding (804) 782-8853
G. Payton Porter (804) 782-8820
Industrial Flow Control
Kevin R. Maczka, CFA (804) 782-8811
Nicholas V. Prendergast (804) 782-2006
Industrial Machinery
C. Schon Williams (804) 782-8769

ENERGY
Coal
Mark A. Levin (804) 782-8856
Nathan P. Martin (804) 782-8799
Garrett S. Nelson (804) 787-8259
Metals & Mining
Garrett S. Nelson (804) 787-8259
Nathan P. Martin (804) 782-8799

FINANCIAL SERVICES
Banks/Thrifts
Blair C. Brantley, CFA (804) 727-2604
Specialty Finance
Vernon C. Plack, CFA (804) 780-3257
Peter W. Councill, CFA (804) 782-8850

FOOD AND AGRIBUSINESS
Agribusiness/Consumer Foods
Brett M. Hundley, CFA (804) 782-8753
Omar J. Mejias (212) 822-8145
Heather L. Jones (804) 780-3280
Food & Drug Merchandising
Andrew P. Wolf, CFA (617) 316-1322
Jeremy Hennard (617) 316-1321

RETAIL AND CONSUMER
Footwear, Apparel, & Accessories
Corinna L. Freedman (212) 822-8139
Brennan J. Matthews (212) 822-8146
Softline Retailers
Paul S. Alexander, CFA (617) 316-1323
Mark D. Jordan, CFA (617) 316-1324
Specialty/Hardlines Retailers
Anthony C. Chukumba (212) 822-8143
Daniel J. Cannata (212) 822-8158

TRANSPORTATION SERVICES
Airfreight & Logistics/ Maritime
Kevin W. Sterling, CFA (804) 782-8804
William W. Horner (804) 787-1143
Chip Rowe (804) 782-8787
Railroads
Mark A. Levin (804) 782-8856
Nathan P. Martin (804) 782-8799
Garrett S. Nelson (804) 787-8259
Surface Transportation
Thomas S. Albrecht, CFA (804) 787-8210
Willard P. Milby IV (804) 775-7919
Aaron M. Reeves, CFA (804) 780-3237
A. Rhem Wood Jr. (804) 782-8784

RESEARCH DEPARTMENT

Director of Research
Vernon C. Plack, CFA (804) 780-3257

Equity Product Manager
W. Moultrie Dotterer, CFA (804) 780-3279

Supervisory Analysts
Kathleen R. Schneider (732) 567-8766
Denise Bossé Tynar (804) 782-8880
Peggy Myers Walz (804) 782-8785

RESEARCH OFFICES
Richmond
Boston
New York
Reston