BB&T Capital Markets

April 4, 2012

COMMERCIAL AND INDUSTRIAL

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COMPANIES MENTIONED

Fastenal Company
FAST - $53.37 - Hold (2)

MSC Industrial Direct Co., Inc.
MSM - $84.27 - Buy (1)

W.W. Grainger, Inc.
GWW - $219.48 - Hold (2)

BB&TCM'S FASTENER DISTRIBUTOR INDEX (FDI) - MARCH'S INDEX STEADY, BUT SALES STRENGTHEN

Key Points

- **About the Fastener Distributor Index (FDI)**. A joint effort between BB&T Capital Markets and the FCH Sourcing Network, the FDI is a monthly survey of NorAm fastener distributors that aims to provide insight 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). In March, respondents represented $750M–plus in sales, 94% of which were from fasteners.

- **March's FDI is 55.9 (vs. 55.9 in February)–index unchanged, but sales were the strongest component.** For Q1'12, the index averaged 56.4, which would imply stable to slightly better business conditions over Q4'12. That said, while the March FDI reading was mostly unchanged at good levels from February, the strongest component was <u>Sales</u>, which actually got stronger (69.4 in March, vs. 64.5 in February). Other components of the index had just marginal changes. The strong economy is raising pressure to increase <u>Employment</u>; most still are looking to keep employee levels stable, but each month including March some respondents dribbled into the camp that anticipates adding personnel. Channel <u>Inventories</u> look appropriate, but there remains a bias for respondents to believe their inventories are too high and their customers' inventories are too low. Most end markets performed in line with the broad index, but automotive again stood out as relatively strong. Similarly, most geographies performed in line with the broad index, but the Southwest stood out as relatively softer.

- **Outlook: at this point it seems distributors see little to fear through much of 2012**. 66.7% of respondents expect activity to be "higher" in six months while just 5.6% said "lower." This reading edged down each month in Q1'12, but substantively is unchanged at very solid levels.

- **Price: the space is not awash in price, but some distributors may be taking advantage of a strong economy and capturing a little.** Year-over-year, point-of-sale pricing is higher (55.6% of respondents) or "flattish" (30.6%); the rate of change is up 3.2%–3.7%. While this still mostly reflects past actions, March, like February, saw a small increase in the number of respondents reporting sequential pricing. Pricing for distributors (sell to end users) was better than for master distributors (sell to other distributors).

- **Supplemental question: what investments are being made to support growth?** Asked to pick the most important, 57% of respondents listed selling existing products to new markets (~31%) and adding salespeople (26%). 6% were looking to expand SKUs. Here is the problem as we see it: more folks were investing in their catalog (9%) than the Internet (3%), and the numbers investing in services (e.g., vending, bin stocking, CMI/VMI, kitting, etc.) was small. We suspect this is the exact opposite investment profile of the larger distributors, representing a key reason why smaller distributors are losing ground rapidly to larger ones.

- **What does this mean for Fastenal? A good reading, but we think we have it modeled**. It is treacherous to project one month's trend, but with the FDI stable and the sales piece stronger, it suggests **Fastenal**'s sequential DSR in March should be in line with to slightly better than historic norms. This implies a sequential DSR of up 4%–6%, which translates into annual growth of 16.5%–19.0%. This is largely in line with our model. Bearing in mind that Fastenal, **Grainger**, and **MSC Industrial** are 85%–90% correlated over the last 10 years (and 87%–93% correlated over the last five), the February FDI should have positive implications for them also.

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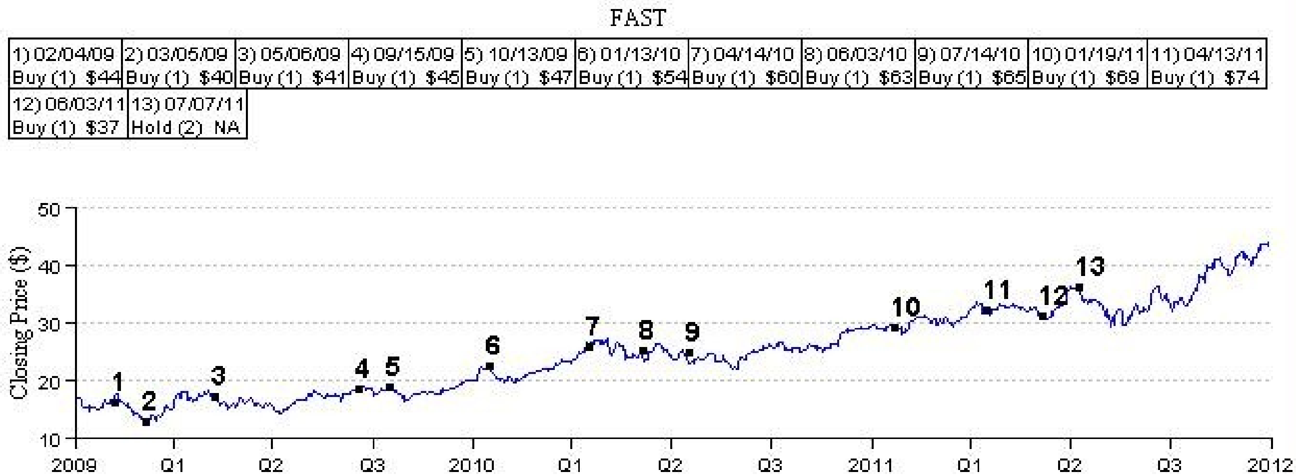
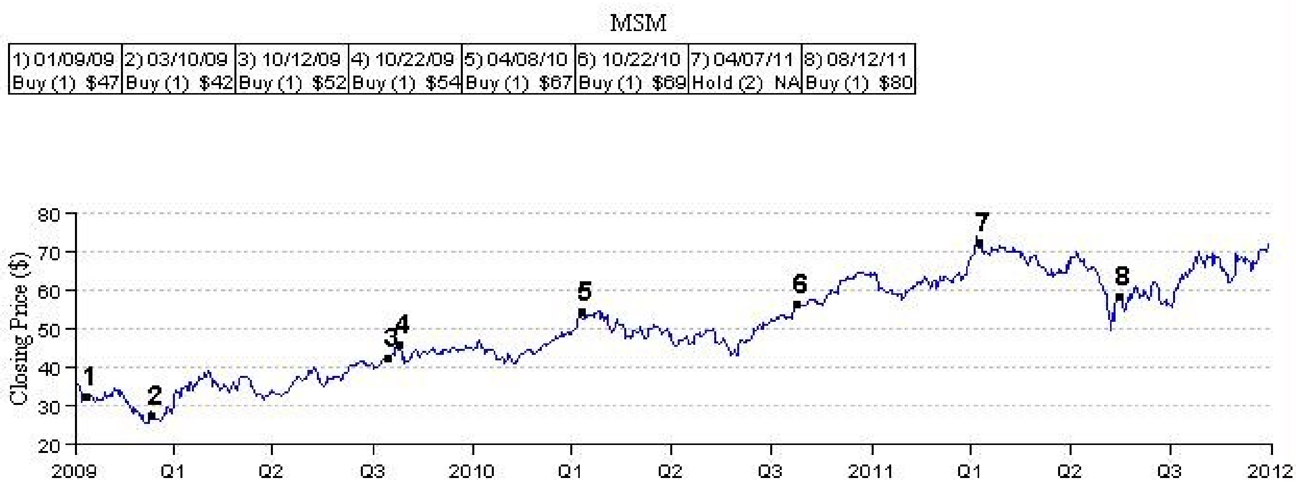
IMPORTANT DISCLOSURES
Price Chart





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Suspended (SP)	0.0%	Suspended (SP)	0.0%

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Underweight (3):estimated total return potential less than 0%

NR: Not Rated **NA:** Not Applicable **NM:** Not Meaningful **SP:** Suspended

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BB&T Capital Markets Equity Research Disclosures as of April 4, 2012

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Fastenal Company (FAST)	1, 6

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

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