Key Takeaway:

The seasonally-adjusted FDI for February 2018 was 60.4, moderating very slightly vs. January’s 60.8 but remaining well in expansionary territory overall. Strong selling conditions continued in February as the seasonally-adjusted sales index came in at 74.2 (January 72.7). Qualitative commentary on market conditions skewed positively, and the six-month outlook remains strong. The Forward-Looking Indicator also moderated following a very strong reading last month, but was nevertheless still a healthy 58.3 (January 64.7).

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. Similarly, the Forward-Looking Indicator (FLI) 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. As diffusion indexes, values above 50.0 signal strength, while readings below 50.0 signal weakness. Over time, results should be directly relevant to Fastenal (FAST) and broadly relevant to other industrial distributors such as W.W. Grainger (GWW) and MSC Industrial (MSM).

February FDI moderates ever so slightly. The seasonally-adjusted February FDI (60.4) moderated ever so slightly m/m vs. January’s 60.8 reading. In the February survey, 51% of respondents indicated sales were “better” relative to seasonal expectations. While a seasonally-slower month, this represents the highest percentage recorded for any February in survey history – demonstrating continued strong underlying market conditions, in our view. This produced a seasonally-adjusted sales index of 74.2, up vs. 72.7 in January. Pricing was again a tailwind for a majority of respondents (62% saw higher prices y/y) amid strong end market demand. This resulted in an FDI pricing index of 78.4 (vs. last month’s 86.4 reading), above the 2017 average of 75.0. Regarding customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (70% of responses), while 24% believe customers’ inventories are too low. This was relatively consistent with January (64% and 33%, respectively).

February FLI moderates from very strong reading. The seasonally-adjusted FLI moderated this month, coming in at 58.3 in February vs. 64.7 in January. A slightly lower 6-month outlook and employment index drove the m/m deceleration. Nevertheless, the FLI remains solidly in expansionary territory and at levels relatively consistent with 2017 averages (60.9). Given solidly expansionary FDI and FLI readings, we believe market conditions are likely to remain in growth mode in the coming months.
**Manufacturing employment modestly lower m/m.** Hiring sentiment was slightly lower this month among survey respondents. Just 27% of respondents saw higher employment levels in February relative to seasonal expectations vs. 33% in January, while another 70% saw employment as in line (January 67%). The resulting FDI Employment Index was 62.2, down vs. January’s 66.7 reading. The January US jobs report, meanwhile, was stronger than expected at +200,000 jobs (+180,000 expected), reflecting continued gains in construction, food services and drinking places, healthcare, and manufacturing. Manufacturing employment continues to trend upwards (+15,000 jobs in January), driven by a gain in durable goods industries (+18,000), which brings the total number of manufacturing jobs added over the last 12 months to +186,000. Average hours per work week for manufacturing employees was down modestly at 40.6 hours (vs. December 40.8). February’s jobs report is expected to be released on 3/9/18, with consensus expectations of +200,000 jobs.

**February sentiment positive.** Commentary again skewed largely positive overall. One respondent indicated “sales are up 15% YTD.” Additionally, a common theme discussed by several respondents this month was the planned 25% tariff on steel imports. One distributor commented on this by noting that the 6 month outlook remains bright, but the potential impact of steel tariffs could be a caveat to this outlook if tariffs become a headwind. Another respondent noted early impacts are already being reflected in input costs by saying, “Steel prices are going up.” In our view, we believe steel tariffs are likely to be a net neutral to slight positive, as most distributors have historically been able to pass on, and potentially even exceed, price increases from suppliers, while higher domestic activity levels could also be a minor positive. Quantitative survey data also continues to support a positive outlook with 65% of respondents expecting higher activity levels over the next six months (down slightly vs. January’s record of 76%), along with another 24% who expect similar activity.

**Fastenal** reported February daily sales growth of 14.8% y/y, nicely above our 10.5% estimate and again reflecting growth in all end markets/product lines. Underlying “core” growth (excluding acquisitions and foreign exchange) was 13.0%, the ninth consecutive month of double-digit growth. Fasteners again saw strong growth at 13.1% y/y, including the Mansco acquisition (+9.5% ex-Mansco). Based on FDI data and other research inputs, we expect continued strength in public industrial distributor growth during 2018, with Fastenal daily sales growth expected to sustain in the double-digits y/y.

**FAST Risk Synopsis**

Risks include economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

**Industrial Distribution Risk Synopsis**

Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.
Fastener Distribution Trends: February 2018

FASTENER DISTRIBUTION AT A GLANCE
February 2018

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<tr>
<th>Index Values</th>
<th>Feb</th>
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<td>FDI (Seasonally Adjusted)</td>
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<td>62.2</td>
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<th>Rate of Change</th>
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<tr>
<td>Sales(SA)</td>
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<td>Forward-Looking(SA)</td>
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<th>Rate of Change</th>
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(Other Metrics; NSA)

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<th>Index Values</th>
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<td>Supplier Deliveries</td>
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<td>Respondent Inventories</td>
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<td>48.2</td>
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<td>51.7</td>
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<td>Customer Inventories</td>
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<td>Month-to-month</td>
<td>68.9</td>
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<td>67.1</td>
<td>64.1</td>
<td>63.3</td>
<td>73.2</td>
<td>72.7</td>
<td>65.0</td>
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<td>Year-to-year</td>
<td>78.4</td>
<td>86.4</td>
<td>82.9</td>
<td>78.1</td>
<td>75.0</td>
<td>83.9</td>
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<th>Rate of Change</th>
<th>Higher</th>
<th>Same</th>
<th>Lower</th>
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<tr>
<td>6-Month Outlook - February</td>
<td>6.5%</td>
<td>24%</td>
<td>11%</td>
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FDI and Pricing are diffusion indexes. At 50, the performance of the category met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.


Fastener Distributor Index (FDI): Seasonally Adjusted

Source: Robert W. Baird & Co., FCH Sourcing Network, company reports
1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)

Source: Robert W. Baird & Co., FCH Sourcing Network
Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned
All stock prices below are as of 3/6/2018.

Fastenal Company (FAST-$56.47-Outperform)
W.W. Grainger Inc. (GWW-$267.76-Outperform)
MSC Industrial Direct Co. Inc (MSM-$90.39-Neutral)
(See recent research reports for more information)
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