Fastener Distributor Index – April 2018

Written by R.W. Baird analyst David J. Manthey, CFA 5/7/18

Key Takeaway:

The seasonally adjusted FDI for April 2018 was 57.4, down modestly m/m (March 59.5) but remaining well in expansionary territory overall. Selling conditions similarly moderated with the seasonally adjusted sales index coming in at 63.0, down vs. a strong 70.1 reading in March. Qualitative commentary on market conditions was very positive regarding demand, while steel tariff impacts remain a topic of heavy discussion among respondents. The six-month outlook remains strong overall, while the Forward-Looking Indicator was down slightly m/m but still very healthy at 58.9 (vs. 59.9 in March).

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**, the **National Fastener Distributors Association**, and **Baird**. It offers insights into current 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)**.

April FDI down slightly. The seasonally adjusted April FDI (57.4) moderated m/m vs. March's 59.5 reading. In the April survey, 56% of respondents indicated sales were "better" relative to seasonal expectations vs. 64% in March. This produced a seasonally adjusted sales index of 63.0 (March 70.1). Pricing gains were again noted by a large majority of respondents, with 81% of respondents seeing higher prices y/y vs. 71% in March. For perspective on the strength of pricing in April – only 20% of respondents reported higher pricing at the low point in March of 2016. The resulting FDI pricing index of 89.1 (vs. March 85.7) was the highest reading in FDI survey history. Respondents continued to comment on inflationary pressures in the channel, with steel tariffs seen as likely to lead to additional supplier price increases over the near to medium-term. Regarding customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (63% of responses), while 31% believe customers' inventories are too low, and another 6% see inventory levels as too high. This was relatively consistent with March (64% in line, 32% too low, and 4% too high).

April FLI down slightly m/m. The seasonally adjusted FLI came down slightly following last month's acceleration, registering 58.9 in April vs. 59.9 in March. The primary drivers of this modest downtick were a slightly lower 6-month outlook and employment levels. Nevertheless, at 58.9, the FLI remains well into expansionary territory and relatively consistent with averages seen across 2017 (60.9). Given solidly expansionary FDI and FLI readings, we believe market conditions are likely to remain in growth mode (albeit potentially moderating growth) in the coming months.

Manufacturing employment relatively stable with last month. Hiring sentiment was relatively stable this month among survey respondents. 19% of respondents saw higher employment levels in April relative to seasonal expectations vs. 29% in March, while another 81% saw employment as in line (March 68%). The resulting FDI Employment Index was 59.4, relatively consistent with March's 62.5 reading (albeit modestly lower). The April US jobs report, meanwhile, was a bit mixed with +164,000 jobs added (+193,000 expected), though the unemployment rate ticked down to 3.9% (vs. 4.0% consensus). April's gains primarily came in professional and business services, manufacturing, health care, and mining. Manufacturing employment continues to trend upwards (+24,000 jobs in April), with most of the gains coming from durable goods manufacturing (machinery +8,000, fabricated metal products +4,000). Total manufacturing jobs added over the past year now stands at +245,000. Average hours per work week for manufacturing employees increased slightly at 41.1 hours (vs. March 40.9).

April sentiment mostly positive. Commentary from respondents skewed positive overall this quarter. Several comments highlighted the current strong pace of demand, with one respondent saying, "Sales are brisk, [we're] having a great year!" Another distributor indicated they are "struggling to keep up" with demand, and another simply said demand is "up, up, up." Steel tariffs also remain a topic of heavy discussion in the industry. Several respondents expressed unease over the still-uncertain impacts of potential tariffs, with one saying, "Everyone [is] worried about how the tariffs on nuts are going to affect costs and [selling] prices." We continue to see impacts from steel tariffs as likely to be net neutral to slight positively, as many distributors have historically been able to pass price increases from suppliers on to customers, while higher domestic activity levels could also be a minor positive. Importantly, quantitative survey data points to continued momentum through 2018, with 53% of respondents expecting higher activity levels over the next six months and 44% expecting similar activity.

Fastenal reported April daily sales growth of 13.4% y/y, above our 13.0% estimate and again reflecting growth in all end markets/product lines. Underlying "core" growth (excluding foreign exchange) was 12.8%, the eleventh consecutive month of double-digit growth. Fasteners again saw strong double-digit growth at 10.7% y/y. Based on FDI data and other research inputs; we expect continued strength in public industrial distributor growth during 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.

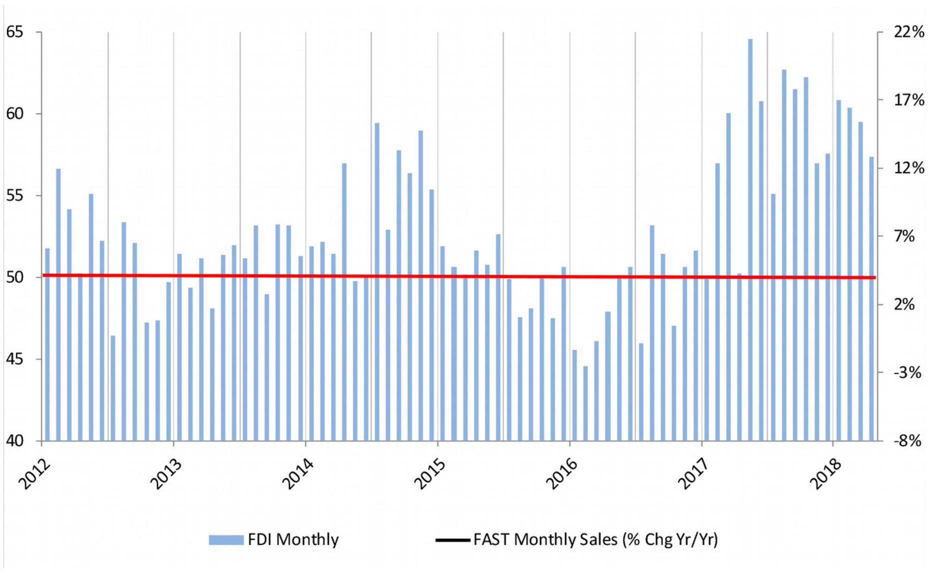
Fastener Distribution Trends: April 2018

FASTENER DISTRIBUTION AT A GLANCE April 2018										
	------------------------ Index Values ------------------------									Rate of
	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Direction	Change
PMI (Manufacturing Sector)	57.3	59.3	60.8	59.1	59.3	58.2	58.7	60.8	Growing	Slower
FDI (Fastener Sector)	59.8	61.2	58.4	64.8	56.8	55.9	61.3	57.6	Growing	Slower
FDI (Seasonally Adjusted)	**57.4**	**59.5**	**60.4**	**60.8**	**57.6**	**56.9**	**62.2**	**61.5**	Growing	Slower
Sales (SA)	63.0	70.1	74.2	72.7	68.4	72.8	80.1	77.3	Growing	Slower
Forward-Looking (SA)	58.9	59.9	58.3	64.7	59.6	57.7	59.1	66.9	Growing	Slower
(Other Metrics; NSA)										
Employment	59.4	62.5	62.2	66.7	58.6	53.1	56.7	57.1	Growing	Slower
Supplier Deliveries	71.9	69.6	64.9	66.7	68.6	68.8	65.0	69.6	Growing	Faster
Respondent Inventories	53.1	60.7	59.5	56.1	58.6	53.1	51.7	48.2	Growing	Slower
Customer Inventories	37.5	35.7	40.5	34.8	37.1	37.5	40.0	37.5	Declining	Slower
Pricing, month-to-month	73.4	76.8	68.9	68.2	67.1	64.1	63.3	73.2	Growing	Slower
Pricing, year-to-year	89.1	85.7	78.4	86.4	82.9	78.1	75.0	83.9	Growing	Faster
				Higher	Same	Lower				
6-Month Outlook - April				53%	44%	3%				

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.

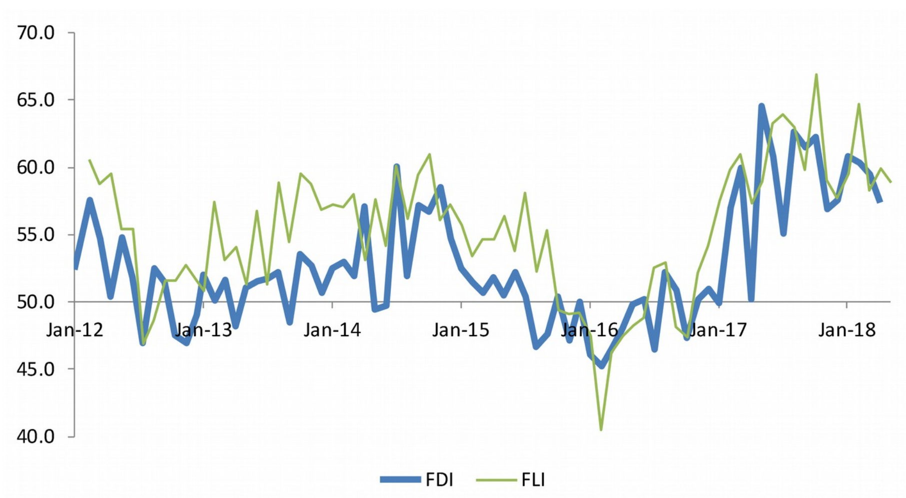
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



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

1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)

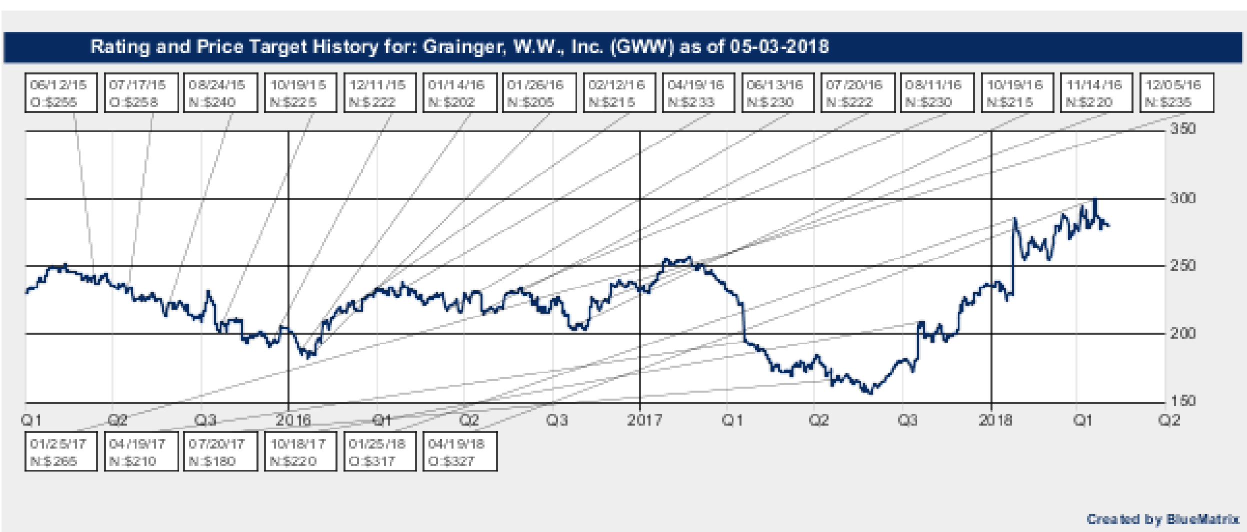


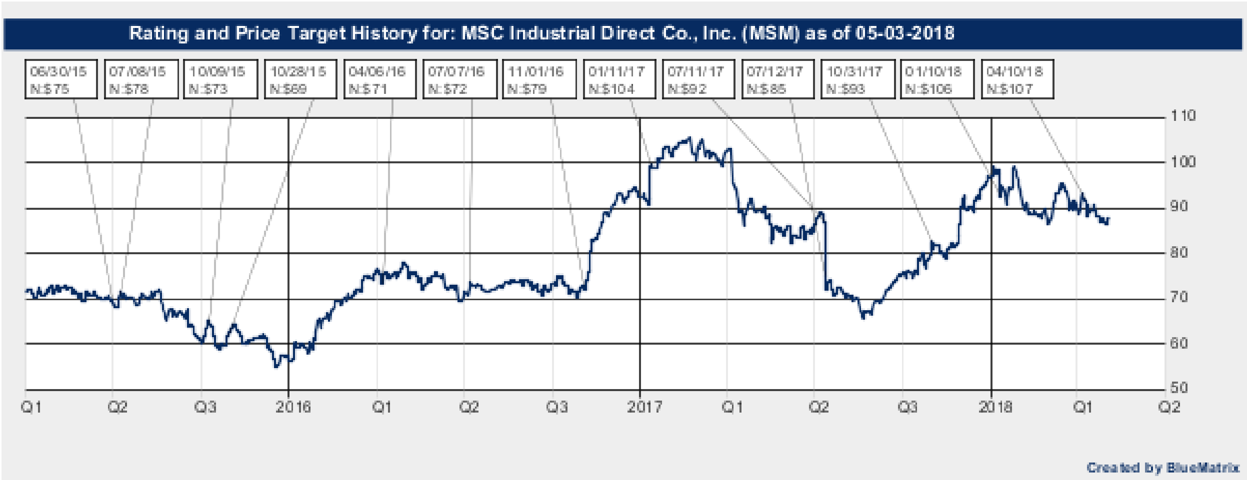
Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are as of 5/4/2018.

Fastenal Company (FAST-$50.44-Outperform)
W.W. Grainger Inc. (GWW-$283.91-Outperform)
MSC Industrial Direct Co. Inc (MSM-$89.30-Neutral)
(See recent research reports for more information)





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