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 panic 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 4th 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

<table>
<thead>
<tr>
<th>FASTENER DISTRIBUTION AT A GLANCE</th>
<th>August 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMI (Overall manufacturing)</td>
<td>49.6</td>
</tr>
<tr>
<td>FDI (Fastener distribution)</td>
<td>51.0</td>
</tr>
<tr>
<td>Sales</td>
<td>51.4</td>
</tr>
<tr>
<td>Employment</td>
<td>54.2</td>
</tr>
<tr>
<td>Supplier Deliveries</td>
<td>52.8</td>
</tr>
<tr>
<td>Respondent Inventories</td>
<td>62.5</td>
</tr>
<tr>
<td>Customer Inventories</td>
<td>45.8</td>
</tr>
<tr>
<td>Pricing, month-to-month</td>
<td>52.8</td>
</tr>
<tr>
<td>Pricing, year-to-year</td>
<td>66.7</td>
</tr>
</tbody>
</table>

6-Month Outlook - August

<table>
<thead>
<tr>
<th>Higher</th>
<th>Same</th>
<th>Lower</th>
</tr>
</thead>
<tbody>
<tr>
<td>31%</td>
<td>42%</td>
<td>28%</td>
</tr>
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</table>

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

BB&T Capital Markets rating distribution by percentage (as of June 30, 2012):

All companies under coverage:
- Buy (1) 53.8%
- Hold (2) 45.6%
- Underweight/Sell (3) 0.6%
- Not Rated (NR) 0.0%

All companies under coverage to which it has provided investment banking services in the previous 12 months:
- Buy (1) 10.6%
- Hold (2) 6.9%
- Underweight/Sell (3) 0.0%
- Not Rated (NR) 0.0%
Suspended (SP) 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

Stocks rated Buy (1) are required to have a published 12-month price target, while it is not required on stocks rated Hold (2) and Underweight (3).

**BB&T Capital Markets Equity Research Disclosures as of September 6, 2012**

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<thead>
<tr>
<th>COMPANY</th>
<th>DISCLOSURE</th>
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<td>Fastenal Company (FAST)</td>
<td>1, 6</td>
</tr>
<tr>
<td>MSC Industrial Direct Co., Inc. (MSM)</td>
<td>1, 6</td>
</tr>
<tr>
<td>W.W. Grainger, Inc. (GWW)</td>
<td>6, 9</td>
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