BB&TCM’S FASTENER DISTRIBUTOR INDEX (FDI) - APRIL STILL SOLID, BUT CLEARY SLOWER THAN MARCH/Q1’12

Key Points

• About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm fastener distributors, conducted in partnership with the FCH Sourcing Network, that aims to provide insight into current trends/outlooks. As a diffusion index, readings above 50 signal strength and below 50 signal weakness. It should be directly relevant to Fastenal and broadly relevant to other distributors (W.W. Grainger, MSC Industrial).

• April’s FDI is 53.8 (vs. 55.9 in March)—a good start to Q2’12, just not as good as Q1’12. In Q1’12 the index averaged 56.4, so April’s reading suggests more tepid growth to begin Q2’12. It is also notable that the FDI underperformed versus the national manufacturing index (PMI). Sales hurt, slipping from the mid- to high-60s in Feb./Mar. to 55.1. Other elements, though, supported a still healthy view, specifically slower Supplier Deliveries (59.0 in April, vs. 51.2 average in Q1’12) and Customer Inventories (42.3 in April) that are still viewed by distributors as too low. Most end markets and geographies did not diverge much from the broad trend, though construction, electronics and the Northeast looked a little softer. Why April was not so robust is hard to say. Maybe direct shipping is accelerating as project/capital spending ramps (thus, a divergence between FDI and PMI). Perhaps Q1’12 had some demand pull forward. But we can say this: a reading of 53–54 still constitutes sequential growth in April over March.

• The outlook is still the strongest component, but a poor trend has to be acknowledged. 61.5% of respondents expect activity to be “higher” in six months; just 10.3% said “lower.” This is a good reading, but one cannot ignore that the spread has narrowed over the last four months. Respondents feel good about things, but not as good as they did to start the year.

• Price: still mildly favorable, not obviously trending. Year-to-year, point-of-sale pricing is up (48.7% of respondents) or “flattish” (43.6%); rate of change backed up a bit to 2.5%–3.0%. We may be seeing past increases anniversarying at a faster rate than new hikes impact. Sequential pricing is still mildly favorable, but did not pick up versus March’s glimmer of optimism.

• Supplemental question: asked what markets companies see suited to invest in, they seem attracted to the flame. We asked distributors inclined to invest in new markets what ones they thought merited investment. Most mentioned: General Industrial/Job Shops (20.3% of responses). This is not aggressive, as “Industrial” is where most firms already play suggesting a low-risk effort to target tangential spots within already known areas. The next three industrial markets most often mentioned were Automotive (15.6%), Oil/Gas (9.4%) and Metal/Mining (7.8%), all clearly exciting markets, in our view. High margin electronics also were targeted (10.9%). It would seem these are the markets where competition could escalate.

• What does this mean for Fastenal? Perhaps a bit of a backing off from what was a strong March. It is treacherous to project one month’s trend, but with the FDI a bit softer led by the sales piece, we believe it would suggest a bit of a weaker trend in Fastenal’s sequential DSR in April relative to historical norms (which for April over March is up 0%–1%). It would not surprise us, then if April’s DSR was “flattish” with March, +/-0.5%, which would imply annual growth of 17.6%–18.8% and put the sales line a bit behind our model. Given that Fastenal, Grainger, and MSC Industrial are 85%–90% correlated over the last 10 years (and 87%–93% correlated over the last five), the April FDI might suggest a little slower results for them as well.
BB&T Capital Markets rating distribution by percentage (as of March 31, 2012):

All companies under coverage:
- Buy (1): 53.0%
- Hold (2): 46.0%
- Underweight/Sell (3): 1.0%
- Not Rated (NR): 0.0%
- Suspended (SP): 0.0%

All companies under coverage to which it has provided investment banking services in the previous 12 months:
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- Hold (2): 3.5%
- Underweight/Sell (3): 0.0%
- Not Rated (NR): 0.0%
- Suspended (SP): 0.0%

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The definition of each rating is as follows:
- Buy (1): estimated total return potential greater than or equal to 10%
- Hold (2): estimated total return potential greater than or equal to 0% and less than 10%
- Underweight (3): estimated total return potential less than 0%

NR: Not Rated  NA: Not Applicable  NM: Not Meaningful  SP: Suspended

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BB&T Capital Markets Equity Research Disclosures as of May 2, 2012

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COMMERCIAL AND INDUSTRIAL

Holden Lewis / (804) 782-8820 / hlewis@bbandtcm.com
John C. Cooper / (804) 787-8293 / jncooper@bbandtcm.com

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May 2, 2012

COMMERCIAL AND INDUSTRIAL

Holden Lewis / (804) 782-8820 / hlewis@bbandtcm.com
John C. Cooper / (804) 787-8293 / jncooper@bbandtcm.com

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EQUITY RESEARCH

Director of Research – Vernon C. Plack, CFA (804) 780-3257
Assistant Director of Research – James H. Weber, CFA (804) 782-8773

COMMERCIAL AND INDUSTRIAL

Building Materials
John F. Kasprzak Jr. (804) 782-8715
Paul Betz (804) 782-8746
Teresa T. Nguyen, CFA (804) 782-8745

Commercial Durables
Matthew S. McCull, CFA (804) 780-3582
Jack C. Stimac, CFA (804) 782-8884

Industrial Equipment–Distribution & Components
Holden Lewis (804) 782-8820
John C. Cooper (804) 787-8293

Industrial Equipment–Flow Control
Kevin R. Maczka, CFA (804) 782-8811
Nicholas V. Prendergast (804) 782-2006

Industrial Equipment–Machinery
C. Schon Williams (804) 782-8769
Aaron M. Reeves (804) 780-3237

Specialty Construction & Facilities Services
Adam R. Thalhimter, CFA (804) 344-8377
Charles E. Redding (804) 782-8853

CONSUMER

Agribusiness/Consumer Foods
Heather L. Jones (804) 780-3280
Brett M. Hundley, CFA (804) 782-8753
Harsh Nahata (804) 482-5775

Apparel, Footwear, & Specialty Retail
Scott D. Krasik, CFA (212) 822-8138
Kelly L. Halsor (212) 822-8132

Automotive Aftermarket
Bret D. Jordan, CFA (617) 316-1345
David L. Kelley (617) 316-1344

Food & Drug Merchandising
Andrew P. Wolf, CFA (804) 787-8224
Ashby W. Price (804) 782-8711

Specialty Hardlines Retailers
Anthony C. Chukumba (212) 822-8143
Eric Cohen (212) 822-8140

ENERGY

Coal/Natural Resources
Mark A. Levin (804) 782-8856
Nathan P. Martin (804) 782-8799
Garrett S. Nelson (804) 787-8259

Energy Infrastructure
Robert F. Norfleet III (804) 787-8231
Bryce D. Humphrey (804) 782-8893

FINANCIAL SERVICES

Banks/Thrifts
Cary A. Morris (804) 782-8831
Blair C. Brantley, CFA (804) 727-2604

Specialty Finance
Vernon C. Plack, CFA (804) 780-3257
Peter W. Councill, CFA (804) 782-8850

TECHNOLOGY

Aerospace & Defense
F. Carter Leake (804) 482-7167
John McLeod (804) 225-5899

Commercial IT Services/Government Services
George A. Price Jr. (703) 471-3892
Jethro R. Solomon (703) 471-3893

Defense
Jeremy W. Devaney (703) 471-3891

TRANSPORTATION SERVICES

Airfreight & Logistics/Maritime
Kevin W. Sterling, CFA (804) 782-8804
William W. Horner (804) 787-1143
Chip Rowe (804) 782-8787

Surface Transportation
Thomas S. Albrecht, CFA (804) 787-8210
John L. Washington (804) 225-5898
A. Rhem Wood Jr. (804) 782-8784

RESEARCH DEPARTMENT

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

Supervisory Analysts
Kathleen R. Schneider (732) 567-8766
Denise Bossé Tynan (804) 782-8880
James H. Weber, CFA (804) 782-8773

Editor
Peggy Myers Walz (804) 782-8785

RESEARCH OFFICES

Richmond—Main Office
901 East Byrd St., Suite 310
Richmond, Virginia 23219
(800) 552-7757

New York—Research, Sales Trading, Sales
1133 Avenue of the Americas, 27th fl
New York, New York 10036
(800) 896-9868

Reston—Research
12010 Sunset Hills Road, 7th fl
Reston, Virginia 20190