

## COMPANIES MENTIONED

## Fastenal Company

FAST - \$42.24 - Hold (2)

## MSC Industrial Direct Co., Inc.

MSM - \$69.30 - Hold (2)

## W.W. Grainger, Inc.

GWW - \$203.44 - Buy (1)

**BB&TCM'S FASTENER DISTRIBUTOR INDEX (FDI) - ECHOING SENTIMENT ELSEWHERE, THE BAD DATA STABILIZES IN AUGUST****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, which aims to provide insights 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).
- **After a rough couple of months, the August FDI signals stabilization (51.0, vs. 45.1 in July).** The souring conditions of June and July seem to have been arrested in August, when conditions seem to have been in line with expectations. It is notable that over the last three months the FDI has averaged 49.2 while the national PMI has averaged 49.7 (**Exhibit 1**, next page). Both measures seem to be signaling stable demand. The **Sales** (51.4, vs. 38.2 in July) component brought the greatest relief, with August being largely as respondents would have expected, after July performed far worse. Other index pieces—Employment, Supplier Deliveries, Customer Inventories—were generally better but really did not change in substance from the past couple months. Construction was the lone end market that stood out, resuming the strength that has been evident through much of the year. *The FDI seems to be echoing what we think is becoming the dominant sentiment within manufacturing: fear of cascading weakness is being supplanted but a sense of stable, slower conditions and a likelihood of “muddling through”.*
- **Outlook: A better month brings out more optimists.** 31% of respondents expect activity to be higher six months from now, essentially the same number that expect lower activity six months out (28%). While we believe balanced sentiment is not great, it is an improvement on July (only 18% expected higher activity then) and the first month this year where sentiment did not erode. *The responses had felt a little panicky of late. That sentiment improved in August, but the balanced reading still points to uncertainty, in our view.*
- **Pricing: we don't know if it is good or bad, but there is just little to write about on this front.** Forced to pick a direction, we would argue pricing is marginally worse in August, but in substance it is largely unchanged. There remains no impetus for fresh price hikes, and given a string where that has been true the annual price increases remain very modest at 1%–2% in August (same as June/July). *In fasteners, revenues look unlikely to get any boost from price.*
- **Pricing, it turns out, is following costs.** This month we asked respondents to expand upon the price/cost dynamic. The largest tranche of responses (36%) indicated that price and cost are in synch. The second largest indicated that costs were rising faster than price (25%). The third was that costs were rising, but this was being more than offset with price (14%). We had other categories, but aggregating them it broke down like this: margin positive responses were 28%, margin neutral responses were 36%, and margin negative responses were 36%. *Like pricing, the price/cost dynamic may be marginally negative, but in substance it is in balance.*
- **The August read-through to other distributors: sitting on a new, lower plateau.** August is a reasonably “clean” month (unlike July; who knows how the July 4<sup>th</sup> holiday played out), so we believe the fact that it is pointing to slower but stable growth, rather than the apparent erosion of the prior two months, is a positive. It probably points to **Fastenal** delivering an August DSR that is consistent with to slightly improved on the historical norm. Given that distributors are highly correlated, we would expect **MSC Industrial** and **Grainger** to exhibit similar stability of results.

**Exhibit 1. A broader swathe of fastener distributors are experiencing subpar results in June, the first time that has been true in 2012**

FASTENER DISTRIBUTION AT A GLANCE												
August 2012												
	Index - July	Index - July	Index - June	Index - May	Index - Apr.	Index - Mar.	Index - Feb.	Index - Jan.	July --> Aug. Change	Direction		
<b>PMI (Overall mfring sector)</b>	49.6	49.8	49.7	53.5	54.8	53.4	52.4	54.1	(3.8)	Declining		
<b>FDI (Fastener distribution)</b>	51.0	45.1	51.6	56.3	53.8	55.9	55.9	57.3	(4.7)	Declining		
Sales	51.4	38.2	42.2	58.8	55.1	69.4	64.5	79.1	(16.6)	Growing		
Employment	54.2	50.0	54.7	58.8	59.0	63.9	59.2	58.1	(4.1)	Growing		
Supplier Deliveries	52.8	51.3	60.9	61.3	59.0	48.6	52.6	52.3	(0.3)	Slowing		
Respondent Inventories	62.5	57.9	60.9	55.0	62.8	59.7	53.9	58.1	5.9	Too High		
Customer Inventories	45.8	40.8	48.4	46.3	42.3	41.7	47.4	39.5	2.2	Too Low		
Pricing, month-to-month	52.8	55.3	57.8	51.3	55.1	61.1	57.9	50.0	6.6	Higher		
Pricing, year-to-year	66.7	61.8	56.3	65.0	70.5	70.8	71.1	65.1	(8.8)	Higher		
6-Month Outlook - August	<u>Higher</u> 31%	<u>Same</u> 42%	<u>Lower</u> 28%									

*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&T Capital Markets' estimates, FCH Sourcing Network, Institute for Supply Management*

**IMPORTANT DISCLOSURES**

**Price Chart**

**FAST**

1) 09/15/09	2) 10/13/09	3) 01/13/10	4) 04/14/10	5) 06/03/10	6) 07/14/10	7) 01/19/11	8) 04/13/11	9) 07/07/11
Buy (1) \$45	Buy (1) \$47	Buy (1) \$54	Buy (1) \$60	Buy (1) \$63	Buy (1) \$65	Buy (1) \$69	Buy (1) \$74	Hold (2) NA



**MSM**

1) 10/12/09	2) 10/22/09	3) 04/08/10	4) 10/22/10	5) 04/07/11	6) 08/12/11	7) 01/06/12	8) 04/05/12	9) 06/29/12
Buy (1) \$52	Buy (1) \$54	Buy (1) \$67	Buy (1) \$69	Hold (2) NA	Buy (1) \$80	Buy (1) \$83	Buy (1) \$95	Buy (1) \$81



**GWW**

1) 10/12/09	2) 01/27/10	3) 04/15/10	4) 06/19/12
Buy (1) \$117	Buy (1) \$120	Hold (2) NA	Buy (1) \$220



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Not Rated (NR)	0.0%

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Suspended (SP)

0.0%

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0.0%

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MSC Industrial Direct Co., Inc. (MSM)	1, 6
W.W. Grainger, Inc. (GWW)	6, 9

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