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COMPANIES MENTIONED

Fastenal
FAST - $50.24 - Hold

W.W. Grainger
GWW - $267.95 - Hold

MSC Industrial Direct
MSM - $84.62 - Hold

BB&TCM's Fastener Distributor Index - Soft July, But Inventories are Leaned Out

KEY TAKEAWAY

The national PMI and the Fastener Distribution Index (FDI) diverged in July, with strength in former and softness in the latter. This happened another time in 2013, and in the end demand remained soft. Recognizing the PMI leads, we believe the experience of our distributors more closely resembles the sluggish FDI. However, July holds seeds of improvement. Respondents see little risk that demand worsens, and believe channel inventories are leaned out. Should some catalyst pry open purse strings, the latter sentiment could generate a little extra lift.

KEY POINTS

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of NorAm fastener distributors, conducted with the **FCH Sourcing Network**. It 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**).

July FDI: still signs of a coiled spring in blah figure, but what springs it? July's 49.7 was a bit worse again than June's 51.3, but as been the case in recent months the overall message is unchanged: it's slow out there. Sales firmed (58.3 vs. 50.0 in June) but the employment metric fell (51.4, vs. 57.1 in June) and customer stocks got lower (31.9, vs. 37.5 in June). These low inventories may yet presage stronger numbers, if only something catalyzed customers restocking. *A sub-50 figure is unwelcome, but the substance is unchanged: there is growth, but not much of it. But this month's reading feels worse because the national PMI surged in July, creating a divergence reminiscent of February 2013 (after which not much happened).*

Outlook: a sunnier outlook returns. Positive sentiment has routinely outpaced negative, but after an ebb in June optimism looked resurgent in July. 50% of respondents had a higher six-month outlook (vs. 29% in June), while just 8% had lower (vs. 14% in June). *One constant remains: there is little fear of an erosion in demand. The monthly responses likely hinge on respondent's views on the potential magnitude of future demand growth.*

Price: back to being bored. The sequential reading got a bit better (52.8, vs. 48.2 in June), but still over three-quarters of respondents stood pat. Annual pricing was a little worse, with a reading of 55.6 (vs. 58.9 in June) suggesting positive pricing but respondents putting it back in the 0.5%-1.5% range (vs. 1%-2% in June). *We will keep writing about it, but clearly there is little pricing momentum in the marketplace.*

Supplemental question: how do you feel about channel inventories? Most believe customer stocks are too low (42%) or sized right (39%). Unsurprisingly, then, just 19% expect further inventory cuts, in contrast to 72% who expect neither a further drawdown or a restocking. Only 8% of respondents are experiencing an inventory rebuild currently. *It is clear to us there is room for some restocking to nudge future growth given some catalyst to loosen purse strings. The vexing thing is that the source of that catalyst at this point in the cycle is unclear.*

What does this mean for other distributors? The stocks of **Grainger**, **Fastenal**, and **MSC** have had a good couple of days in the wake of the solid PMI number. But that figure is not being supported by the more targeted FDI. Thus, we worry about two things. One, that the national PMI is being driven by areas that have less impact on industrial distributors, such as housing. Two, it is just noise, a la February 2013. Either way, it is not clear to us that we are going to hear a significantly improved tone from distributors as monthly sales results are released.

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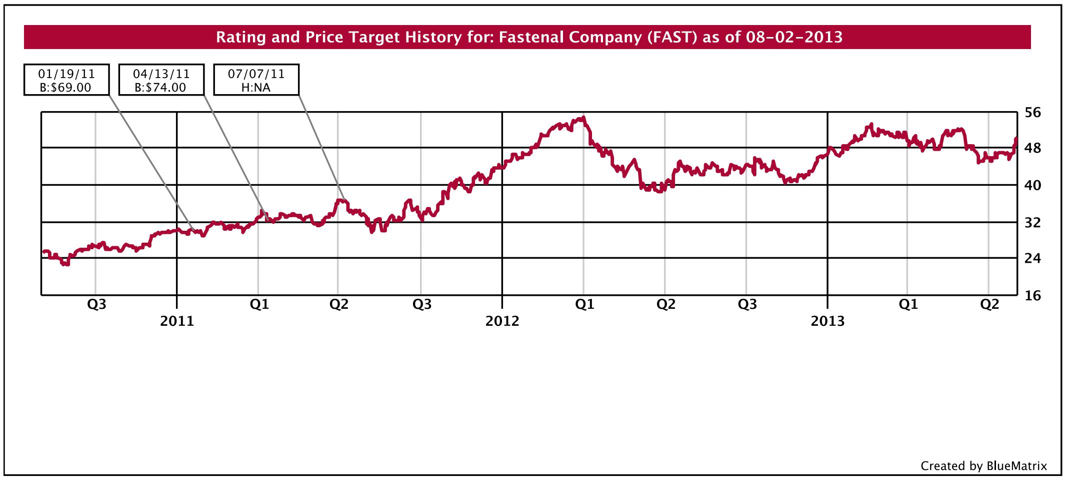
FASTENER DISTRIBUTION AT A GLANCE July 2013									
	---------------------- Index Values ----------------------							Jun.-->Jul.	
	July	June	May	Apr.	Mar.	Feb.	Jan.	Change	Direction
PMI (Overall mftring sector)	55.4	50.9	49.0	50.7	51.3	54.2	53.1	4.5	Growing
FDI (Fastener distribution)	49.7	51.3	52.4	51.6	52.8	48.7	56.9	(1.7)	Declining
Sales	58.3	50.0	63.9	68.8	58.3	48.7	82.8	8.3	Growing
Employment	51.4	57.1	56.9	45.3	56.9	56.4	60.3	(5.8)	Growing
Supplier Deliveries	56.9	60.7	51.4	53.1	52.8	47.4	44.8	(3.8)	Slowing
Respondent Inventories	62.5	69.6	55.6	60.9	68.1	60.3	65.5	(7.1)	Too High
Customer Inventories	31.9	37.5	37.5	39.1	43.1	42.3	39.7	(5.6)	Too Low
Pricing, month-to-month	52.8	48.2	56.9	54.7	50.0	52.6	56.9	4.6	Higher
Pricing, year-to-year	55.6	58.9	65.3	65.6	56.9	62.8	60.3	(3.4)	Higher
	Higher	Same	Lower						
6-Month Outlook - July	50%	42%	8%						

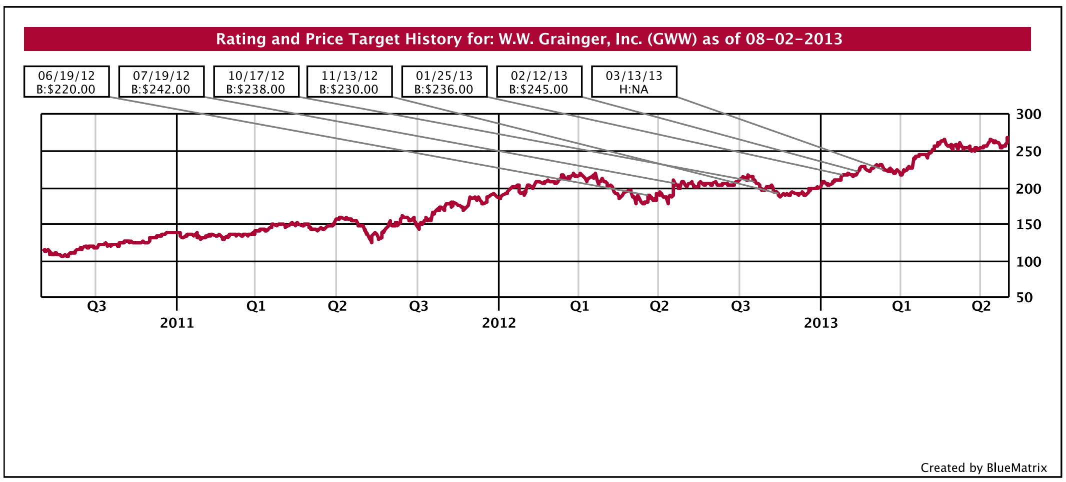
FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.

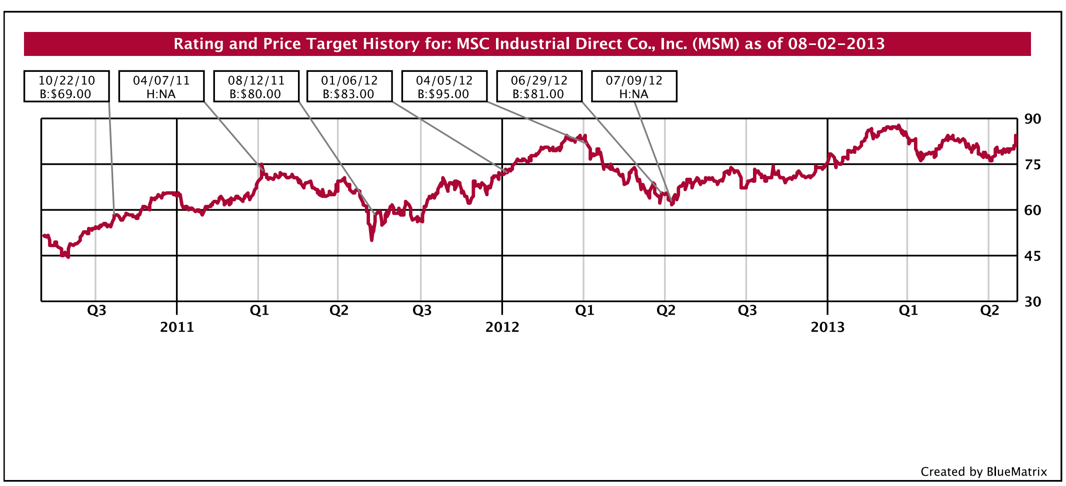
Sources: BB&T Capital Markets' estimates, FCH Sourcing Network, Institute for Supply Management

IMPORTANT DISCLOSURES

Price Chart







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All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
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Not Rated (NR)	0.00%	Not Rated (NR)	0.00%

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B: Buy **H**: Hold **UW**: Underweight **NR**: Not Rated **NA**: Not Applicable **NM**: Not Meaningful **SP**: Suspended

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