

Fastener Distributor Index – December 2019

Written by R.W. Baird analyst David J. Manthey, CFA 1/9/20



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for December was **44.4**, slowing further vs. November and dipping further into contractionary territory. Sales trends on a seasonally adjusted basis were slightly weaker m/m, with a majority of respondents' sales below expectations. The six-month outlook was also slightly worse, while the Forward-Looking Indicator (FLI) was similar sequentially but remains decidedly sub-50. Overall, December fastener market conditions were soft for the second consecutive month, while respondents' implied January forecasts are for less bad demand conditions given an improved (but still sub-50) FLI.

Fastener Distribution Trends: December 2019

FASTENER DISTRIBUTION AT A GLANCE										
December 2019										
	----- Index Values -----									
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Direction	Rate of Change
PMI (Manufacturing Sector)	47.2	48.1	48.3	47.8	49.1	51.2	51.7	52.1	Declining	Faster
FDI (Fastener Sector)	43.4	45.5	52.2	52.4	55.5	50.9	48.8	55.9	Declining	Faster
FDI (Seasonally Adjusted)	44.4	46.7	52.1	56.0	55.9	52.2	48.3	53.8	Declining	Faster
Sales (SA)	34.9	35.5	48.2	56.4	52.1	40.4	38.5	57.4	Declining	Faster
Forward- Looking (SA)	46.2	46.5	44.2	44.0	48.0	44.9	44.4	47.7	Declining	Faster
(Other Metrics; NSA)										
Employment	45.3	48.5	48.7	51.6	55.9	55.4	56.5	57.8	Declining	Faster
Supplier Deliveries	53.1	51.5	55.1	58.1	58.8	64.3	50.0	60.9	Growing	Faster
Respondent Inventories	65.6	65.2	69.2	69.4	64.7	69.6	61.3	65.6	Growing	Faster
Customer Inventories	43.8	51.5	52.6	53.2	52.9	48.2	51.6	43.8	Declining	Faster
Pricing, month-to-month	60.9	57.6	59.0	61.3	61.8	66.1	66.1	62.5	Growing	Faster
Pricing, year-to-year	79.7	78.8	84.6	79.0	80.9	80.4	82.3	89.1	Growing	Faster
6-Month Outlook - December					Higher		Same		Lower	
					25%		47%		28%	
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 by the **FCH Sourcing Network** and **Baird** with support from the **National Fastener Distributors Association**. 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 decelerates further. The seasonally adjusted December FDI was **44.4**, down-ticked from an already lackluster November reading of 46.7. This was driven by slightly softer selling conditions, which produced a seasonally adjusted sales index of just 34.9 vs. 35.5 last month, as well as deterioration in the survey's employment component. For the second consecutive month, a majority of respondents (56%) saw sales growth below seasonal expectations, while just 19% characterized sales as above seasonal expectations. Lastly, pricing remained stable sequentially for a large majority of respondents.

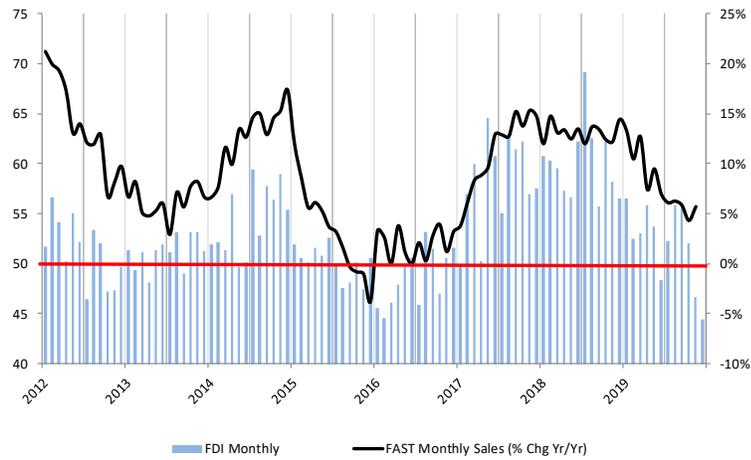
December FII similar m/m, but remains in contractionary territory. The seasonally adjusted FII decelerated just slightly to **46.2** (November 46.5). A more conservative six-month outlook was the main driver behind the slightly lower headline reading, while respondent and customer inventory levels were mixed. While the relative sequential stability is encouraging, this month's reading nonetheless remains below the neutral level of 50 and represents the eleventh sub-50 reading of 2019, signaling expectations for a somewhat sluggish start to 2020.

Hiring sentiment unchanged. Hiring sentiment again remained relatively stable m/m, as 81% of respondents characterized the pace of hiring as similar to/unchanged from November. Looking at the broader economy, the December jobs report is scheduled to be released January 10. Economists are forecasting 160,000 job additions. This compares to a better-than-expected November jobs report in which 266,000 jobs were added (182,500 expected), including 41,000 additional auto making jobs following the resolution of the GM/UAW strike. Nevertheless, the rate of adds has slowed since the end of 2018, when the economy was adding an average of 223,000 jobs per month. The unemployment rate in November decreased 0.1% to 3.5%. Manufacturing employment in November increased by 54,000, an underlying increase of 13,000 jobs excluding the impacts of the GM strike.

Respondent commentary skews negative. Feedback on the demand environment suggest a generally weaker pace of business activity currently. One respondent commented, "November/December [were] down from the earlier months of 2019. Customers pushed out deliveries to 2Q20 instead of taking in inventory at end of 2019." Another commented, "Heavy Truck market showing considerable slowing for the past couple months." The six-month outlook showed moderate deterioration compared to last month and remains somewhat muted overall, with 28% of respondents now expecting lower activity six months from now (November 27%), 47% expecting similar activity (November 42%), and 25% expecting higher activity (November 30%).

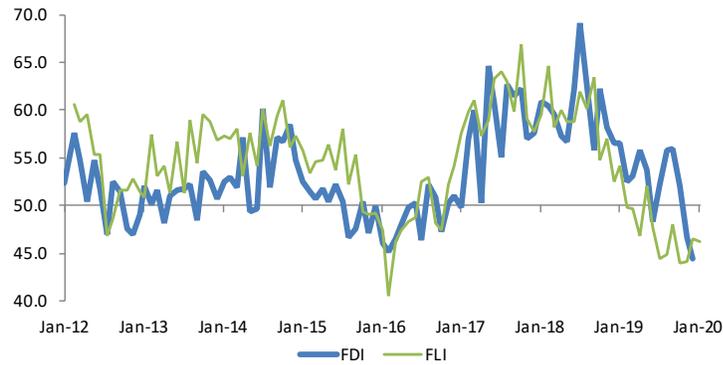
Fastenal reported +5.7% overall November daily sales growth, slightly above our comparable 4.8% estimate. Sales growth to manufacturing customers accelerated nearly 2% m/m, while non-residential construction end market growth accelerated 1% sequentially. Overall organic growth of +5.8% improved vs. +4.4% in October. Fastener growth specifically was slightly worse, however, at +2.4% (October +3.4%), consistent with the weaker FDI reading last month. December daily sales growth will be reported on January 17 in conjunction with 4Q19 earnings. Based on FDI data and other research inputs, we model December ADS +3.2%, moderating vs. November levels although we consider December daily sales to be seasonally less significant.

Fastener Distributor Index (FDI); Seasonally Adjusted



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 1/8/2020.

Fastenal Company (FAST-\$36.20-Neutral)
 W.W. Grainger Inc. (GWW-\$341.41-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$75.96-Neutral)
 (See recent research reports for more information)



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