

HIGHLIGHTED COVERAGE

Fastenal
FAST - \$46.20 - Hold

W.W. Grainger
GWW - \$227.79 - Hold

MSC Industrial Direct
MSM - \$74.78 - Hold

BB&TCM Fastener Distributor Index (FDI): Early Momentum Continues in May

KEY TAKEAWAY

May's seasonally adjusted FDI reading (50.1) proved modestly higher for the third consecutive month, entering expansion territory (above 50) for the first time this year. May results benefitted from a slight uptick in sales bias among respondents, while yr/yr pricing ticked positive for the first time since December (consistent with the early movement in CPI and higher raw material pricing). While the 50+ reading is encouraging, we continue to temper our expectations for more material near-term expansion among fastener distributors. Anecdotes (both public and private) still reflect material caution (commodity dislocation, ongoing currency headwinds, mixed industrial production, etc.). We also note the outlook for survey respondents remains uncertain, with 58% still expecting unchanged or declining conditions in six months. We will continue watching closely for signs of more tangible strengthening.

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**).

May sales see continued improvement. The seasonally adjusted May FDI (50.1) entered expansion territory for the first time this year, implying nascent stability in the overall environment. Of the items measured (sales, employment, delivery times, inventories, customer inventories), we believe top-line sentiment remains the most compelling indicator in the Index. 66% of May participants noted similar or better sequential sales growth (64% in April). Regarding customer inventories, 15% of participants viewed current levels as "too high". We note that during the headier growth period of 2013-2014, this metric averaged 4%.

Annual pricing also sees nascent expansion. The May sequential point-of-sale pricing index remained in expansion territory (51.5) after jumping above 50 in April for the first time since June 2015. On an annual basis, the pricing index reached similar levels this month (53.0) for the first time since December 2014. According to participant commentary, higher material costs, to include inflated steel pricing (HRC steel futures +8% in May), could portend continued pricing growth near-term (*Bloomberg*). We believe the overall environment for pricing remains notably soft given minimal inflation, although the April CPI expansion (+50 bps sequentially) was a modest positive, nonetheless (*Bureau of Labor Statistics*). Last quarter, Fastenal reported fastener price deflation of 1.5%-2%.

Labor remains stagnant. Employment (51.5) was largely unchanged for May, as 91% of participants noted unchanged or reduced hiring versus the preceding month. On an absolute basis, Fastenal decreased total headcount by 91 in April, the fifth consecutive month of contraction. In Q1'16, the company reiterated its hiring freeze, excluding necessary vending/IT administration adds.

How does the FDI stack up to comparable macro indices? We believe positive FDI momentum in April/May is broadly consistent with the PMI, which has turned in 50+ readings in each of the last three months. May PMI totaled 51.3, with 12 of the 18 respective end markets surveyed reporting growth during the period (*ISM*). Conversely, the May Metalworking Business Index (MBI) fell further into contraction territory (45.3), marking the Index's 14th consecutive sub-50 reading (*Gardner*). We believe the FDI, while certainly specialized, should retain a higher correlation to the PMI going forward.

Overall, industry sentiment remains mixed. Despite the FDI's move into expansion territory, we believe there remains a divergence among survey respondents. As one participant noted, "*May activity (bookings and shipments) was better than preceding months.*" However, another noted, "*Several markets still doing poorly- ag/construction equipment and oil and gas. These three may not have hit bottom yet.*" Given overall uncertainty, we continue to await more consistent results.

Additional Discussion

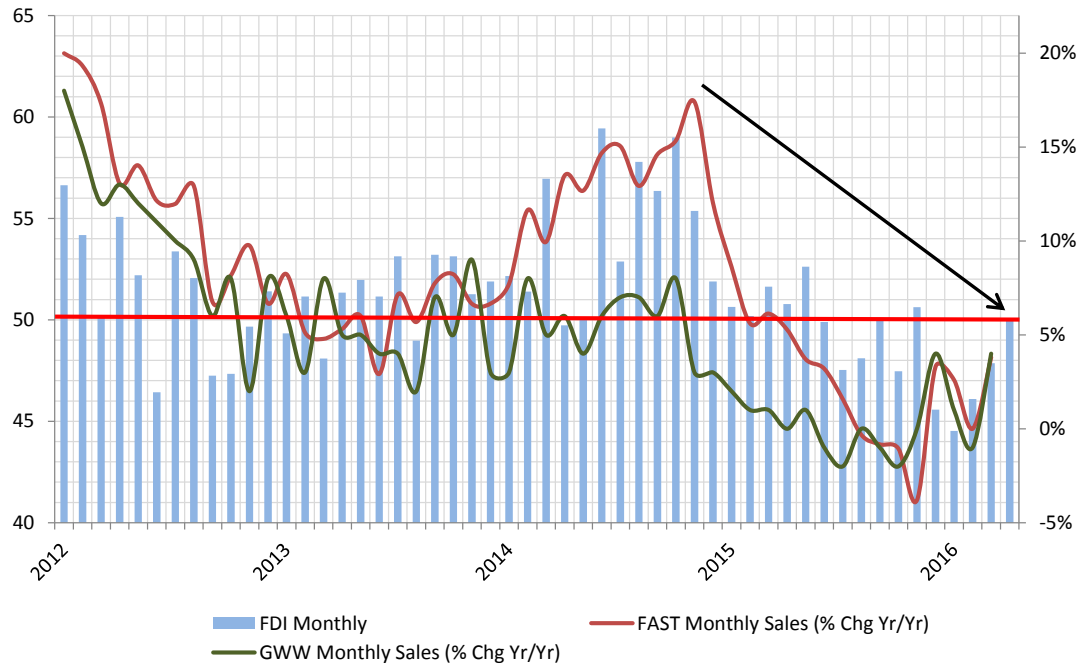
Fastener Distribution Trends; May 2016

FASTENER DISTRIBUTION AT A GLANCE									
May 2016									
	----- Index Values -----						Apr.-->May		
	May	Apr.	Mar.	Feb.	Jan.	Dec.	Change	Direction	
PMI (Manufacturing Sector)	51.3	50.8	51.8	49.5	48.2	48.0	0.5	Growing	
FDI (Fastener Sector)	51.1	51.3	47.6	44.0	50.4	49.4	(0.2)	Growing	
FDI (Seasonally Adjusted)	50.1	47.9	46.1	44.5	45.6	50.6	2.2	Growing	
Sales (SA)	48.4	38.2	38.6	36.7	36.6	50.4	10.2	Declining	
(Other Metrics; NSA)									
Employment	51.5	51.3	52.4	44.8	46.4	48.8	0.2	Growing	
Supplier Deliveries	54.5	56.6	53.7	51.7	55.4	55.0	(2.0)	Slowing	
Respondent Inventories	68.2	71.1	69.5	69.0	69.6	68.8	(2.9)	Too High	
Customer Inventories	48.5	50.0	41.5	44.8	50.0	50.0	(1.5)	Too Low	
Pricing, month-to-month	51.5	53.9	40.2	43.1	48.2	45.0	(2.4)	Higher	
Pricing, year-to-year	53.0	47.4	36.6	43.1	41.1	50.0	5.7	Higher	
<u>Higher</u> <u>Same</u> <u>Lower</u>									
6-Month Outlook - May	42%	39%	18%						

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

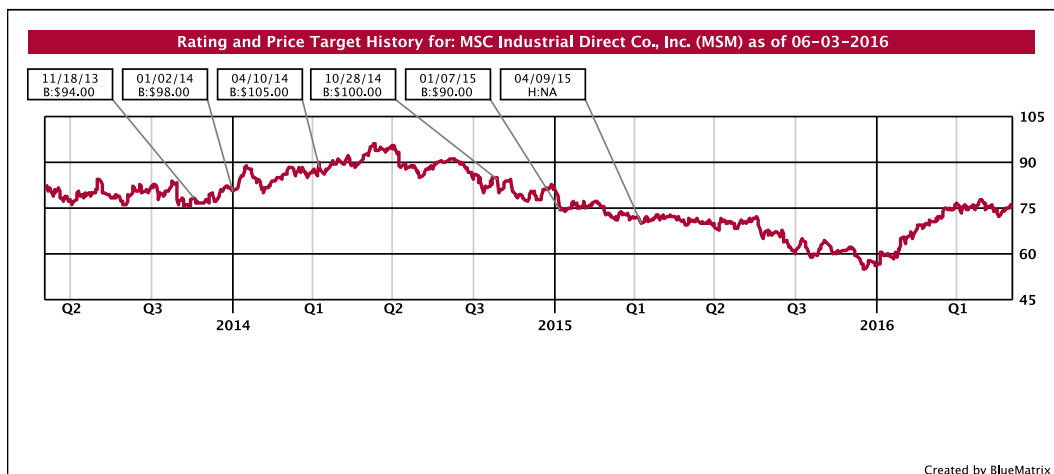
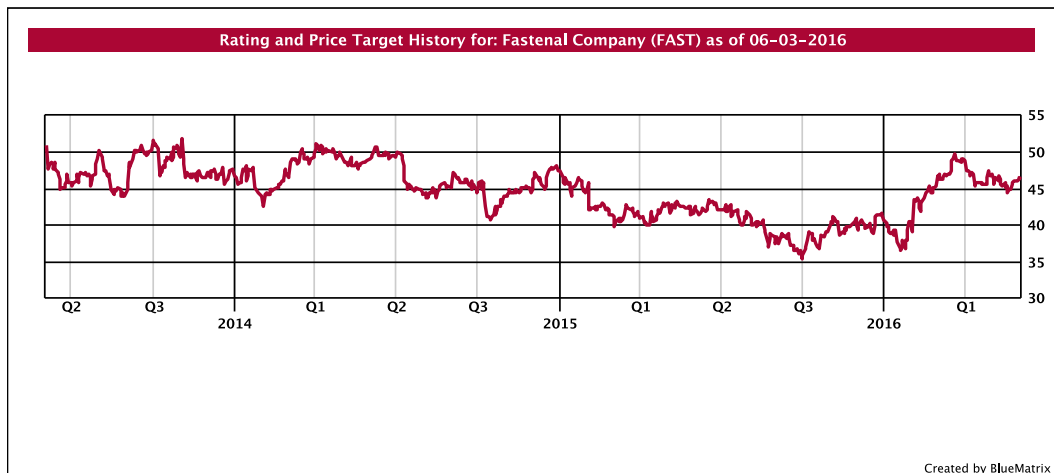
Fastener Distributor Index (FDI); Seasonally Adjusted



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

IMPORTANT DISCLOSURES

Price Chart



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Buy (1)	44.02%	Buy (1)	28.48%
Hold (2)	52.19%	Hold (2)	16.76%
Underweight/Sell (3)	3.79%	Underweight/Sell (3)	30.77%
Not Rated (NR)	0.00%	Not Rated (NR)	0.00%

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