

Fastener Distributor Index – Report #127 July 2022

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 8/8/22



Key Takeaway:

The July seasonally adjusted Fastener Distributor Index (FDI) decreased noticeably vs. last month to **46.1**, reading below 50 for the first time since May 2020 – indicating softening market conditions. Demand commentary was mixed, with some noting continued strength despite rising macro uncertainty, while others indicated weakness was starting to materialize. Pricing remained stable at elevated levels. Looking forward, the Forward-Looking Indicator (FLI) remained solid at **58.1**, implying this month’s contraction could be short lived; a bounce back in August is seemingly anticipated by most respondents. Net, we believe some cracks in overall market conditions began to emerge more concretely in July for the first time in over two years.

Fastener Distribution Trends: July 2022

FASTENER DISTRIBUTION AT A GLANCE											
July 2022											
	----- Index Values -----									Rate of	
	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Direction	Change	
ISM PMI (Manufacturing)	52.8	53.0	56.1	55.4	57.1	58.6	57.6	58.7	Growing	Slower	
FDI	46.1	53.8	52.7	52.6	57.2	56.0	52.7	56.2	Declining	Faster	
FLI	58.1	51.5	55.4	55.1	65.4	55.6	62.8	63.7	Growing	Faster	
(Other Metrics)											
Sales	43.2	65.5	56.3	60.5	75.2	79.1	64.5	75.7	Declining	Faster	
Employment	62.5	59.1	62.9	53.1	62.1	48.3	55.0	54.7	Growing	Faster	
Supplier Deliveries	52.1	65.2	69.4	68.8	69.7	72.4	71.7	79.7	Growing	Slower	
Respondent Inventories	66.7	63.6	62.9	59.4	50.0	56.9	41.7	46.9	Growing	Faster	
Customer Inventories	27.1	28.8	27.4	29.7	21.2	25.9	18.3	15.6	Declining	Faster	
Pricing, month-to-month	68.8	68.2	77.4	78.1	83.3	81.0	81.7	85.9	Growing	Faster	
Pricing, year-to-year	91.7	90.9	95.2	95.3	95.5	94.8	95.0	96.9	Growing	Faster	
6-Month Outlook - July				Higher			Same			Lower	
				50%			13%			38%	

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 dips to contractionary territory. The seasonally adjusted July FDI (46.1) fell m/m (June 53.8) and retreated below 50 for the first time since May 2020. The sales index was the biggest reason for the sharp decline as demand seemingly has softened for many respondents, with 46% indicating sales were below seasonal expectations (highest since May 2020). Pricing was consistent with last month's readings and remains at elevated levels, but recently moderating commodity prices (steel) and container/freight costs could suggest some normalizing ahead, in our view, which could lead the index to decline. Overall, we believe July's FDI reading was indicative of a weakening demand backdrop for the first time in over two years.

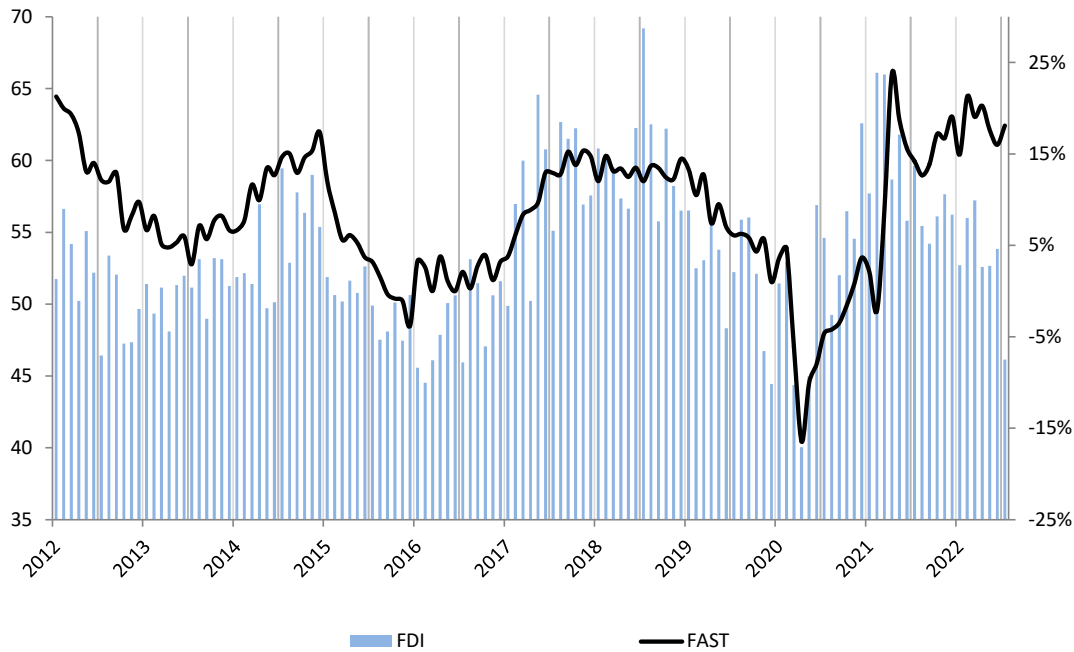
That said, the FLI suggests this slowdown could be short lived. Despite the weak July FDI, the seasonally adjusted FLI came in at 58.1, improving from last month's 51.5 and signaling an expectation for a return to growth next month. An improved six-month outlook was the principal catalyst for the m/m bounce in the FLI, along with a slight improvement in the employment index. Regarding the outlook, the percentage of respondents expecting higher activity levels six months from now compared to today (50%) was the highest in a year. However, this is far from a consensus view, as another 38% of respondents anticipate lower activity levels vs. an average of just ~12% over the past 24 months. Commentary from participants is similarly mixed, with some continuing to forecast solid demand ahead while others are beginning to see signs of slowing and bracing for recession. Overall, uncertainty seems to be the consistent theme.

FDI employment index moderately increases. The FDI employment index came in at 62.5 for July, slightly improving from 59.1 in June. Most participants indicated they were at levels of employment that is seasonally normal/appropriate (58%), with just 8% saying employment levels were low (compared to a post-COVID high of 26% in September 2021). The broader economy saw similar strength in the employment situation in July, adding +528,000 jobs (which well surpassed economists' estimate of +250,000), while June's job additions were also revised upwards to +398,000. Average hourly earnings rose +5.2% y/y in July as firms compete for workers in the current broadly inflationary backdrop.

Outlook mixed after a weak July and in the wake of macroeconomic uncertainty. Forward-looking commentary this month was once again mixed amid macro uncertainty and recession fears. Some participants forecast continued growth ahead: *"Even though we hear chatter about a recession on the news, our customer base...is growing their demand forecasting."* Some, however, are already beginning to see cracks: *"Business is getting soft, lots of customers [are] asking to move out delivery dates."* Lastly, material shortages and supply chain issues continue to persist. As one participant stated, *"Lead times continue to move further out"* and *"tooling and material deliveries are lagging seriously causing further delays in shipping orders."* However, that respondent noted that extended lead times are (at least so far) having *"no effect on incoming sales orders."*

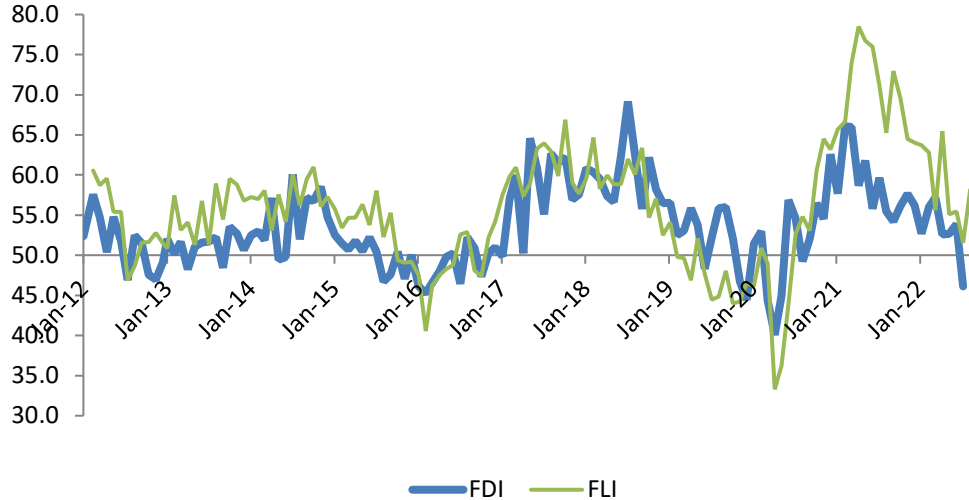
Fastenal's +18.1% overall July daily sales growth came in above our +16.6% estimate and normal seasonality (~1.3% better m/m growth than seasonally normal). Fastener sales grew by +19.8% y/y (accelerating vs. June's +18.1% y/y growth). Additionally for FAST, safety was +13.6% and other non-fasteners were +18.9%. Looking ahead to August daily sales, we model overall daily sales +16.5% y/y. This would be slightly below normal seasonality as we assume underlying demand conditions continue to soften exiting 2022 with outright recession in 2023. FAST will report August daily sales on September 6th.

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.

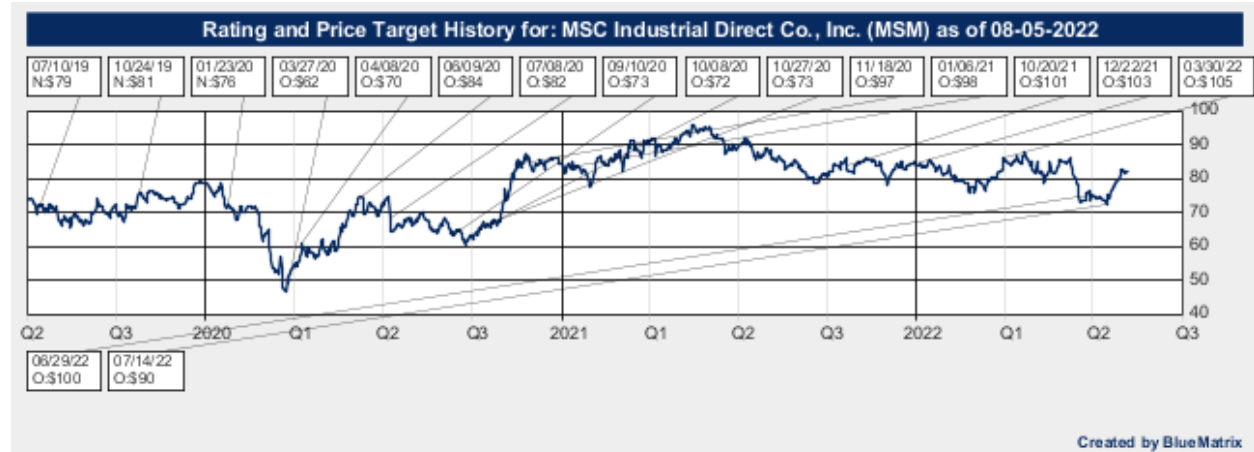
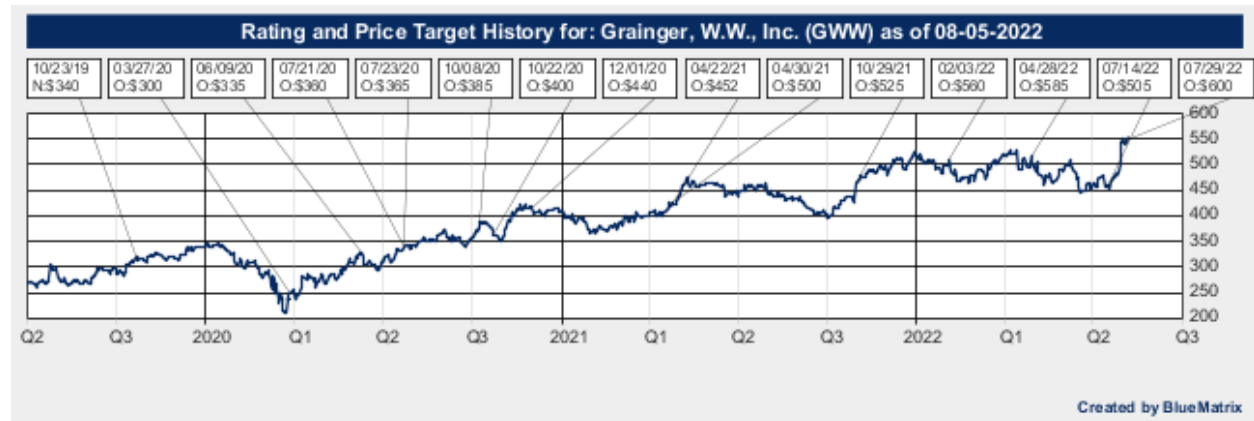
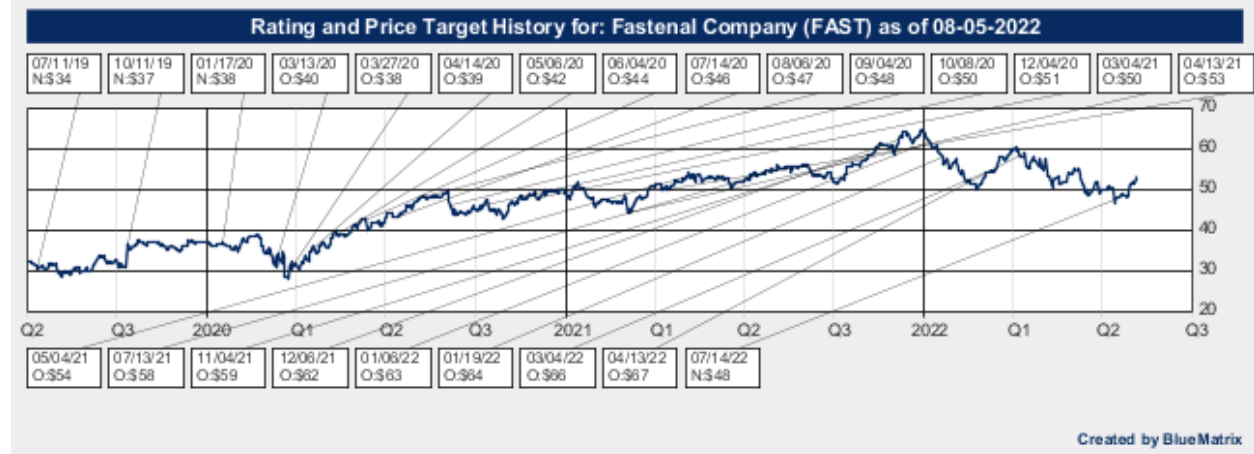
Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 8/5/2022.

Fastenal Company (FAST-\$52.95-Outperform)
 W.W. Grainger Inc. (GWW-\$556.02-Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$82.07-Outperform)
 (See recent research reports for more information)



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