

Fastener Distributor Index – Report #126 June 2022

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 7/7/22



Key Takeaway:

The June seasonally adjusted Fastener Distributor Index (FDI) reading is **53.8**, improved vs. last month, indicating slightly faster growth than May. The pricing indices moderated some (albeit remaining at elevated levels) as respondents noted softening commodity prices and some improvement in material shortages/lead times. Customer demand seemingly remains solid/strong, although a few participants noted some softening ahead was expected. Accordingly, the Forward-Looking Indicator (FLI) fell to just mildly above expansionary levels at **51.5** as respondents offered mixed outlooks (some see no signs of slowdown, others predict softening customer demand in coming months). Net, we believe growth and overall market conditions in June remained solid but see potential signs of decelerating growth in the second half of the year.

Fastener Distribution Trends: June 2022

FASTENER DISTRIBUTION AT A GLANCE										
June 2022										
	----- Index Values -----									Rate of
	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Direction	Change
ISM PMI (Manufacturing)	53.0	56.1	55.4	57.1	58.6	57.6	58.7	61.1	Growing	Slower
FDI	53.8	52.7	52.6	57.2	56.0	52.7	56.2	57.6	Growing	Faster
FLI	51.5	55.4	55.1	65.4	55.6	62.8	63.7	64.0	Growing	Slower
(Other Metrics)										
Sales	65.5	56.3	60.5	75.2	79.1	64.5	75.7	76.6	Growing	Faster
Employment	59.1	62.9	53.1	62.1	48.3	55.0	54.7	63.6	Growing	Slower
Supplier Deliveries	65.2	69.4	68.8	69.7	72.4	71.7	79.7	78.8	Growing	Slower
Respondent Inventories	63.6	62.9	59.4	50.0	56.9	41.7	46.9	53.0	Growing	Faster
Customer Inventories	28.8	27.4	29.7	21.2	25.9	18.3	15.6	15.2	Declining	Slower
Pricing, month-to-month	68.2	77.4	78.1	83.3	81.0	81.7	85.9	83.3	Growing	Slower
Pricing, year-to-year	90.9	95.2	95.3	95.5	94.8	95.0	96.9	95.5	Growing	Slower
6-Month Outlook - June										
					<u>Higher</u>	<u>Same</u>	<u>Lower</u>			
					27%	33%	39%			

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: Baird, FCH Sourcing Network, Institute for Supply Management

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American fastener distributors, conducted with the **FCH Sourcing Network** and **Baird**. It offers insights into current fastener 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)**.

Key Points:

FDI increased in June. The seasonally adjusted June FDI (53.8) climbed m/m (May 52.7), consistent with continued growth but at a slightly more measured pace relative to earlier this year (1Q22 average FDI 55.3). The sales index did see nice m/m improvement from May, however, which was seemingly due to improved material availability and deliveries. Pricing moderated slightly vs. last month, which respondents attributed to softening commodity prices (steel) and freight costs. Overall, we believe the FDI showed continued growth in June but at more measured rate relative to earlier this year and 2H21.

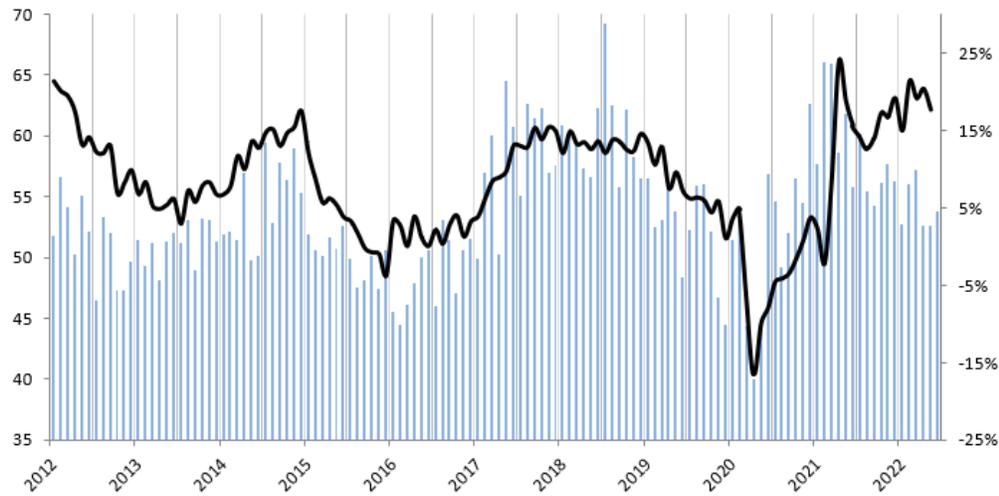
FLI signals slowing growth. The seasonally adjusted FLI came in at 51.5—down from last month’s 55.4—signaling the expectation of slower growth ahead. A weaker six-month outlook was the principal m/m drag in the FLI, along with a slight drag from the employment index. Regarding the outlook, more respondents are expecting lower (39%) than higher (27%) activity levels over the next six months compared to today; this is the first time the outlook skewed negatively since the COVID-19 driven recession (April 2020). Multiple participants indicated they are bracing for slowing growth and/or declining demand, although whether the economy enters outright recession or merely slows is unknown.

FDI employment index softens moderately. The FDI employment index came in at 59.1 for June after bouncing up to 62.9 in May. Most participants indicated they were at levels of employment that is seasonally normal/appropriate (76%), with just 3% saying employment levels were low (compared to a post-COVID high of 26% in September 2021). Turning to the broader economy, economists’ consensus estimates call for 270,000 jobs to be added in June. May saw +390,000 job additions (which beat economists’ initial estimate of +328,000). It is worth noting that average hourly earnings rose +5.2% y/y in May as competition for workers remains intense.

Demand remains strong for now but softening ahead seems to be the consensus. Overall, while forward-looking commentary this month was mixed, commentary on June was near universally positive. Multiple participants noted record sales despite brewing macroeconomic headwinds: *“June 2022 was our largest sales month in history.”* Looking forward, however, many are beginning to forecast weakening customer demand. As one participant said, *“Customer demand is OK for now, but is trending softer.”* Another commented, *“The growth rate acceleration is expected to be slower in Q3 and beyond.”* Respondents had mixed feedback on whether outright recession is imminent, but most nonetheless are expecting some slowing in growth ahead. Pricing could also be starting to moderate given the recent decline in steel/other commodities: *“Commodities’ pricing softened this month (scrap at \$760/ton for June and \$600/ton for July). Freight costs are coming down, but still much higher than pre-pandemic levels. Continued inflationary pressure in cost due to inputs other than material.”* Lastly, persistent material shortages and extended delivery times could be showing signs of improvement. As one participant noted, *“Material shortages are starting to stabilize however tooling availability has become a major issue. Lead times continue to increase but that is not affecting incoming sales at all.”* Another respondent said, *“Inventory starting to arrive earlier than previously expected while customers are starting to ask for pushed out deliveries.”*

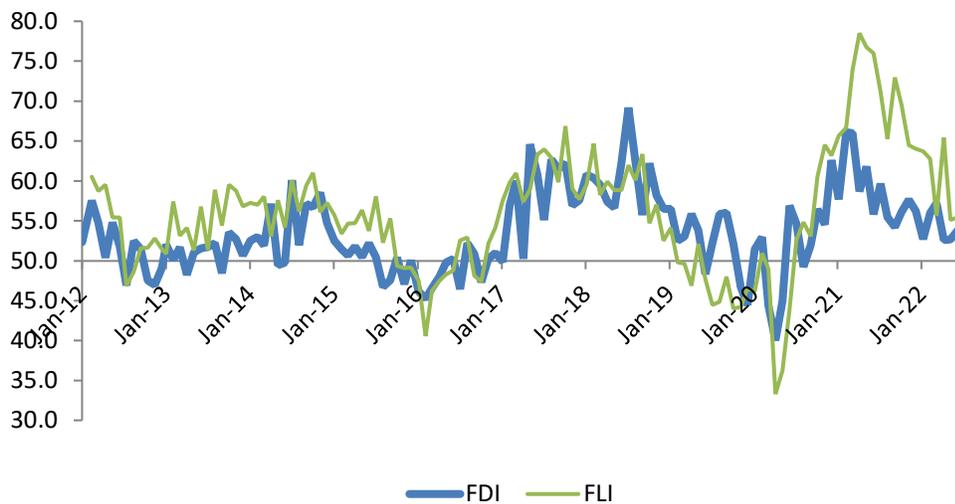
Fastenal’s +17.6% overall May daily sales growth came in above our +16.6% estimate and normal seasonality. Consistent with the FDI, fastener sales were again very strong (but moderating) at +20.0% y/y (compared to April’s +25.5% growth), while safety was +15.6% and other non-fasteners were +16.1%. Looking ahead to June daily sales, we model overall daily sales +18.8% y/y. This would again be slightly better than normal seasonality given the strong June FDI reading. FAST will report June daily sales in conjunction with 2Q22 earnings on July 13.

Fastener Distributor Index (FDI); Seasonally Adjusted



*FAST March 2020 – December 2021 Monthly Sales Presented as ex. Safety Products
Source: Baird, FCH Sourcing Network, Company reports

1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)



Source: Baird, FCH Sourcing Network

Risk Synopsis

Fastenal: 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: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 7/6/2022.

Fastenal Company (FAST-\$50.42-Outperform)
 W.W. Grainger Inc. (GWW-\$470.12-Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$74.37-Outperform)
 (See recent research reports for more information)



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