

Fastener Distributor Index – April 2017

Written by R.W. Baird analyst David J. Manthey, CFA 5/5/17



Key Takeaway:

The seasonally-adjusted FDI for April 2017 was 50.2, remaining in expansionary territory but declining materially from March's record-high 60.0 reading. April's result was consistent with a slight down-tick in last month's Forward-Looking Indicator, which foreshadowed a weaker FDI this month. Recent sales momentum slipped in April, with the seasonally-adjusted sales index coming in at 43.8 (the lowest result since October 2016). Commentary on market conditions indicates growth remains solid, though perhaps slightly below heightened expectations. The six-month outlook remains favorable, with several distributors noting strong backlogs and customer activity starting to pick up. Forward indicators are also positive, with the FDI Forward-Looking Indicator registering a seasonally-adjusted 58.9 – down from a peak 61.0 in February, but a slight uptick vs. 57.4 last month.

Key Points:

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American fastener distributors, conducted with the **FCH Sourcing Network** and the **National Fastener Distributors Association**. It offers insights into current industry trends/outlooks. As a diffusion index, figures above 50 signal strength, while readings below 50 signal weakness. Over time, results should be directly relevant to **Fastenal (FAST)** and broadly relevant to other industrial distributors (**W.W. Grainger [GWW]**, **MSC Industrial [MSM]**).

April FDI ticks down. The seasonally adjusted April FDI (50.2) decreased from March's record-high 60.0 reading, consistent with March's less bullish Forward-Looking Indicator. Top-line sentiment was notably less positive than March and YTD results, with 32% of distributors indicating sales were better relative to seasonal expectations in April vs. the March level of 68% and YTD average of 58%. This resulted in a seasonally-adjusted sales index of just 43.8, representing the lowest result seen since October 2016. Respondents continue to indicate customer inventory levels are roughly in line with expectations, as only 6% of respondents indicated inventories are too high, while 29% indicated inventories are too low. This compares to March results of 10% and 22%, respectively.

FDI Forwarding-Looking Indicator ticks back up. The FDI Forward-Looking Indicator is based on a weighted average of four forward-looking inputs from the FDI survey. This indicator is designed to provide directional perspective on future expectations for fastener market conditions. April's seasonally-adjusted Forward-Looking Indicator had a value of 58.9 vs. 57.4 in March. The Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 59.3 year-to-date in 2017. Based on an expansionary Forward-Looking Indicator, significant reset in the April FDI, and still mostly supportive end markets, we would not be surprised to see a moderate rebound in the FDI next month.

Manufacturing employment outlook ticks down slightly. Survey respondents indicated a slight deceleration in hiring vs. March, with 21% of respondents indicating hiring picked up in April (vs. 24% in March, 29% in February, and 21% in January). Nevertheless, April represents the fifth consecutive month of above-50 readings for the FDI employment index following four consecutive sub-50 readings – suggesting employment has stabilized/improved of late. March’s US jobs report, meanwhile, came in below expectations (+98,000 adds vs. +180,000 consensus), though domestic manufacturing employment saw a slight gain (+11,000 jobs added vs. February, *US BLS*). The average workweek for manufacturing employees edged down slightly m/m at 40.6 hours.

April sentiment mostly positive. Commentary on current market conditions was again mostly positive, with various distributors noting strong backlog and customer trends. One respondent commented, “Our backlog doubled in April. It was a good month for us;” while another indicated “most of our customers say they have a lot of jobs on the board and that it is going to get very busy.” Consistent with a slight deceleration in the FDI reading, April results were mostly characterized as solid, though perhaps falling short of heightened expectations following a very strong March. One distributor indicated, “I rated the activity the same as the previous month, but it is still considerable growth over last year,” while another noted a deceleration near the end of the month. Overall, optimism continues despite April growth that largely fell short of heightened expectations following an exceptionally strong March.

Fastenal reported slightly lower-than-expected April daily sales growth of 8.9% y/y, reflecting growth in all end markets/product lines. Stripping out acquisitions, foreign exchange, and days issues, underlying “core” growth was closer to 9.5% -- accelerating vs. comparable growth of approximately 6% and 7% in February and March, respectively. Fastener growth was up a solid 6% y/y, including the recent Mansco acquisition. This report exceeded expectations and represents strong accelerating trends – a divergence from the April FDI. Based on FDI data and other inputs, we have been expecting a substantial uptick in growth among the public industrial distributors this year, with Fastenal daily sales growth now expected to average double-digit growth rates for the remainder of 2017.

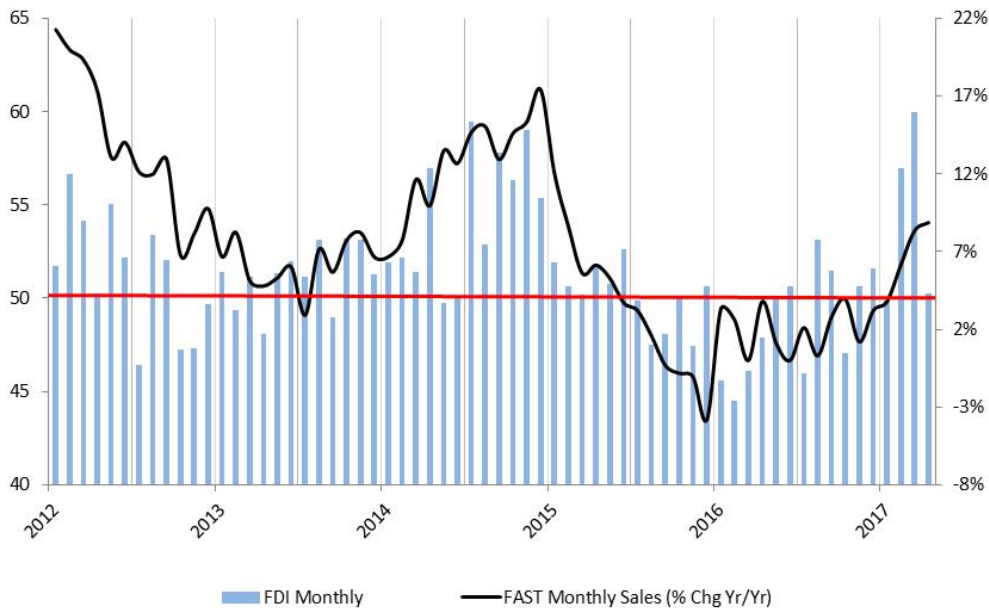
Fastener Distribution Trends: April 2017

FASTENER DISTRIBUTION AT A GLANCE										
April 2017										
	----- Index Values -----							Apr.--> Mar.		
	April	Mar.	Feb.	Jan.	Dec.	Nov.	Oct.	Change	Directon	
PMI (Manufacturing Sector)	54.8	57.2	57.7	56.0	54.5	53.2	51.9	(2.4)	Growing	
FDI (Fastener Sector)	53.7	61.3	55.4	54.5	50.3	49.3	46.6	(7.6)	Growing	
FDI (Seasonally Adjusted)	50.2	60.0	57.0	49.9	51.6	50.6	47.1	(9.8)	Growing	
Sales (SA)	43.8	74.6	62.7	51.6	60.6	64.5	38.3	(30.8)	Growing	
Forward- Looking (SA)	58.9	57.4	61.0	59.8	57.6	54.2	52.2	1.6	Growing	
(Other Metrics; NSA)										
Employment	57.4	59.8	62.9	57.6	51.3	45.7	47.0	(2.4)	Growing	
Supplier Deliveries	66.2	61.0	61.4	56.1	56.4	55.7	54.5	5.2	Growing	
Respondent Inventories	52.9	61.0	58.6	59.1	59.0	65.7	63.6	(8.0)	Growing	
Customer Inventories	38.2	43.9	40.0	36.4	41.0	42.9	43.9	(5.7)	Declining	
Pricing, month-to-month	60.3	63.4	60.0	62.1	56.4	61.4	50.0	(3.1)	Higher	
Pricing, year-to-year	73.5	72.0	70.0	68.2	60.3	61.4	56.1	1.6	Higher	
6-Month Outlook - Apr					Higher	Same	Lower			
					59%	38%	3%			

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

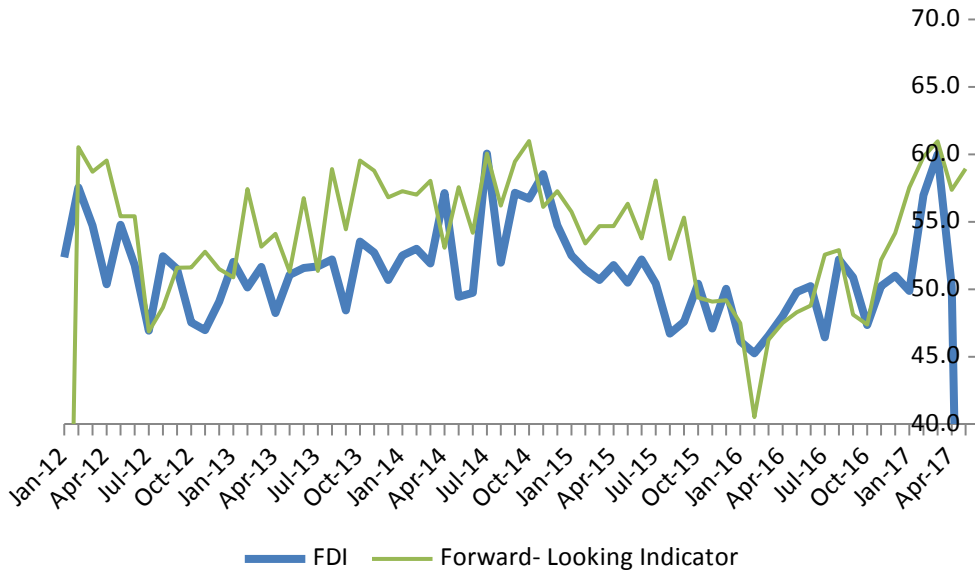
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

FDI vs. Forward- Looking Indicator (Seasonally Adjusted)



Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

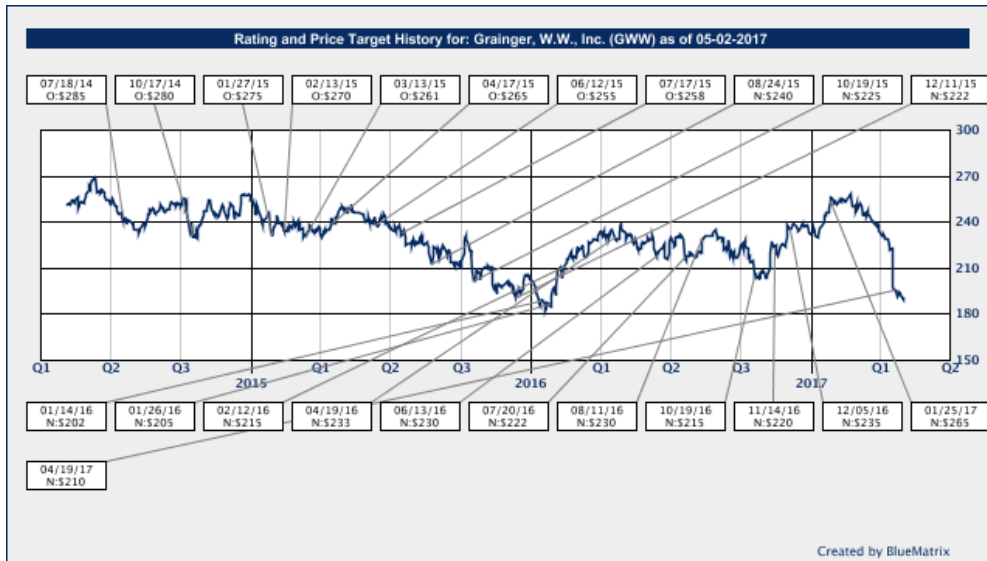
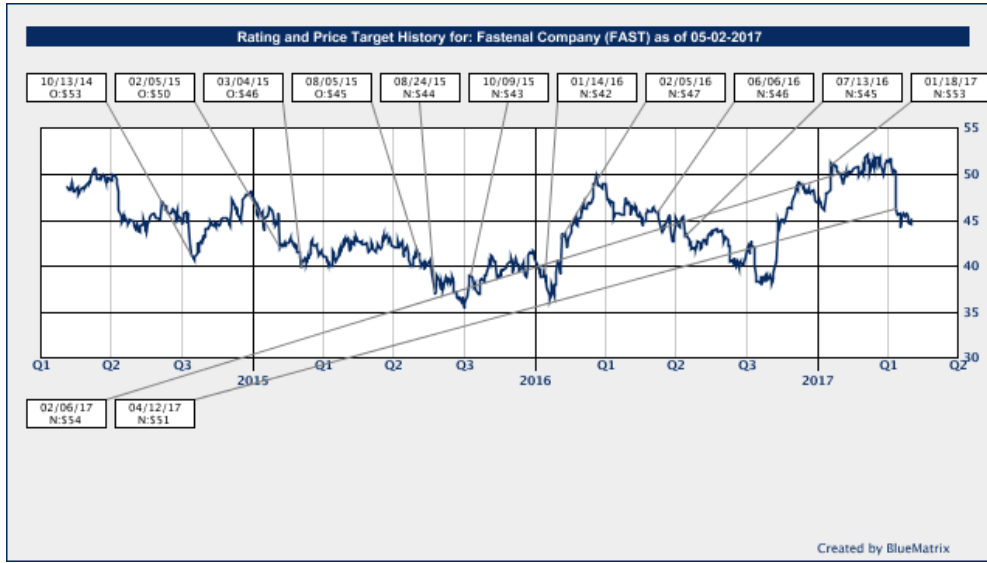
All stock prices below are the 5/3/17 closing price.

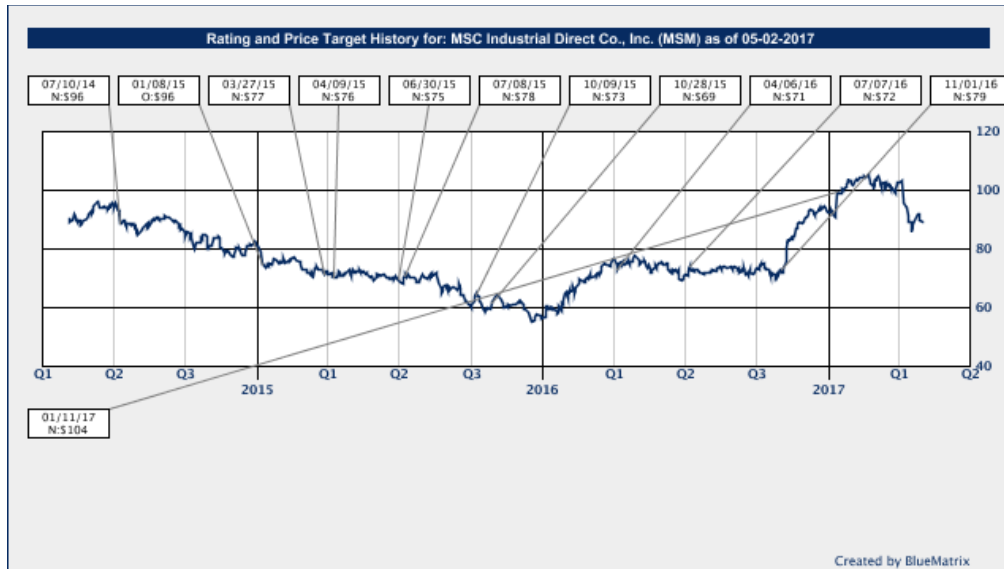
Fastenal Company (FAST- \$45.25)

WW Grainger Inc. (GWW- \$192.02)

MSC Industrial Direct Co. Inc (MSM- \$89.47)

(See recent research reports for more information)





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