BB&T Capital Markets

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COMMERCIAL AND INDUSTRIAL

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COMPANIES MENTIONED

Fastenal Company
FAST - $44.30 - Hold (2)

MSC Industrial Direct Co., Inc.
MSM - $67.72 - Hold (2)

W.W. Grainger, Inc.
GWW - $212.76 - Buy (1)

BB&TCM'S FASTENER DISTRIBUTOR INDEX (FDI) - SEPTEMBER SETTLES INTO AN UNCOMFORTABLE EQUILIBRIUM

Key Points

- **About the Fastener Distributor Index (FDI).** The FDI is a monthly survey of NorAm fastener distributors, conducted in partnership with the FCH Sourcing Network, which aims to provide insights 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).

- **September establishes its own trend: sluggish equilibrium (48.2, vs. 51.0 in August).** Technically, fastener distributors saw conditions get a little worse in September over August. Still, at this point we think taking a multi-month view is perhaps more helpful. Going back to June, what we see is that the FDI has oscillated around 50, averaging 49.0. The broader PMI has behaved similarly, straddling 50 and averaging 50.2 since June (**Exhibit 1**, next page). Sales (45.7, vs. 51.4 in August) again signaled a bit of weakening, worryingly alone in that distinction. The other three categories–Employment, Supplier Deliveries, and Customer Inventories–were mostly unchanged from August. Auto and construction markets stood out as relatively strong among end markets. *A pattern has formed the past several months of stubbornly sluggish conditions. But in as much as the step-down that occurred in June has plateaued rather than been followed by another should be taken as a positive.*

- **The 6-month outlook: similarly non-committal**. 31% of respondents expect activity to be higher six months from now, balanced against 26% that expect lower activity. ~43% of survey respondents expect business conditions to be the same as today. Strikingly, these readings are little changed from those of August. *The balance between those seeing things worsening versus improving and month-to-month stability points to a trendless environment, in our view*.

- **Pricing: any movement in September could be found in a continued mild worsening of pricing.** We suggested pricing was very marginally worse in August, and we think the same was true in September. The large majority of respondents saw no change in sequential pricing, but of those who did for the first time slightly more saw it down than up. More respondents still have higher annual pricing, but by the narrowest margin since we started the FDI. *We still see year-to-year pricing up 1%–2% in September. But the likelihood remains high it will continue to trend toward 0% over the near term as past increases anniversary*.

- **A quick question about how inside fastener sales people are paid**. This falls more under the category of curiosity, but we wanted to know how inside sales people tended to be paid in the fastener distribution industry. The answer: 63% receive a salary only, 29% receive a salary plus commission, and 9% receive a salary plus a bonus based on corporate profitability.

- **The September read-through to other distributors: should deliver an "as expected" September to finish off the quarter.** Granted, Fastenal's August DSR wound up disappointing relative to what we thought would happen based on this survey, but with the stability that is settling in it seems September's results should be consistent with the historical norm, maybe a touch better based on days. We think that points to a September DSR for Fastenal of up 13%–14%. That might be good enough to be in-line with to slightly above our Q3'12 forecast ($800.3M), but is likely not good enough to meet consensus ($805.6M). Given that distributors are highly correlated, we suspect the bias at **MSC Industrial** and **Grainger** is similar: in-line to lower than expected sales.

Exhibit 1.

FASTENER DISTRIBUTION AT A GLANCE
September 2012

	Index - Sept.	Index - August	Index - July	Index - June	Index - May	Index - Apr.	Index - Mar.	Index - Feb.	Index - Jan.	Aug. --> Sep. Change	Direction
PMI (Overall mftring sector)	51.5	49.6	49.8	49.7	53.5	54.8	53.4	52.4	54.1	1.9	Growing
FDI (Fastener distribution)	48.2	51.0	45.1	51.6	56.3	53.8	55.9	55.9	57.3	(2.8)	Declining
Sales	45.7	51.4	38.2	42.2	58.8	55.1	69.4	64.5	79.1	(5.7)	Declining
Employment	51.4	54.2	50.0	54.7	58.8	59.0	63.9	59.2	58.1	(2.7)	Growing
Supplier Deliveries	50.0	52.8	51.3	60.9	61.3	59.0	48.6	52.6	52.3	(2.8)	Speeding Up
Respondent Inventories	62.9	62.5	57.9	60.9	55.0	62.8	59.7	53.9	58.1	0.4	Too High
Customer Inventories	45.7	45.8	40.8	48.4	46.3	42.3	41.7	47.4	39.5	(0.1)	Too Low
Pricing, month-to-month	47.1	52.8	55.3	57.8	51.3	55.1	61.1	57.9	50.0	(5.6)	Lower
Pricing, year-to-year	55.7	66.7	61.8	56.3	65.0	70.5	70.8	71.1	65.1	(11.0)	Higher

	Higher	Same	Lower
6-Month Outlook - Sept.	31%	43%	26%

FDI and Pricing are diffision 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: BB&T Capital Markets' estimates, FCH Sourcing Network, Institute for Supply Management

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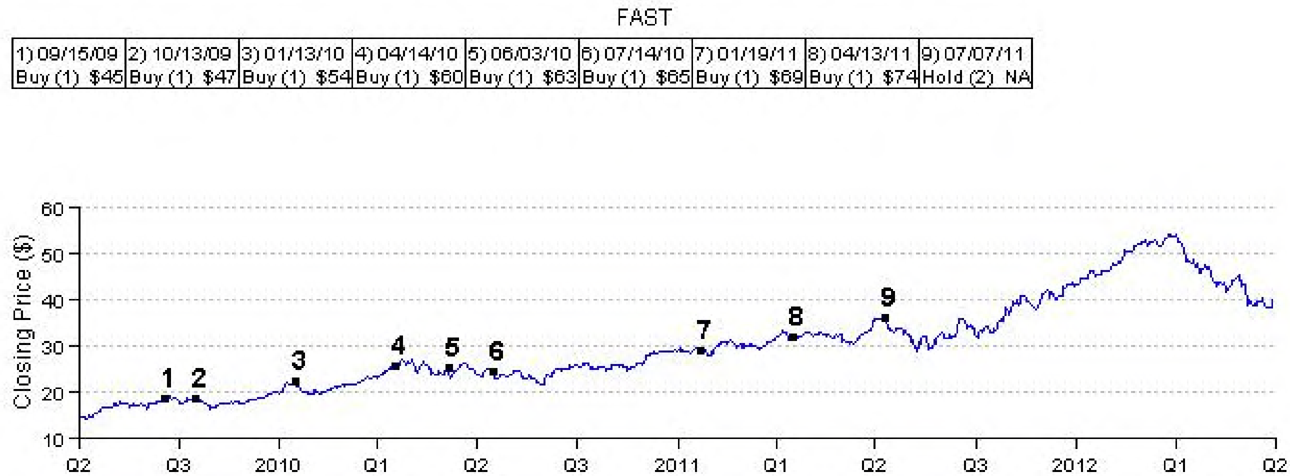
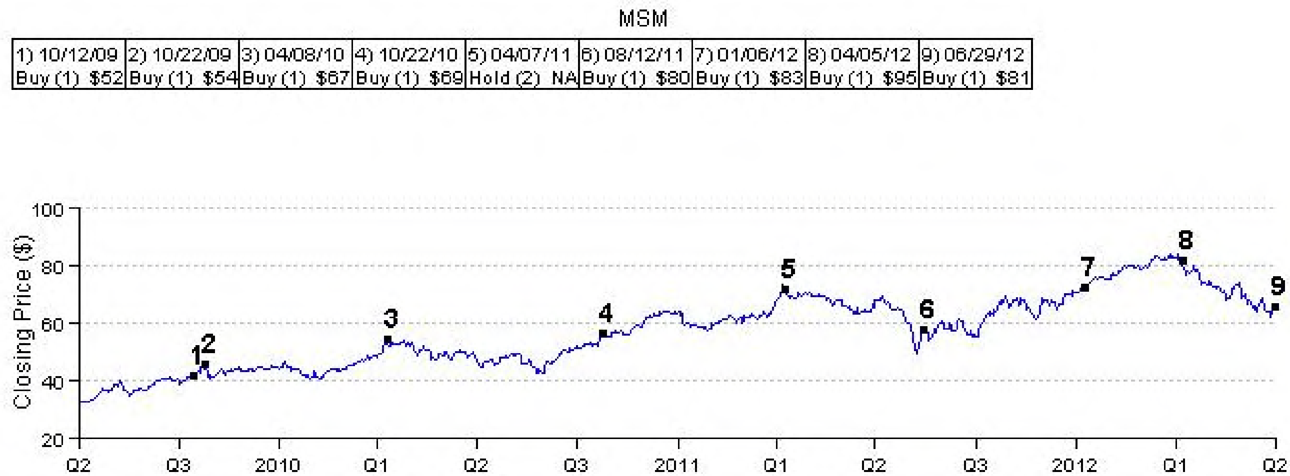
Price Chart





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All companies under coverage:		All companies under coverage to which it has provided investment banking services in the previous 12 months:	
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Not Rated (NR)	0.0%	Not Rated (NR)	0.0%

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

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

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