

Fastener Distributor Index – December 2017

Written by R.W. Baird analyst David J. Manthey, CFA 1/9/18



Key Takeaway:

The seasonally adjusted FDI for December 2017 was 57.6 – up modestly vs. November’s 56.9 reading and remaining well in expansionary territory overall. Selling conditions flattened out slightly with the seasonally adjusted sales index coming in at a still strong 68.4 (November 72.8). Qualitative commentary on market conditions was a bit more mixed re: December trends, but optimism broadly remains regarding expectations over 1H18. The FDI Forward-Looking Indicator also remained very positive, registering a seasonally adjusted reading of 59.6, up vs. November (57.7).

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)**.

December FDI ticks up slightly. The seasonally adjusted December FDI (57.6) was up modestly m/m (November 56.9), reversing the deceleration seen in November. In the December survey, 43% of respondents indicated sales were “better” relative to seasonal expectations – down slightly vs. 50% in November but nevertheless still much improved vs. average 2016 levels (31%). Relative to historical seasonal readings in the month of December, this month’s seasonally adjusted sales index of 68.4 suggests selling conditions remain very strong overall. Pricing was again a solid tailwind as 66% of distributors saw higher prices y/y (up slightly vs. 63% in November) amid generally improving end markets. This produced an FDI pricing index of 82.9, up vs. last month’s 78.1 reading and above the 2017 average of 75.0. As it relates to customer inventories, a majority of respondents continue to view inventory levels as in line with expectations (63% of responses), while 31% see inventory levels as too low. This was relatively consistent with November results of 75% and 25%, respectively.

FDI Forward-Looking Indicator accelerates. 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. The seasonally adjusted Forward-Looking Indicator accelerated following two straight months of deceleration, registering a seasonally-adjusted 59.6 in December vs. last month’s 57.7. Gains were primarily driven by a slightly more bullish 6-month outlook and improved hiring sentiment (more on this below). For context, the Forward-Looking Indicator averaged 49.7 during 2016 and 60.9 in 2017. Given solidly expansionary FDI

and Forward-Looking Indicator readings, market conditions still appear likely to remain in growth mode in the coming months.

Manufacturing employment modestly higher m/m. Hiring sentiment was slightly higher this month among survey respondents. 20% of respondents saw higher employment levels in December relative to seasonal expectations vs. 13% in November, while 77% saw employment as in line with seasonal expectations (November 81%). This produced an FDI Employment Index of 58.6, up vs. November's 53.1 reading. The December US jobs report, meanwhile, was a bit weaker than expected at +148,000 jobs (+190,000 expected), mainly reflecting a decline in retail-related positions. Encouragingly, manufacturing employment was up m/m (+25,000 jobs), primarily driven by a gain in durable goods industries (+21,000). Total manufacturing jobs added during 2017 totaled 196,000 vs. a slight decline seen in 2016 (-16,000). Average hours per work week for manufacturing employees was down modestly at 41.9 hours (vs. November 42.0).

December sentiment mixed. Qualitative responses on current market conditions were fewer than typical this month. That being said, survey commentary was more mixed regarding this month's trends amid normal seasonal slowness around the holidays, while January is generally expected to be a good month based on strong backlogs. Reflecting this, one respondent noted, "The limited number of production hours in December made December an average month, but if backlog is any indication of the future, January 2018 should join most of 2017 in breaking records." Quantitative survey data also points to a mostly positive outlook with 60% of respondents expecting higher activity levels over the next six months (up vs. 47% in November), and another 37% expecting similar activity.

Fastenal reported November daily sales growth of 15.4% y/y, nicely ahead of our 14.4% estimate and reflecting growth in all end markets/product lines. Underlying "core" growth (excluding acquisitions and foreign exchange) was 13.4%, the sixth consecutive month of double-digit growth. Fasteners saw strong growth at 14.1% y/y (up vs. +11.5% last month), including the recent Mansco acquisition (+10.0% ex-Mansco). The company plans to report December daily sales growth in conjunction with its 4Q earnings release on January 17. Based on FDI data and other research inputs, we expect a continued uptick in growth among the public industrial distributors in 2018, with Fastenal daily sales growth expected to sustain in the double-digits y/y.

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.

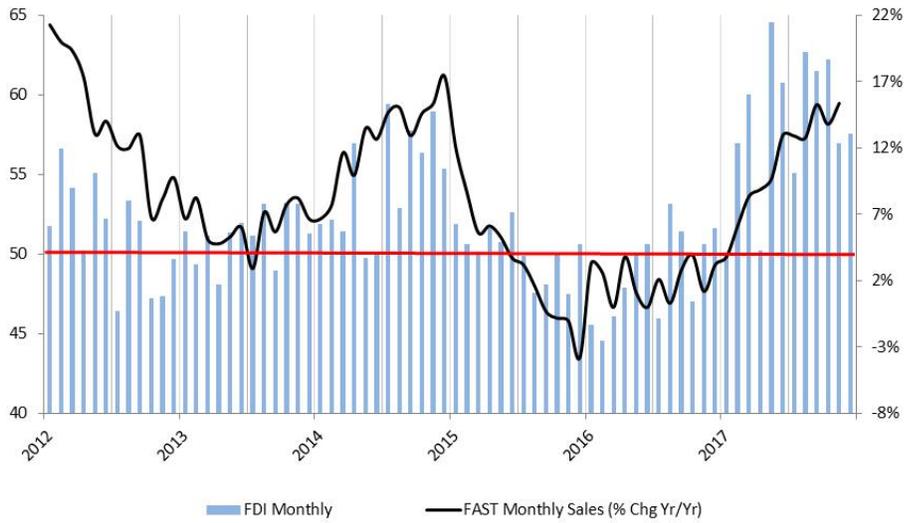
Industrial Distribution Risk Synopsis

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

FASTENER DISTRIBUTION AT A GLANCE										
December 2017										
	----- Index Values -----									Rate of Change
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Directbn	
PMI (Manufacturing Sector)	59.7	58.2	58.7	60.8	58.8	56.3	57.8	54.9	Growing	Faster
FDI (Fastener Sector)	56.8	55.9	61.3	57.6	61.0	52.9	60.5	66.3	Growing	Faster
FDI (Seasonally Adjusted)	57.6	56.9	62.2	61.5	62.7	55.1	60.8	64.6	Growing	Faster
Sales (SA)	68.4	72.8	80.1	77.3	77.1	69.8	86.6	79.6	Growing	Slower
Forward- Looking (SA)	59.6	57.7	59.1	66.9	59.9	62.9	64.0	63.3	Growing	Faster
(Other Metrics; NSA)										
Employment	58.6	53.1	56.7	57.1	62.1	53.3	68.0	73.6	Growing	Faster
Supplier Deliveries	68.6	68.8	65.0	69.6	65.2	65.0	64.0	72.2	Growing	Slower
Respondent Inventories	58.6	53.1	51.7	48.2	62.1	51.7	52.0	58.3	Growing	Faster
Customer Inventories	37.1	37.5	40.0	37.5	39.4	35.0	32.0	36.1	Declining	Faster
Pricing, month-to-month	67.1	64.1	63.3	73.2	72.7	65.0	52.0	59.7	Growing	Faster
Pricing, year-to-year	82.9	78.1	75.0	83.9	78.8	76.7	66.0	75.0	Growing	Faster
						Higher	Same	Lower		
6-Month Outlook - December						60%	37%	3%		
<p><i>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.</i></p>										

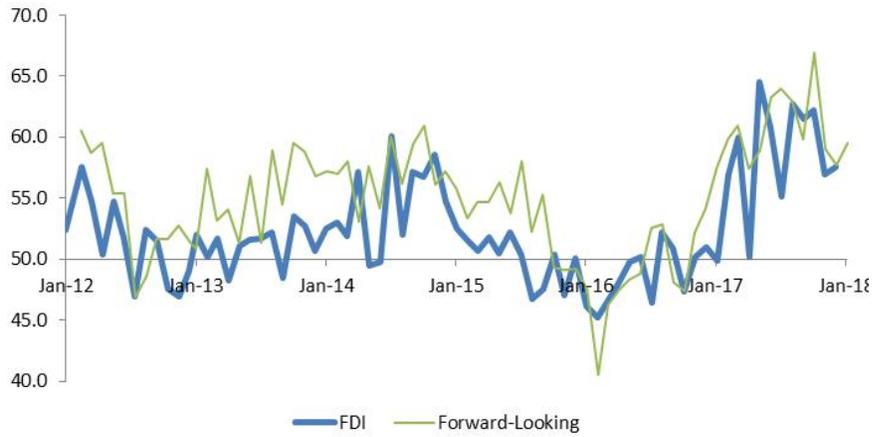
Source: Robert W. Baird & Co., FCH Sourcing Network, Institute for Supply Management

Fastener Distribution Trends: December 2017 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

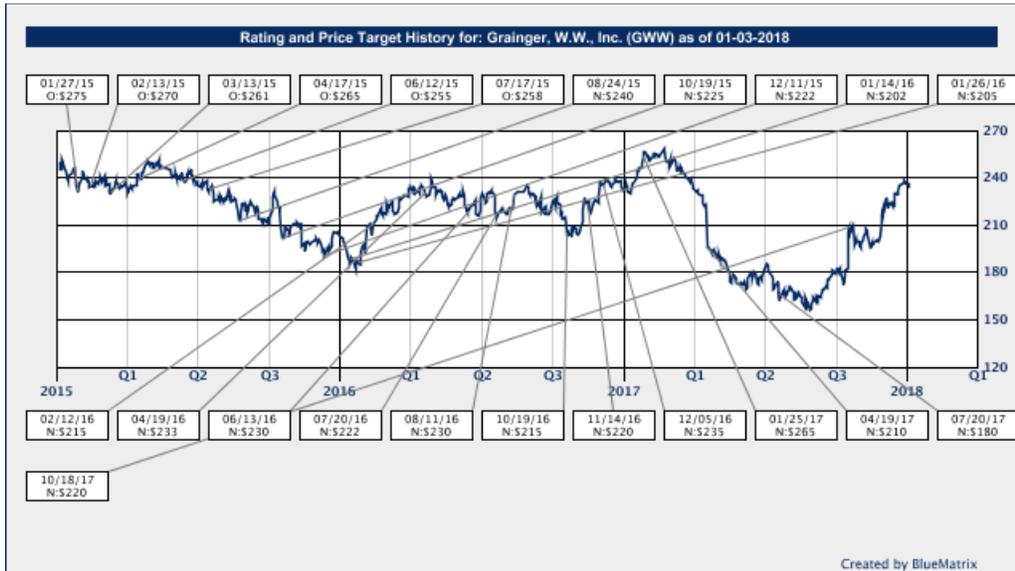
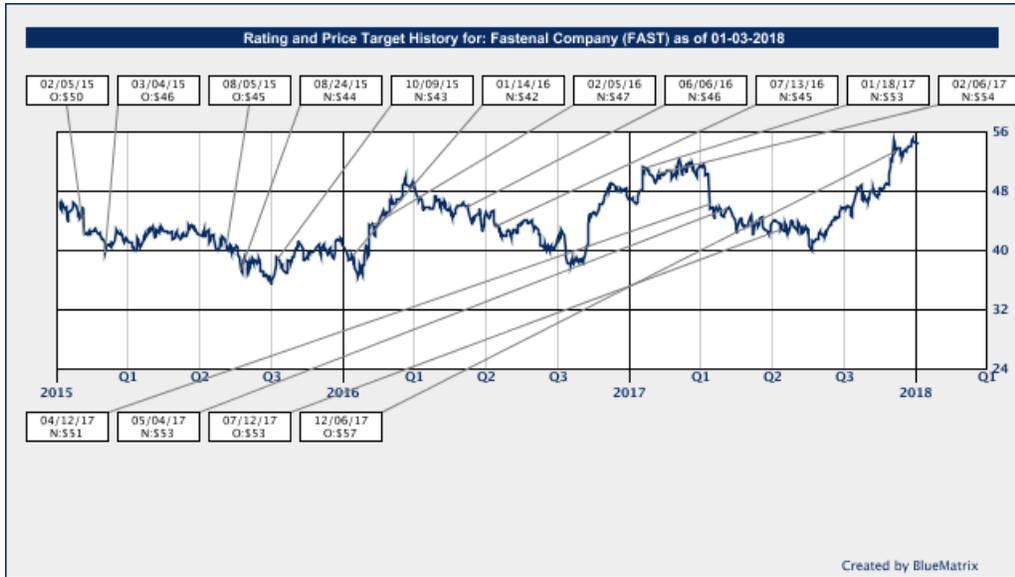
All stock prices below are as of 1/9/2018.

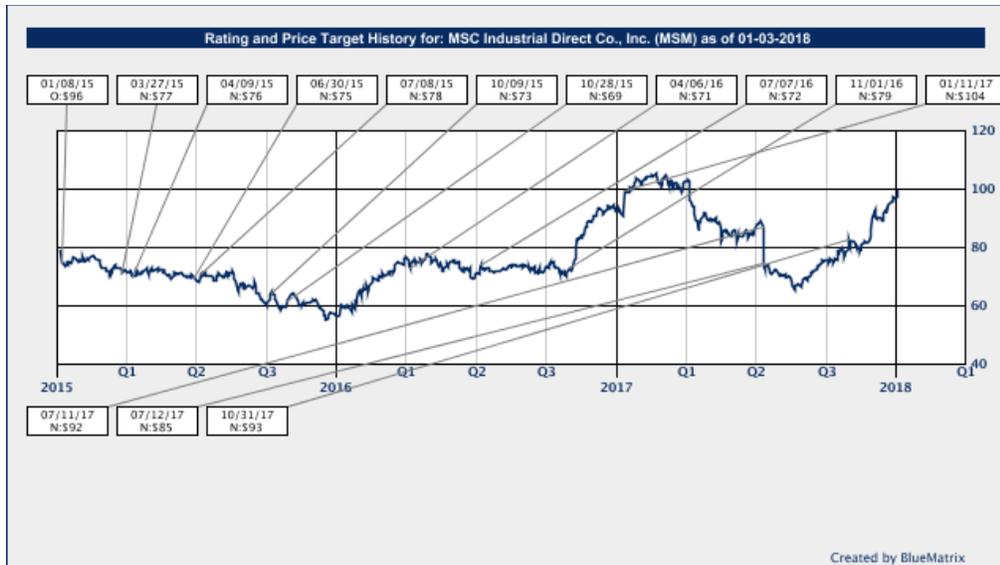
Fastenal Company (FAST-\$55.47-Outperform)

W.W. Grainger Inc. (GWW-\$238.25-Neutral)

MSC Industrial Direct Co. Inc (MSM-\$98.38-Neutral)

(See recent research reports for more information)





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