

Fastener Distributor Index – January 2018

Written by R.W. Baird analyst David J. Manthey, CFA 1/6/18



Key Takeaway:

The seasonally adjusted FDI for January 2018 was 60.8 – up slightly vs. December’s 57.6 reading and starting the new year well in expansionary territory overall. Selling conditions accelerated m/m with the seasonally adjusted sales index coming in at a very strong 72.7 (December 68.4). Qualitative commentary on market conditions skewed positive overall, and the six-month outlook remains strong. The FDI Forward-Looking Indicator also accelerated, registering a seasonally adjusted reading of 64.7, up vs. December (59.6).

Key Points:

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American 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, 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)**.

January FDI ticks up slightly. The seasonally adjusted January FDI (60.8) accelerated modestly m/m for the second straight month (December 57.6, November 56.9). In the January survey, a full 82% of respondents indicated sales were “better” relative to seasonal expectations – the highest percentage recorded since FDI inception. This produced a seasonally adjusted sales index of 72.7, up vs. 68.4 in December and suggesting selling conditions remain very strong overall. Pricing was again a solid tailwind as 73% of distributors saw higher prices y/y (up vs. 66% in December) amid strong end market demand. This resulted in an FDI pricing index of 86.4 (vs. last month’s 82.9 reading), which was nicely above the 2017 average of 75.0. As it relates to customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (64% of responses), while 33% believe inventory levels are too low. This was very consistent with December (63% and 31%, respectively).

FDI Forward-Looking Indicator accelerates. The FDI 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. The seasonally adjusted FLI accelerated again this month, coming in at 64.7 in January vs. December’s 59.6. Gains were again driven by a more bullish 6-month outlook and improved hiring sentiment (more on this below). For context, the FLI averaged 49.7 during 2016 and 60.9 in 2017. Given solidly expansionary FDI and FLI readings, market conditions still appear likely to remain in growth mode in the coming months.

Manufacturing employment higher m/m. Hiring sentiment was again slightly higher this month among survey respondents. 33% of respondents saw higher employment levels in January relative to seasonal expectations vs. 20% in December, while 67% saw employment as in line with seasonal expectations (December 77%). The resulting FDI Employment Index was 66.7, up vs. December's 58.6 reading. The January US jobs report, meanwhile, was stronger than expected at +200,000 jobs (+180,000 expected), reflecting continued gains in construction, food services and drinking places, health care, and manufacturing. Manufacturing employment continues to trend upwards (+15,000 jobs in January), driven by a gain in durable goods industries (+18,000), which brings the total number of manufacturing jobs added over the last 12 months to +186,000. Average hours per work week for manufacturing employees was down modestly at 40.6 hours (vs. December 40.8).

January sentiment positive. Recall, December commentary was a bit more mixed but respondents were largely expecting strong January trends. This dynamic played out as expected with the FDI accelerating and respondent commentary skewing positively. One distributor characterized this month as the "best January ever!" Another respondent, however, expressed concerns regarding pricing pressure in the channel coming from large customers. Nevertheless, quantitative survey data continues to point to a mostly positive outlook with 76% of respondents expecting higher activity levels over the next six months (also an FDI record and improved vs. 60% in December), along with another 21% who expect similar activity.

Fastenal reported January daily sales growth of 12.0% y/y, slightly above our 11.5% estimate and again reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was 10.0%, the eighth straight month of double-digit growth. Fasteners again saw strong growth at 10.1% y/y, including the Mansco acquisition (+6.2% ex-Mansco). Based on FDI data and other research inputs, we expect a continued uptick in growth among the public industrial distributors in 2018, with Fastenal daily sales growth expected to sustain in the double-digits y/y.

FAST Risk Synopsis

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 Risk Synopsis

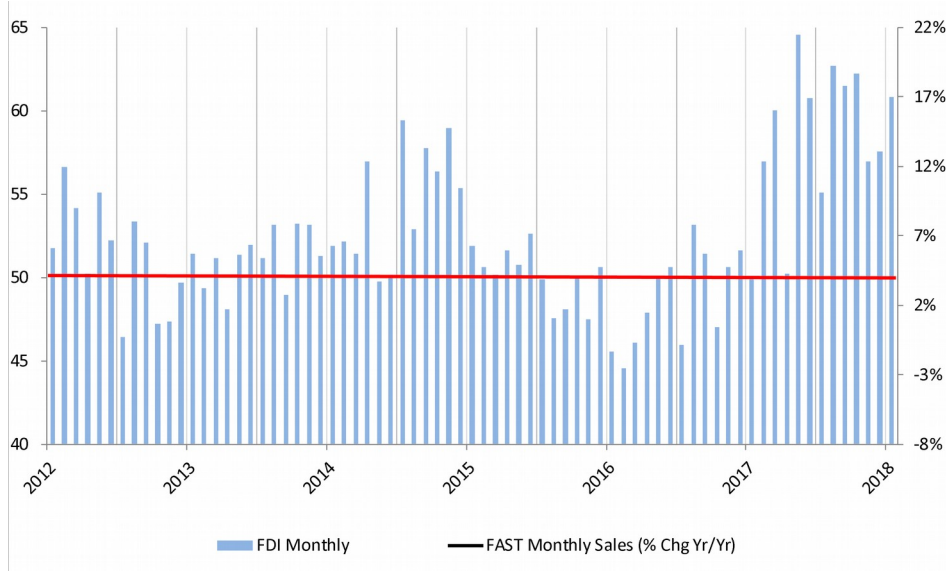
Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Fastener Distribution Trends: January 2018

FASTENER DISTRIBUTION AT A GLANCE										
January 2018										
	----- Index Values -----								Directiøn	Rate of Change
	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun		
PMI (Manufacturing Sector)	59.1	59.3	58.2	58.7	60.8	58.8	56.3	57.8	Growing	Slower
FDI (Fastener Sector)	64.8	56.8	55.9	61.3	57.6	61.0	52.9	60.5	Growing	Faster
FDI (Seasonally Adjusted)	60.8	57.6	56.9	62.2	61.5	62.7	55.1	60.8	Growing	Faster
Sales (SA)	72.7	68.4	72.8	80.1	77.3	77.1	69.8	86.6	Growing	Faster
Forward-Looking (SA)	64.7	59.6	57.7	59.1	66.9	59.9	62.9	64.0	Growing	Faster
(Other Metrics; NSA)										
Employment	66.7	58.6	53.1	56.7	57.1	62.1	53.3	68.0	Growing	Faster
Supplier Deliveries	66.7	68.6	68.8	65.0	69.6	65.2	65.0	64.0	Growing	Slower
Respondent Inventories	56.1	58.6	53.1	51.7	48.2	62.1	51.7	52.0	Growing	Slower
Customer Inventories	34.8	37.1	37.5	40.0	37.5	39.4	35.0	32.0	Declining	Faster
Pricing, month-to-month	68.2	67.1	64.1	63.3	73.2	72.7	65.0	52.0	Growing	Faster
Pricing, year-to-year	86.4	82.9	78.1	75.0	83.9	78.8	76.7	66.0	Growing	Faster
				Higher	Same	Lower				
6-Month Outlook - January				76%	21%	3%				
<p><i>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.</i></p>										

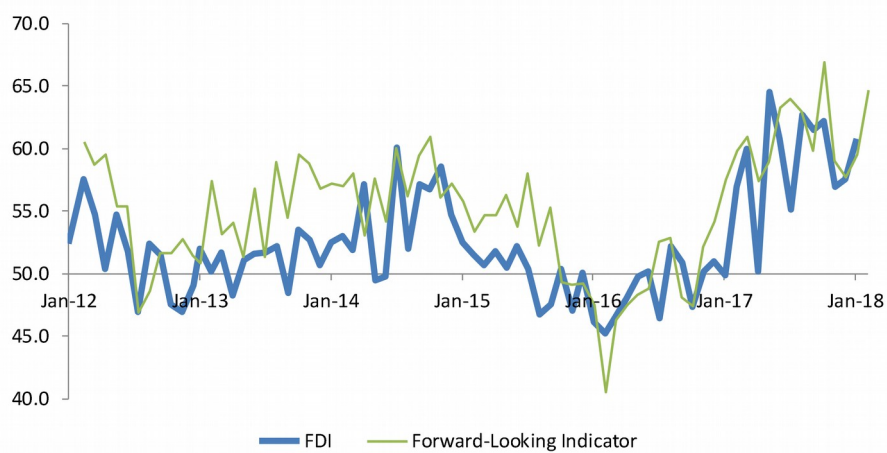
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

FDI vs. Forward-Looking Indicator (Seasonally Adjusted)



Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

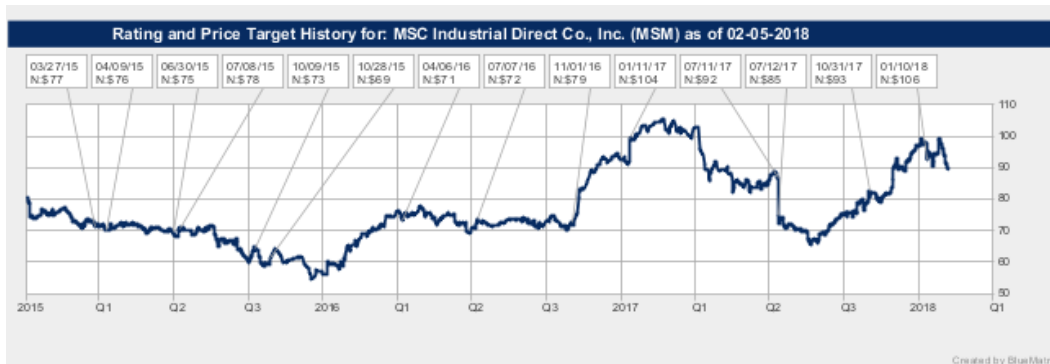
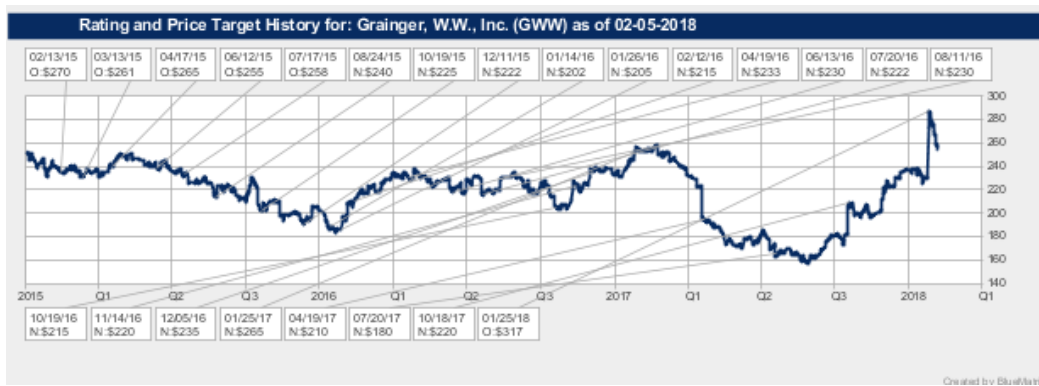
All stock prices below are as of 2/6/2018.

Fastenal Company (FAST-\$52.38-Outperform)

W.W. Grainger Inc. (GWW-\$258.90-Outperform)

MSC Industrial Direct Co. Inc (MSM-\$90.43-Neutral)

(See recent research reports for more information)



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