

## Fastener Distributor Index – May 2018

Written by R.W. Baird analyst David J. Manthey, CFA 6/7/18



### Key Takeaway:

The seasonally-adjusted FDI for May 2018 was 56.6, continuing the YTD theme of a modest m/m deceleration, while still remaining well in expansionary territory. Selling conditions similarly moderated, with the seasonally-adjusted sales index coming in at 61.2 vs. 63.0 in April. Qualitative commentary on demand remains positive, and increasingly inflationary pressures from raw material increases/tariffs were again a common theme across respondent commentary. The six-month outlook remains strong overall, and the Forward-Looking Indicator was essentially unchanged m/m at 58.8 (April 58.9).

### 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**, the **National Fastener Distributors Association**, 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)**.

**May FDI down slightly.** The seasonally-adjusted May FDI (56.6) moderated m/m vs. April's 57.4 reading, consistent with YTD trends (fourth straight month of deceleration, albeit off of a very high 60.8 January reading to start the year). In the May survey, 54% of respondents indicated sales were "better" relative to seasonal expectations vs. 56% in April. This produced a seasonally adjusted sales index of 61.2 (April 63.0). Pricing gains were again noted by a large majority of respondents, with 75% of respondents seeing higher prices y/y (and 50% m/m) vs. 81% in April. For perspective on the strength of pricing in May – only 20% of respondents reported higher pricing at the low point in March of 2016. The resulting FDI pricing index of 87.5 came down just slightly off of April's record 89.1 reading. Several respondents again commented on inflationary pressures in the channel, with one comment indicating material distributors are seemingly using tariffs to justify price increases even on products not affected by tariffs. Regarding customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (68% of responses), 29% believe customers' inventories are too low, and just 4% see inventory levels as too high. This was fairly consistent with April (63% in line, 31% too low, and 6% too high).

**May FLI steady m/m.** The seasonally-adjusted FLI was essentially unchanged m/m, registering 58.8 in May vs. 58.9 in April, as a slightly better employment index was offset by a modestly lower six month outlook. At 58.8, the FLI remains well into expansionary territory and is only slightly below averages seen across 2017 (60.9). Given solidly-expansionary FDI and FLI readings, we believe market conditions are likely to remain in growth mode (albeit potentially moderating growth) in the coming months.

**Manufacturing employment improves slightly.** Hiring sentiment improved this month among survey respondents. 32% of respondents saw higher employment levels in May relative to seasonal expectations vs. 19% in April, while 57% saw employment as in line (April 81%). The resulting FDI Employment Index was 60.7, up vs. April's 59.4 reading. The May US jobs report was similarly better than expected with +223,000 jobs added (+188,000 expected) and the unemployment rate ticked down to 3.8% (3.9% expected), an 18 year low. May's largest gains were registered in retail trade, health care, and construction. Manufacturing employment continues to trend upwards (+18,000 jobs in May), with most of the gains again coming from durable goods manufacturing (machinery +6,000). Total manufacturing jobs added over the past year now stands at +259,000, with 75% of the growth coming from durable goods industries. Average hours per work week for manufacturing employees decreased slightly at 40.8 hours (vs. April 41.1).

**May sentiment mostly positive.** Commentary from respondents skewed positive overall again this quarter. According to several participants, demand remains strong, with one respondent indicating "open orders are up 39% compared to last year at this time." Another distributor highlighted construction as a particularly strong end market, saying "Watch the markets on cement companies and contractors. Their demand is going way up nationwide. Time to get in!" Steel tariffs and global trade remain topics of heavy discussion in the industry. One respondent indicated that they "still [have] concerns over the Chinese tariffs if they go through!" Inflationary pressures from raw material increases and steel/aluminum tariffs are increasingly evident in the channel. One distributor commented on this by saying, "Material prices in general are up, and some material distributors may take advantage of the situation and raise other material prices not subject to tariffs [i.e.] brass." Quantitatively, survey data points to sustained momentum expected through 2018, with 50% of respondents expecting higher activity levels over the next six months and 43% expecting similar activity.

**Fastenal** reported May daily sales growth of 12.5% y/y, above our 11.5% estimate and again reflecting growth in all end markets/product lines. Underlying "core" growth (excluding foreign exchange) was 12.0%, the twelfth straight month of double-digit growth. Fasteners again saw strong growth at 9.1% y/y. Based on FDI data and other research inputs; we expect continued strength in public industrial distributor growth during 2018, with Fastenal y/y daily sales growth expected to remain in the double-digits through yearend.

### **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.

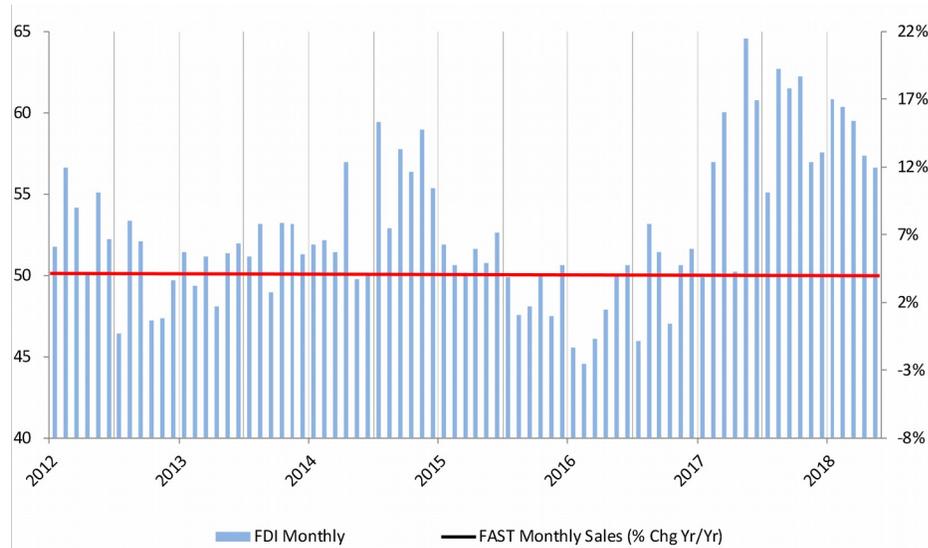
## Fastener Distribution Trends: May 2018

FASTENER DISTRIBUTION AT A GLANCE										
May 2018										
	----- Index Values -----								Direction	Rate of Change
	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct		
PMI (Manufacturing Sector)	58.7	57.3	59.3	60.8	59.1	59.3	58.2	58.7	Growing	Faster
FDI (Fastener Sector)	59.4	59.8	61.2	58.4	64.8	56.8	55.9	61.3	Growing	Slower
<b>FDI (Seasonally Adjusted)</b>	<b>56.6</b>	<b>57.4</b>	<b>59.5</b>	<b>60.4</b>	<b>60.8</b>	<b>57.6</b>	<b>56.9</b>	<b>62.2</b>	Growing	Slower
Sales (SA)	61.2	63.0	70.1	74.2	72.7	68.4	72.8	80.1	Growing	Slower
Forward- Looking (SA)	58.8	58.9	59.9	58.3	64.7	59.6	57.7	59.1	Growing	Slower
<b>(Other Metrics; NSA)</b>										
Employment	60.7	59.4	62.5	62.2	66.7	58.6	53.1	56.7	Growing	Faster
Supplier Deliveries	73.2	71.9	69.6	64.9	66.7	68.6	68.8	65.0	Growing	Faster
Respondent Inventories	57.1	53.1	60.7	59.5	56.1	58.6	53.1	51.7	Growing	Faster
Customer Inventories	37.5	37.5	35.7	40.5	34.8	37.1	37.5	40.0	Declining	Same
Pricing month-to-month	75.0	73.4	76.8	68.9	68.2	67.1	64.1	63.3	Growing	Faster
Pricing year-to-year	87.5	89.1	85.7	78.4	86.4	82.9	78.1	75.0	Growing	Slower
6-Month Outlook - May				Higher	Same	Lower				
				50%	43%	7%				

*FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectatbns. A reading above 50 suggests the category outperformed expectatbns, while a reading below 50 suggests the category underperformed expectatbns.*

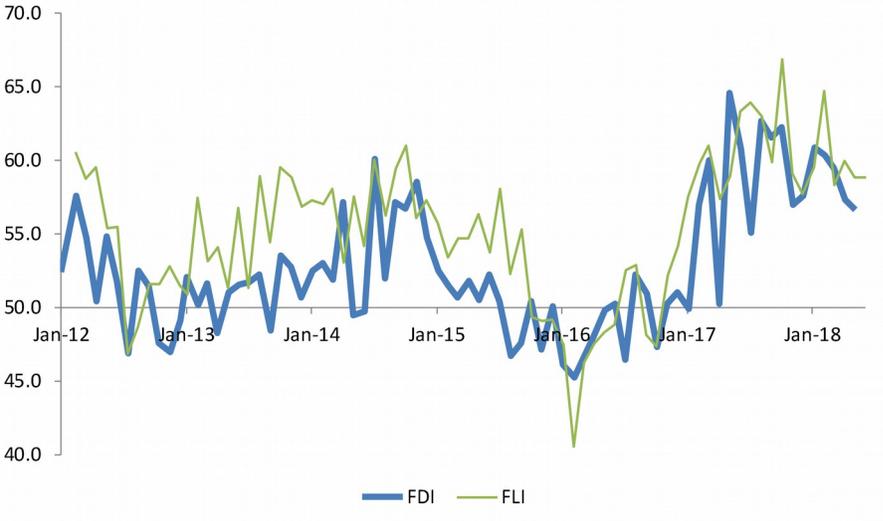
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

## Fastener Distributor Index (FDI); Seasonally Adjusted



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

**1-Month Lagged FDI vs. FLI (Both 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 6/7/2018.

Fastenal Company (FAST-\$52.36-Outperform)

W.W. Grainger Inc. (GWW-\$312.23-Outperform)

MSC Industrial Direct Co. Inc (MSM-\$92.15-Neutral)

(See recent research reports for more information)





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