BB&T Capital Markets

February 4, 2013

Advanced Manufacturing & Distribution

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COMPANIES MENTIONED

Fastenal
FAST - $50.66 - Hold

W.W. Grainger
GWW - $219.62 - Buy

MSC Industrial Direct
MSM - $80.40 - Hold

BB&TCM's Fastener Distributor Index (FDI) - Anxiety Disappears to Start 2013

KEY TAKEAWAY

After a November/December that could be seen as poor (bad sales) with a silver lining (good outlook), January was unambiguously positive, marked by a recovery in sales, a still stronger outlook, and a little upward wiggle to price. Thus, solving (such as it is) the presidential election/fiscal cliff does seem to have rekindled demand. We believe this suggests January results for industrial distributors are likely to have strengthened as the month progressed.

KEY POINTS

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm fastener distributors, conducted with the **FCH Sourcing Network**, which offers insights into current trends/ outlooks. As a diffusion index, figures 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).

January (56.9, vs. 48.4 in Dec.) is resurgent. After six months ranging from 45 to 51 (so flat to slightly soft), the January FDI mimicked the national PMI and solidly recovered to 56.9. Sales were especially good (82.8, vs. 32.8 in Dec.) offset some by a broadening feeling that customer inventories are still too low (39.7, vs. 46.9 in Dec.; it is better if customers are rebuilding). *November/December were very poor, and we suspect some of January's strength reflects this easy comp. Still, January is unambiguously positive as it suggests late-2012 weakness was a lull, not a trend.*

The January Outlook remains unambiguously robust. What we really liked about the January FDI was that it seemed to have been presaged by solid outlook statements the last two months. And that outlook only solidified further: 62% of respondents expect higher conditions six months out (vs. 55% in Dec.) while just 7% expect things to be worse in six months (vs. 23% in Dec.). *Better current readings and outlooks ... all seems forgiven post-presidential election/fiscal cliff.*

Pricing: marginal, but tangible, improvement. Sequential pricing was up slightly, though most still saw no change. We would say the same about the annual price responses. Basically, a small contingent of respondents left the "same" camp for the "higher". *Pricing still strikes us as flat to slightly up at this point, but that a slightly greater number of respondents are willing to seek an increase is positive.*

Supplemental query: is consolidation occurring? Investors assume fastener distribution is consolidating. So do distributors: only 24% of respondents think it IS NOT, while 76% think the fastener distribution industry IS as larger firms acquire (36%), outcompete (18%), or both (45%). But it is slow: most respondents have 5-20 competitors in each territory they compete in, and fully 65% of those don't see those numbers getting cut in half for at least 10 years.

What does this mean for the "Big 3" distributors? When Grainger posted EPS, it had positive things to say about January. Fastenal and MSC, in contrast, were much more cautious about January, but did report much earlier in the month. So the trend was unclear, in our view. This seems to suggest the issue was *when* Fastenal and MSC reported and that the month probably finished stronger for them. We will get our first feel for this on February 5, 2013 when Fastenal reports its January DSRs.

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FASTENER DISTRIBUTION AT A GLANCE
January 2013

	Index - Jan.	Index - Dec.	Index - Nov.	Index - Oct.	Index - Sept.	Index - August	Dec.-->Jan. Change	Direction
PMI (Overall mftring sector)	53.1	50.7	49.5	51.7	51.5	49.6	2.4	Growing
FDI (Fastener distribution)	56.9	48.4	46.1	46.8	48.2	51.0	8.5	Growing
Sales	82.8	32.8	34.4	48.6	45.7	51.4	49.9	Growing
Employment	60.3	53.1	50.0	51.4	51.4	54.2	7.2	Growing
Supplier Deliveries	44.8	60.9	56.3	48.6	50.0	52.8	(16.1)	Speeding Up
Respondent Inventories	65.5	64.1	59.4	62.9	62.9	62.5	1.5	Too High
Customer Inventories	39.7	46.9	43.8	38.6	45.7	45.8	(7.2)	Too Low
Pricing, month-to-month	56.9	51.6	48.4	50.0	47.1	52.8	5.3	Higher
Pricing, year-to-year	60.3	57.8	53.1	58.6	55.7	66.7	2.5	Higher

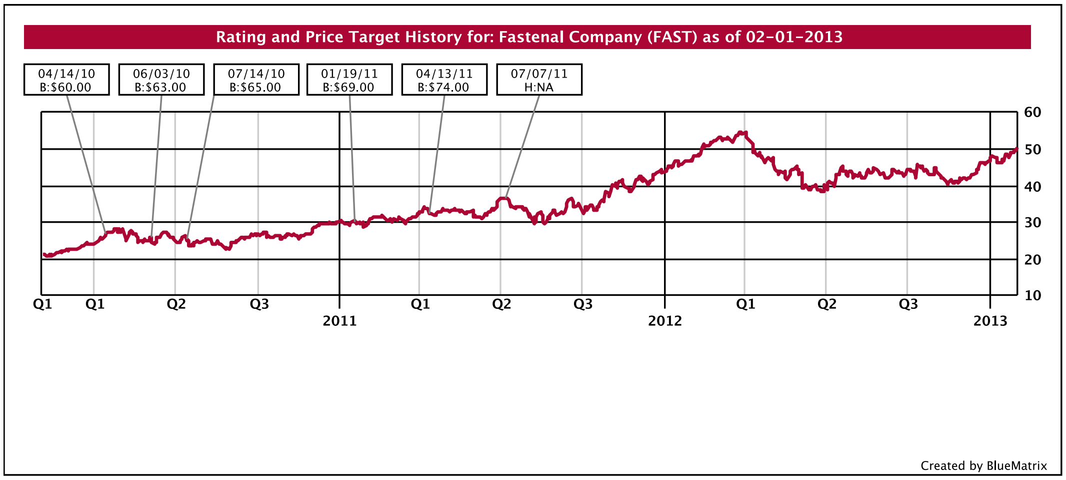
	Higher	Same	Lower
6-Month Outlook - Dec.	62%	31%	7%

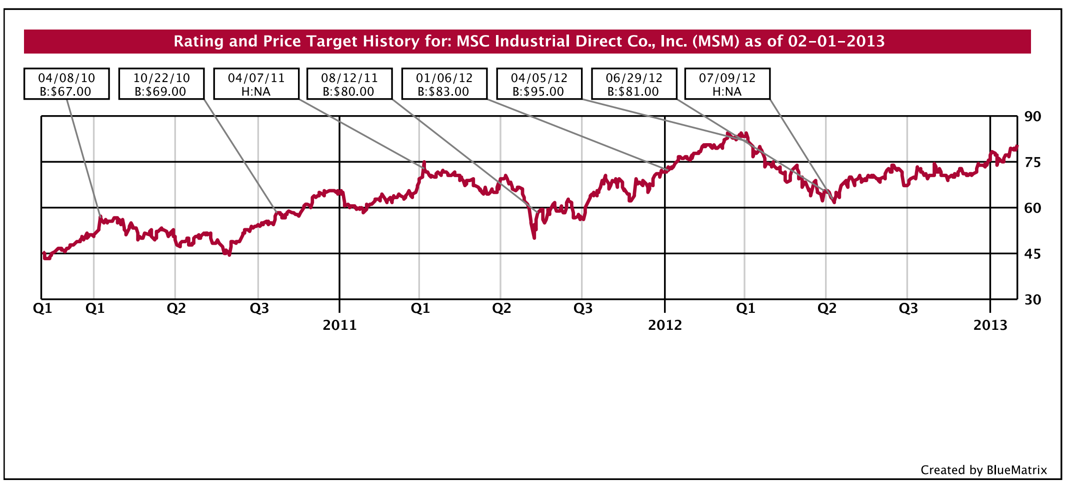
FDI and Pricing are diffision indexes. At 50, the performance of the category listed met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.

Sources: BB&T Capital Markets, FCH Sourcing Network, Institute for Supply Management

IMPORTANT DISCLOSURES

Price Chart





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