

Fastener Distributor Index – October 2017

Written by R.W. Baird analyst David Manthey, 11/6/17



Key Takeaway:

The seasonally adjusted FDI for October 2017 was 62.2 – up slightly vs. September’s 61.5 reading and remaining well in expansionary territory overall. Selling conditions accelerated slightly m/m with the seasonally adjusted sales index registering 80.1 vs. 77.3 in September. Qualitative commentary on market conditions was again mostly positive with respondents noting strong demand, generally favorable end-market conditions, and a healthy pricing environment. The FDI Forward-Looking Indicator also remains very positive, registering a seasonally adjusted reading of 59.1, though decelerating vs. last month’s YTD high (66.9).

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. As a diffusion index, 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)**.

October FDI stays strong. The seasonally adjusted October FDI (62.2) was up modestly m/m (September 61.5), consistent with last month’s YTD high for the forward-looking indicator. In the October survey, 73% of respondents indicated sales were “better” relative to seasonal expectations – the highest in FDI survey history and up significantly vs. September levels of 57%. Relative to historical seasonal readings in the month of October, this month’s seasonally adjusted sales index of 80.1 suggests selling conditions remain very strong overall. Pricing was again a solid tailwind as 60% of distributors saw higher prices y/y (vs. 2016 average levels of just 30%). This produced an FDI y/y pricing index of 75.0, down vs. last month’s very strong 83.9 reading but still very consistent with strong YTD levels. As it relates to customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (80% of responses), while 20% see inventory levels as too low. This compares to August results of 54% and 36%, respectively.

FDI Forward-Looking Indicator slightly lags YTD average. The FDI Forward-Looking Indicator 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. October’s seasonally adjusted Forward-Looking Indicator decelerated to 59.1 vs. last month’s YTD high of 66.9. The Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 61.3 year-to-date in 2017. Given solidly expansionary FDI and Forward-Looking Indicator readings, market conditions appear likely to remain in growth mode in the coming months.

Manufacturing employment stable m/m. Hiring sentiment was relatively stable m/m among survey respondents. 27% of respondents indicated employment was higher in October relative to seasonal expectations vs. 25% in September, while 60% saw hiring levels as in line with seasonal expectations (September 64%). This produced an FDI Employment Index of 56.7, flattish vs. September's 57.1 reading. The October US jobs report, meanwhile, was very solid at +261,000 jobs. Upward revisions to prior months (September revised to +18,000 adds vs. previous estimate -33,000, for example) may explain the delta vs. even more aggressive October consensus expectations of +310,000. Recent hurricane-related disruption that weakened September's jobs report largely faded in October. Manufacturing employment was also up m/m (+24,000 jobs), with gains noted in computer and electronic products, chemicals, and fabricated metals – bringing the total number of manufacturing jobs added since November 2016 to +156,000. Average hours per work week for manufacturing employees was also up slightly at 41.0 hours (vs. September 40.8).

October sentiment positive. Survey commentary on current market conditions was once again mostly positive this month. Demand remains overall healthy amid favorable end markets, with one distributor indicating, "Construction industry trends are up. Ag production is doing very well and aged equipment is being upgraded/replaced... We're on what appears to be a steady upward trend." Looking forward, most respondents expressed a generally favorable outlook, with 90% expecting stable to higher activity levels over the next six months. As one respondent put it, "[I] think the overall activity will be the same or slightly better, however, [the] end of the year tends to be slow so two of the next six months can impact the growth."

Fastenal reported September daily sales growth of 15.3% y/y, nicely ahead of our 13.0% estimate and reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was 13.5%, the fourth consecutive month of double-digit growth. Additionally, Hurricane-related disruption was an estimated 40-50bps headwind in the month. Fasteners saw strong growth at 13.0% y/y (up vs. 12.2% last month), including the recent Mansco acquisition (+9.4% ex-Mansco). Based on FDI data and other research inputs, we expect a continued uptick in growth among the public industrial distributors this year, with Fastenal daily sales growth expected to sustain in the low-teens y/y for the remainder of 2017.

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.

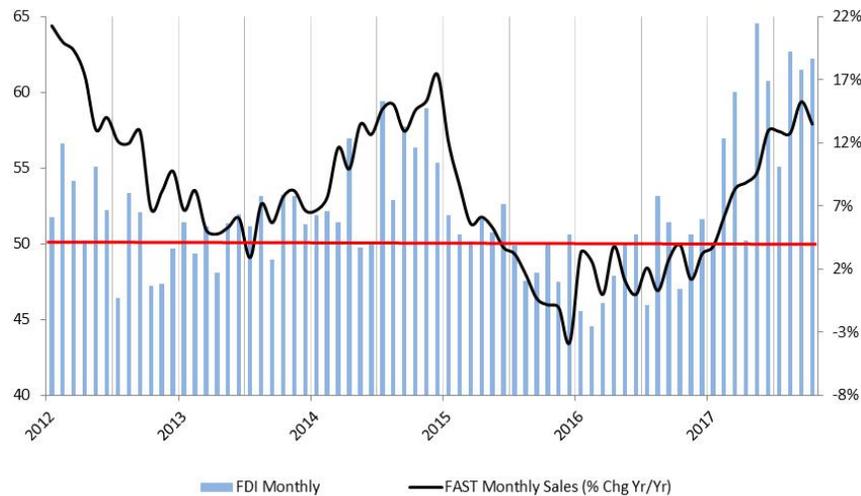
Fastener Distribution Trends: October 2017

FASTENER DISTRIBUTION AT A GLANCE									
September 2017									
	----- Index Values -----							Directiøn	Rate of Change
	Oct	Sep	Aug	Jul	Jun	May	Apr		
PMI (Manufacturing Sector)	58.7	60.8	58.8	56.3	57.8	54.9	54.8	Growing	Slower
FDI (Fastener Sector)	61.3	57.6	61.0	52.9	60.5	66.3	53.7	Growing	Faster
FDI (Seasonally Adjusted)	62.2	61.5	62.7	55.1	60.8	64.6	50.2	Growing	Faster
Sales (SA)	80.1	77.3	77.1	69.8	86.6	79.6	43.8	Growing	Faster
Forward-Looking (SA)	59.1	66.9	59.9	62.9	64.0	63.3	58.9	Growing	Slower
(Other Metrics; NSA)									
Employment	56.7	57.1	62.1	53.3	68.0	73.6	57.4	Growing	Slower
Supplier Deliveries	65.0	69.6	65.2	65.0	64.0	72.2	66.2	Growing	Slower
Respondent Inventories	51.7	48.2	62.1	51.7	52.0	58.3	52.9	Growing	Faster
Customer Inventories	40.0	37.5	39.4	35.0	32.0	36.1	38.2	Declining	Slower
Pricing month-to-month	63.3	73.2	72.7	65.0	52.0	59.7	60.3	Higher	Slower
Pricing year-to-year	75.0	83.9	78.8	76.7	66.0	75.0	73.5	Higher	Slower
6-Month Outlook - October				Higher	Same	Lower			
				50%	40%	10%			

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: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Robert W. Baird & Co., FCH Sourcing Network, company reports

FDI vs. Forward-Looking Indicator (Seasonally Adjusted)



Source: Robert W. Baird & Co., FCH Sourcing Network

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

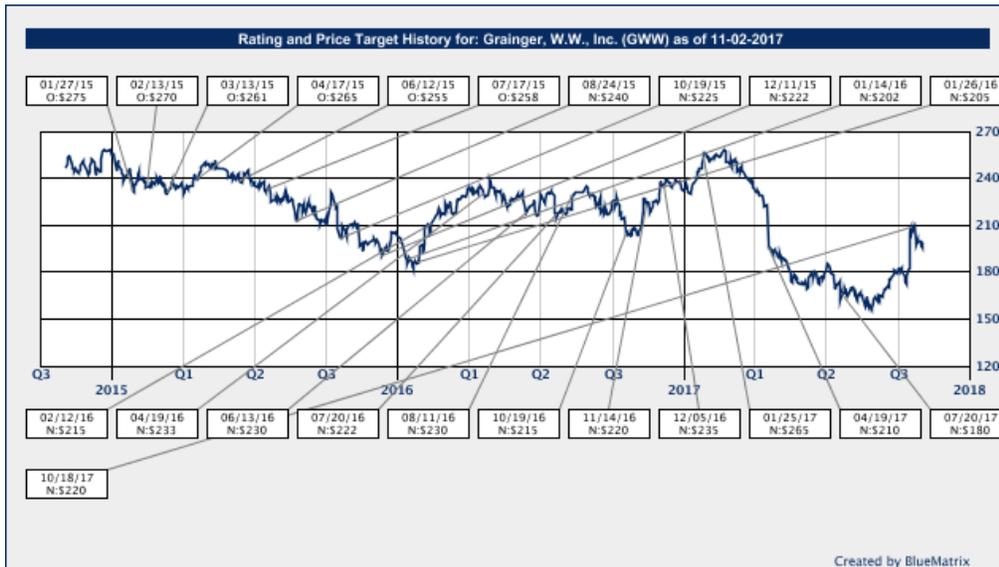
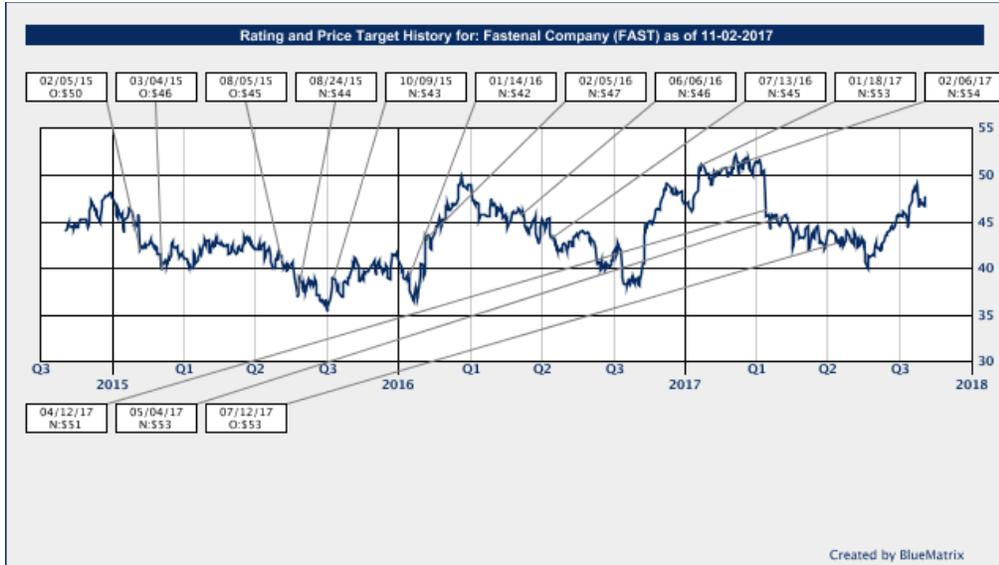
All stock prices below are as of 10/13/2017.

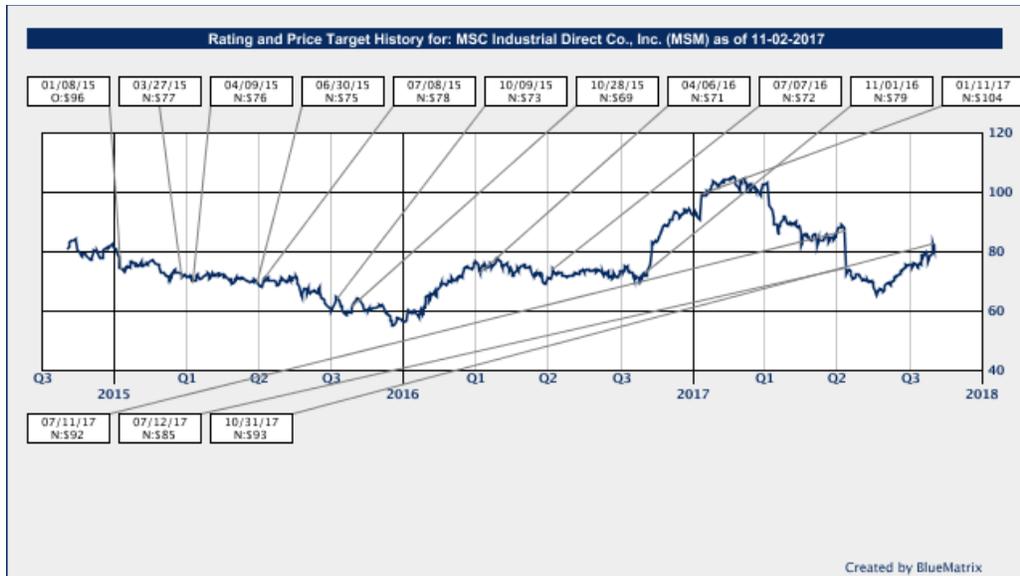
Fastenal Company (FAST-\$47.73-Outperform)

W.W. Grainger Inc. (GWW-\$200.64-Neutral)

MSC Industrial Direct Co. Inc (MSM-\$81.80-Neutral)

(See recent research reports for more information)





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