

## HIGHLIGHTED COVERAGE

**Fastenal**  
FAST - \$38.80 - Hold

**W.W. Grainger**  
GWW - \$194.79 - Hold

**MSC Industrial Direct**  
MSM - \$59.19 - Hold

## BB&TCM Fastener Distributor Index (FDI): Uptick Implied; We Remain Cautious

### 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. A seasonally adjusted headline reading of 50.8 for December implies marginal sequential expansion over a notably weak November. Despite the positive movement, we note that just 35% of survey respondents cited improving sales during the period, and less than one-half expect stronger conditions six months from now. Perhaps more importantly, anecdotal color from industry participants remains dour, in our view, which we believe implies added weakness for domestic manufacturing near-term. Our outlook for fastener distributors is notably cautious, although we will watch closely for additional signs of fundamental stabilization.

### 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**).

**FDI ticks modestly higher.** The December FDI (50.8) implies a slight uptick in overall conditions versus a notably weak November. The implied sequential improvement is consistent with modestly improved late year sales reported last week by MSC (December sales -1.4% versus -6.1% in November), although the company did benefit from ~two extra days of favorable seasonal timing (~250 bps impact). To the positive, MSC noted no major negative impact from weather in the quarter, and management characterized late year shutdown activity as largely similar to last year. Based on our conversations with industry contacts, we believe recent flooding (particularly TX, LA) could have a more material impact on near-term results for select manufacturers and distributors.

**Although sales, industry anecdotes remain largely negative.** While we view the sequential improvement as a nascent positive, overwhelming anecdotal evidence points to continued systemic weakness within domestic manufacturing. 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. Only 35% of respondents reported sequential improvement in sales for December. One participant noted, "This was our weakest month in terms of gross revenue in the past 10 years- we set a new record low, even lower than 2009." Overall, the majority of fastener distributors continue to see material sales pressure across many diverse end markets. The employment component of the FDI (48.8) ticked slightly lower in December, as 90% of participants noted unchanged or reduced hiring (seasonally adjusted) versus the preceding month.

**Pricing still tepid, offsets taking hold for MSC.** Point-of-sale pricing for December was unchanged versus November for 80% of survey participants (15% lower). 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 yr/yr price adjustments from Grainger (-1% in Q3'15) and Fastenal (-2% on fasteners). MSC has proven to be an outlier here, with modest price realization partially attributed to nascent traction on supplier discounts and renewed freight initiatives.

**Six-month outlook still mixed.** Overall sentiment among FDI participants continues to reflect ongoing weakness within the domestic economy. 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 in early FY'16, and less than one-half of FDI survey participants expect materially improved activity six-months from now. Despite the largely negative outlook, monthly sales should benefit from easier comps in H2'16, in our view, and early guidance from Grainger implies steady sequential sales improvement later in 2016.

**Additional Discussion**

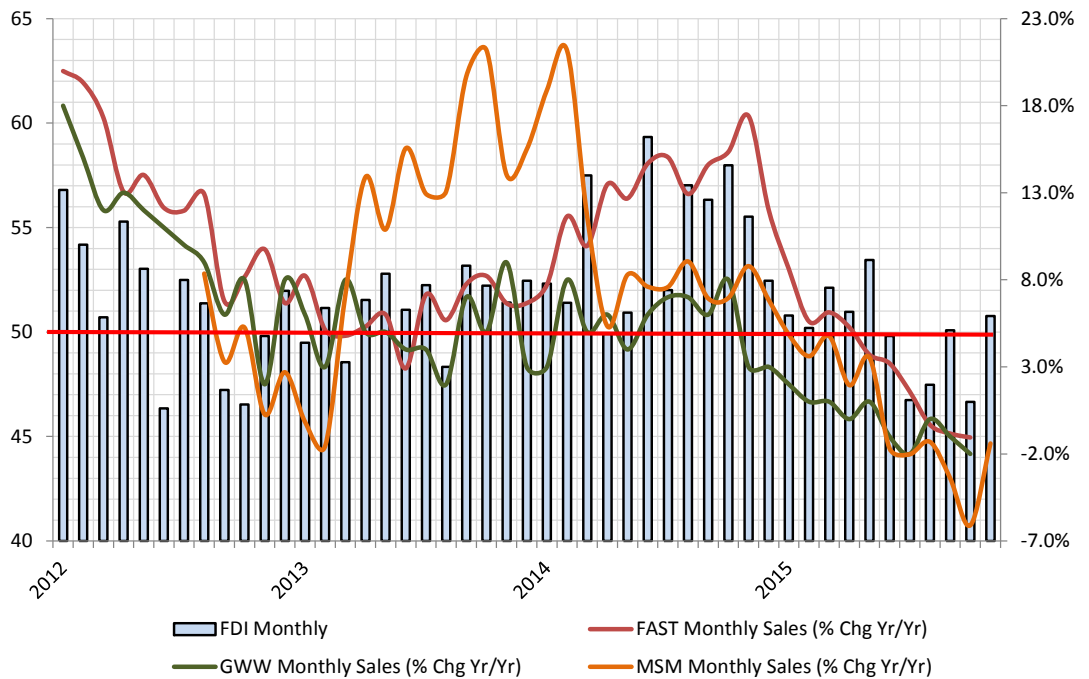
**Fastener Distribution Trends; December 2015**

FASTENER DISTRIBUTION AT A GLANCE									
December 2015									
	----- Index Values -----						Nov.-->Dec.		
	Dec.	Nov.	Oct.	Sep.	Aug.	Jul.	Change	Direction	
PMI (Manufacturing Sector)	48.2	48.6	50.1	50.2	51.1	52.7	(0.4)	Declining	
FDI (Fastener Sector)	49.4	46.2	49.6	44.6	45.5	48.4	3.2	Declining	
<b>FDI (Seasonally Adjusted)</b>	<b>50.8</b>	<b>46.7</b>	<b>50.1</b>	<b>47.5</b>	<b>46.7</b>	<b>49.8</b>	4.1	Growing	
Sales (SA)	51.3	34.8	48.4	32.4	45.3	35.4	16.5	Growing	
<b>(Other Metrics; NSA)</b>									
Employment	48.8	50.0	53.1	48.7	52.3	52.1	(1.2)	Declining	
Supplier Deliveries	55.0	59.1	51.6	56.4	56.8	58.3	(4.1)	Slowing	
Respondent Inventories	68.8	68.2	65.6	67.9	70.5	64.6	0.6	Too High	
Customer Inventories	50.0	45.5	42.2	43.6	29.5	50.0	4.5	Too Low	
Pricing, month-to-month	45.0	42.4	43.8	44.9	45.5	45.8	2.6	Lower	
Pricing, year-to-year	50.0	48.5	53.1	51.3	54.5	58.3	1.5	Lower	
<u>Higher</u> <u>Same</u> <u>Lower</u>									
6-Month Outlook - Dec.	45%	35%	20%						

*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

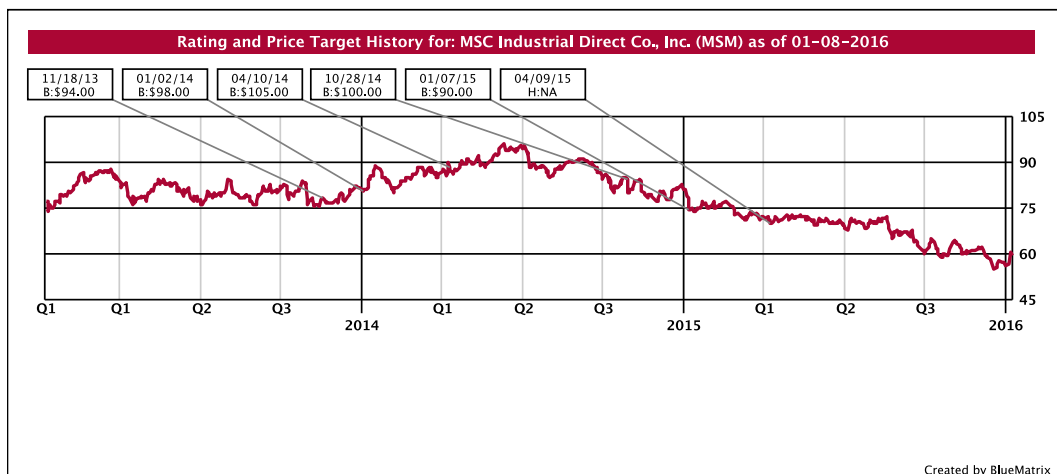
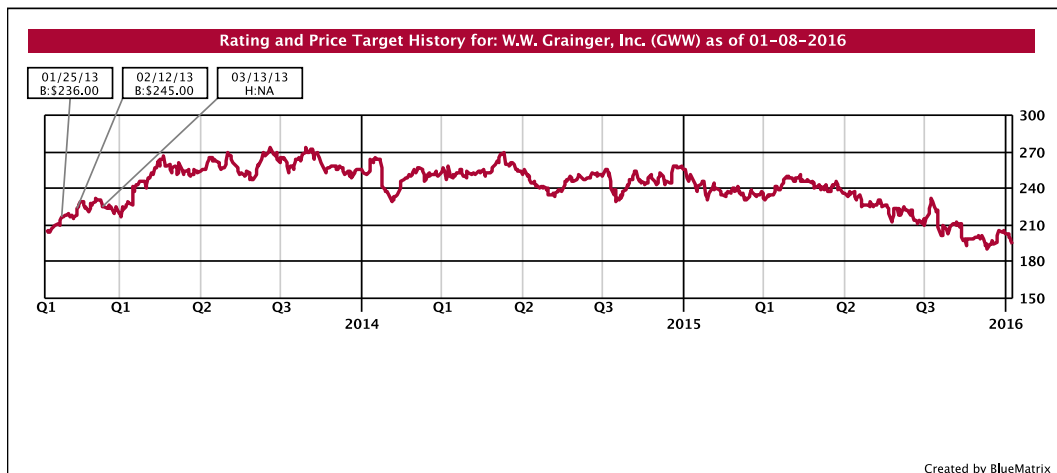
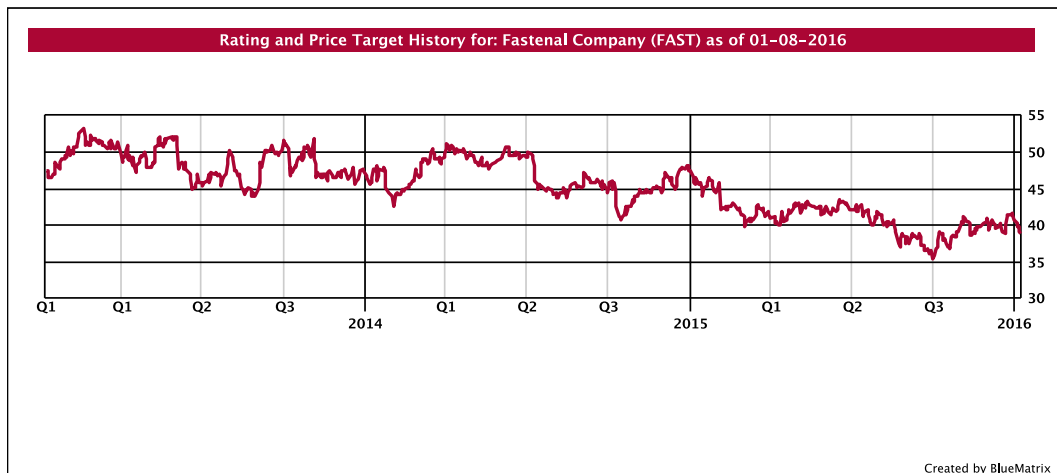
**Fastener Distributor Index (FDI); Seasonally Adjusted**



Source: BB&TCM, FCH Sourcing Network, company reports

**IMPORTANT DISCLOSURES**

**Price Chart**



**BB&T Capital Markets rating distribution by percentage (as of January 11, 2016):**

All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
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Hold (2)	52.77%	Hold (2)	18.78%
Underweight/Sell (3)	2.33%	Underweight/Sell (3)	25.00%
Not Rated (NR)	0.00%	Not Rated (NR)	0.00%

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The definition of each rating is as follows:

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