BB&T's Fastener Distributor Index (FDI) - July Continues Trend of Broadening Negative Sentiment

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).

- **Mirroring the PMI, July's FDI signals contraction (45.1, vs. 51.6 in June).** Building on a June that reflected slowing (51.6, from 56.3 in May), July's FDI fell to 45.1 (Exhibit 1, next page). Being below 50 suggests more fastener distributors are experiencing worse-than-expected conditions that point to conditions that are or may soon be contracting. Again, Sales was the highlighter, reflecting far worse than expected performance with a reading of 38.2 (from 42.2 in June). But for the first month since the series started Employment was not up (50.0 in July). It is also notable that Supplier Deliveries (51.3, vs. 60.9 in June) sped up, suggesting that demands on production are moderating. Automotive was clearly a stronger end market. After a stronger start to the year, Construction was mixed in July. Mirroring many broader economic measures, more fastener distributors saw worse than expected performance in July, representing a risk to the cycle.

- **Outlook: Pessimism rises sharply, again.** Erosion of optimism in recent months continued in July: 18% of respondents expect higher activity in six months (25% in June), vs. 45% that expect lower (38% in June). Confidence continued to fail, in our view.

- **Pricing, at least, remains stable.** Still no sign of fresh price (but who expects it at this point?), but nor is there any sign that pricing is sliding. Respondents with positive annual gains (36.8% of total) still easily outpace those feeling pricing pressure (13.2% of respondents); those seeing annual price as the same has swelled to 50% of the total. All this makes the trend in the annual rate of change unsurprising: point-of-sale pricing was ~1.5% in July, consistent with June but half the rate of growth through the first part of 2011 (~3.0%). With no impetus to raise prices and past increases anniversarizing, annual pricing is drifting toward 0%. But it could be worse.

- **The July FDI continues to cast a negative pall on distributor results.** Fastenal posted a sluggish looking July, so that would seem consistent with the FDI result. However, Fastenal felt this was due to the July 4 holiday more than further slowing in the economy. The result would seem to suggest the issue is more durable than that. Given that the distributors are highly correlated, we would expect MSC Industrial and Grainger to have had a tough July as well. However, Grainger, with less production exposure and possibly benefiting from seasonal products (hot temperatures), may prove more resilient than its distribution peers.
**Additional Discussion**

**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>July 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Index -</td>
<td>Index -</td>
</tr>
<tr>
<td>July</td>
<td>June</td>
</tr>
<tr>
<td>PMI (Overall manufacturing sector)</td>
<td>49.8</td>
</tr>
<tr>
<td>FDI (Fastener distribution)</td>
<td>45.1</td>
</tr>
<tr>
<td>Sales</td>
<td>58.2</td>
</tr>
<tr>
<td>Employment</td>
<td>50.0</td>
</tr>
<tr>
<td>Supplier Deliveries</td>
<td>51.3</td>
</tr>
<tr>
<td>Respondent Inventories</td>
<td>57.9</td>
</tr>
<tr>
<td>Customer Inventories</td>
<td>40.8</td>
</tr>
<tr>
<td>Pricing, month-to-month</td>
<td>55.3</td>
</tr>
<tr>
<td>Pricing, year-to-year</td>
<td>61.8</td>
</tr>
<tr>
<td>June to July</td>
<td>(3.8)</td>
</tr>
<tr>
<td>Change</td>
<td>Declining</td>
</tr>
<tr>
<td>Direction</td>
<td></td>
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</table>

| Index -                           | Index -   | Index -   | Index -   | Index -   | Index -   | Index -   |
| PMI (Overall manufacturing sector)| 49.7      | 53.5      | 54.8      | 53.4      | 52.4      | 54.1      |
| FDI (Fastener distribution)       | 51.6      | 56.3      | 53.8      | 55.9      | 55.9      | 57.3      |
| Sales                             | 43.2      | 58.8      | 59.1      | 60.4      | 64.5      | 79.1      |
| Employment                        | 54.7      | 58.8      | 59.0      | 63.9      | 59.2      | 58.1      |
| Supplier Deliveries               | 60.9      | 61.3      | 59.0      | 48.6      | 52.6      | 52.3      |
| Respondent Inventories            | 59.0      | 55.0      | 62.8      | 59.7      | 53.9      | 58.1      |
| Customer Inventories              | 48.4      | 46.3      | 42.3      | 41.7      | 47.4      | 39.5      |
| Pricing, month-to-month            | 57.8      | 51.3      | 55.1      | 61.1      | 57.9      | 50.0      |
| Pricing, year-to-year              | 56.3      | 65.0      | 70.5      | 70.8      | 71.1      | 65.1      |
| 6-Month Outlook - July            | Higher    | Same      | Lower     |
|                                    | 18%       | 37%       | 45%       |

Note: 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
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%
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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).

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<th>COMPANY</th>
<th>DISCLOSURE</th>
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<tbody>
<tr>
<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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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. McCall, CFA (804) 780-3582
Jack C. Stimac, CFA (804) 782-8844
Industrial Equipment—Distribution & Components
Holden Lewis (703) 471-3894
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/Environmental Services
Adam R. Thalhimer, 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
John Ellison (804) 782-8732

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
Railroads
Mark A. Levin (804) 782-8856
Nathan P. Martin (804) 782-8799
Garrett S. Nelson (804) 787-8259
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 Tyznar (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 (800) 552-7757
Richmond, Virginia 23219
New York—Research, Sales Trading, Sales
1133 Avenue of the Americas, 27th fl (800) 896-9868
New York, New York 10036
Reston—Research
12010 Sunset Hills Road, 7th fl
Reston, Virginia 20190