

Fastener Distributor Index – March 2020

Written by R.W. Baird analyst David J. Manthey, CFA 4/7/20



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for **March was 44.4**, deteriorating rapidly as the COVID-19 pandemic and ensuing shutdowns took hold. Sales trends on a seasonally adjusted basis were much weaker. The six-month outlook was revised sharply lower, which along with lower employment levels pushed the Forward-Looking Indicator (FLI) down to the lowest reading in survey history. In response to this month’s supplemental question on the impacts of the economic shutdown, respondents were roughly evenly split on whether economic trends will deteriorate further from here or return to previous levels, although the percentage expecting lower activity over the next six months surged (73% vs. 32% in February).

Fastener Distribution Trends: March 2020

FASTENER DISTRIBUTION AT A GLANCE											
March 2020											
	----- Index Values -----										
	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Direction	Rate of Change
PMI (Manufacturing Sector)	49.1	50.1	50.9	47.8	48.1	48.3	47.8	49.1	51.2	Dedining	Faster
FDI (Fastener Sector)	45.6	51.3	55.4	43.4	45.5	52.2	52.4	55.5	50.9	Dedining	Faster
FDI (Seasonally Adjusted)	44.4	53.0	51.4	44.4	46.7	52.1	56.0	55.9	52.2	Dedining	Faster
Sales (SA)	34.6	54.9	50.0	34.9	35.5	48.2	56.4	52.1	40.4	Dedining	Faster
Forward-Looking (SA)	33.3	48.9	50.9	46.2	46.5	44.2	44.0	48.0	44.9	Dedining	Faster
(Other Metrics; NSA)											
Employment	27.0	48.2	56.7	45.3	48.5	48.7	51.6	55.9	55.4	Dedining	Faster
Supplier Deliveries	68.9	66.1	58.3	53.1	51.5	55.1	58.1	58.8	64.3	Growing	Faster
Respondent Inventories	64.9	64.3	63.3	65.6	65.2	69.2	69.4	64.7	69.6	Growing	Faster
Customer Inventories	48.6	41.1	41.7	43.8	51.5	52.6	53.2	52.9	48.2	Dedining	Slower
Pricing, month-to-month	50.0	50.0	58.3	60.9	57.6	59.0	61.3	61.8	66.1	Dedining	Same
Pricing, year-to-year	60.8	58.9	70.0	79.7	78.8	84.6	79.0	80.9	80.4	Growing	Faster
6-Month Outlook -March				Higher Same Lower							
				16% 11% 73%							

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** with support from the **National Fastener Distributors Association**. 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 plunges in March. The seasonally adjusted March FDI (44.4) experienced a sharp m/m contraction (February 53.0) as the COVID-19 pandemic and ensuing shutdowns took hold over the latter half of the month. The seasonally adjusted sales index mirrored the deceleration seen in the overall survey, decreasing to 34.6 vs. 54.9 last month. Pricing was again stable m/m for a large majority of respondents.

March FLI dips to record low. The seasonally adjusted FLI decreased to **33.3** (February 48.9), registering a record low for the index amid the uncertainty caused by COVID-19. This reflected a lower six-month outlook and employment levels that are below seasonal expectations. Additionally, supply chain constraints continued to manifest as further respondents noted slower deliveries coming from suppliers.

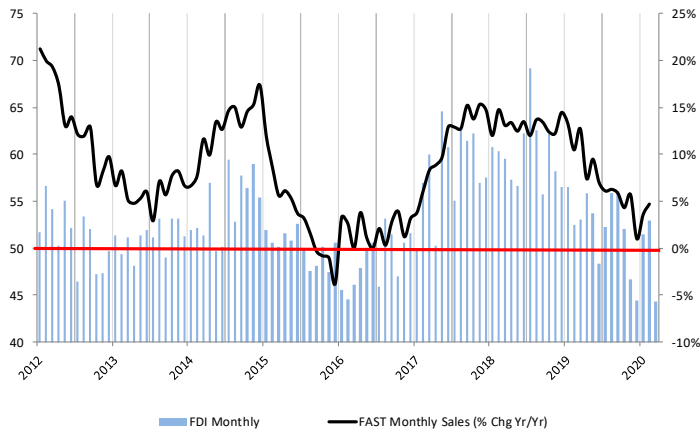
Hiring sentiment deteriorates. Perhaps a sign of layoffs that have already occurred or are soon to occur in the fastener industry, the FDI employment index was significantly lower m/m, coming in at 27.0 vs. 48.2 in February. No respondent noted employment levels were higher than seasonal expectations, while 46% characterized employment as below expectations, the highest percentage recorded in survey history (since 2012). The broader economy has seen an even more marked and rapid decline in employment with a record ~10 million US workers filing initial claims for unemployment benefits over the past two weeks. Economists believe this implies a real-time unemployment rate in the low double digits vs. recent ~3.5% levels with wide swaths of the economy currently shut down.

Respondent commentary exhibits widespread forecasting uncertainty. Most respondents were hesitant to speculate on the direction of overall economic and business trends given the rapidly evolving economic environment. One respondent summarized this uncertainty by saying, "On the 30th of March, I believe there is much more to figure out before my response is more concrete," while another said "[I'll] let you know next month if the virus is past." Others see a significant short-term weakening in the economy but a return to normal levels shortly thereafter. As one respondent said, "Regarding the economic trend, the short term (30-60 days) I see receding and the long term (10-12 months) I see returning to where we were prior to Covid-19." Looking at expected activity levels over the next six months, however, shows a clear consensus near-term expectation for lower activity levels. 73% of respondents expect lower activity over the next six months (February just 32%), while only 16% expect higher activity (compared to 50% last month) and another 11% expect similar activity (February 18%).

Supplemental question. This month we asked a supplemental question on the impact of the economic shutdown, US-China trade relations, and the potential for re-shoring of manufacturing to the US. 49% of respondents expect economic trends will return or nearly return to previous levels, while 43% expect economic trends to deteriorate further. 51% of respondents believe the COVID-19 pandemic will lead to worse trade relations between the US and China, while 24% do not anticipate a major impact on trade relations. Regarding the potential for re-shoring of manufacturing back to the US, 59% believe there will be some minor return of manufacturing, but only 3% anticipate a major return. Lastly, 68% anticipate a minor shifting in sourcing away from China and another 11% expect a major shift away from sourcing from China.

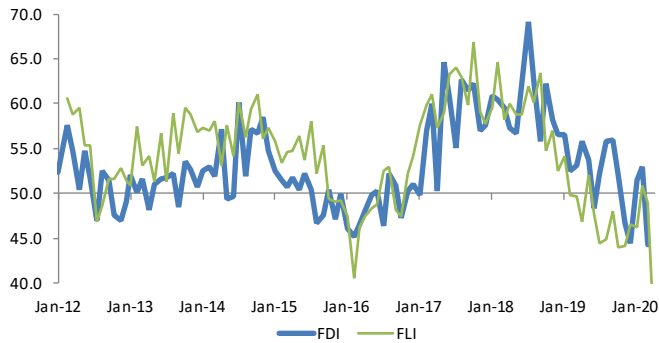
Fastenal reported +4.7% overall February daily sales growth vs. our +3.8% estimate prior to the COVID-19 pandemic in the US. Fastener sales fared slightly worse than the overall, however, with sales increasing 1.6% y/y (January +1.3%). March daily sales growth will be reported in conjunction with first-quarter earnings on April 14. We are expecting a sharp loss of momentum near term with daily sales -8.0% y/y, consistent with the m/m deceleration seen in the March FDI.

Fastener Distributor Index (FDI); Seasonally Adjusted



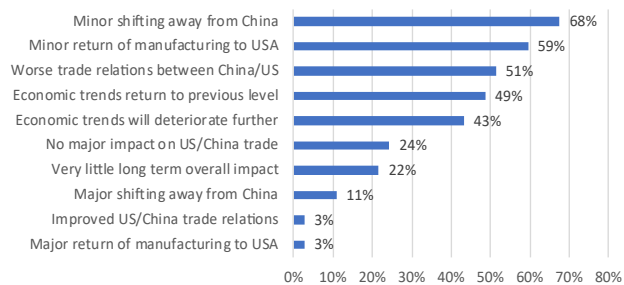
Source: Baird, FCH Sourcing Network, Company reports

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



Source: Baird, FCH Sourcing Network

Respondents Anticipating the Following Impacts of COVID-19:



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.

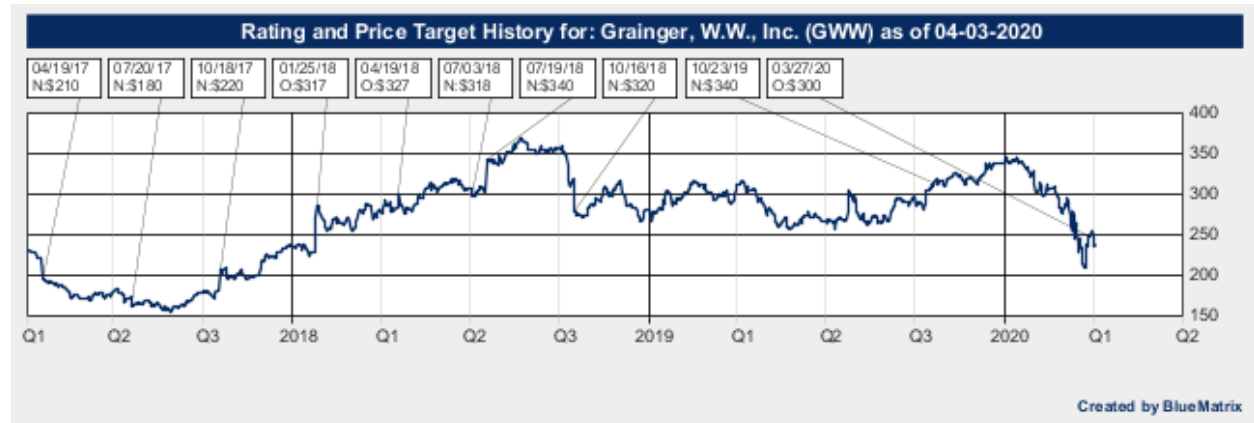
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 4/6/2020.

Fastenal Company (FAST-\$31.61-Outperform)
 W.W. Grainger Inc. (GWW-\$247.97-Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$57.06-Outperform)
 (See recent research reports for more information)



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