

Fastener Distributor Index – February 2020

Written by R.W. Baird analyst David J. Manthey, CFA 3/3/20



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for February was **53.0**, showing m/m improvement for the second consecutive month. Sales trends on a seasonally adjusted basis further improved, albeit mostly due to the seasonal adjustment factor (February is typically a weaker month), as the percentage of respondents seeing better-than-expected sales dipped vs. January. The six-month outlook was essentially unchanged, but weakness in other components pushed the Forward-Looking Indicator (FLI) down into contractionary levels, **48.9**. Lastly, a noticeable uptick in respondents seeing slower deliveries from suppliers, coupled with respondent commentary suggests potential Corona virus-related supply chain disruption will be an area to closely monitor going forward.

Fastener Distribution Trends: February 2020

FASTENER DISTRIBUTION AT A GLANCE											
February 2020											
	----- Index Values -----										
	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Direction	Rate of Change	
PMI (Manufacturing Sector)	50.1	50.9	47.8	48.1	48.3	47.8	49.1	51.2	Growing	Slower	
FDI (Fastener Sector)	51.3	55.4	43.4	45.5	52.2	52.4	55.5	50.9	Growing	Slower	
FDI (Seasonally Adjusted)	53.0	51.4	44.4	46.7	52.1	56.0	55.9	52.2	Growing	Faster	
Sales (SA)	54.9	50.0	34.9	35.5	48.2	56.4	52.1	40.4	Growing	Faster	
Forward-Looking (SA)	48.9	50.9	46.2	46.5	44.2	44.0	48.0	44.9	Declining	Faster	
(Other Metrics; NSA)											
Employment	48.2	56.7	45.3	48.5	48.7	51.6	55.9	55.4	Declining	Faster	
Supplier Deliveries	66.1	58.3	53.1	51.5	55.1	58.1	58.8	64.3	Growing	Faster	
Respondent Inventories	64.3	63.3	65.6	65.2	69.2	69.4	64.7	69.6	Growing	Faster	
Customer Inventories	41.1	41.7	43.8	51.5	52.6	53.2	52.9	48.2	Declining	Faster	
Pricing, month-to-month	50.0	58.3	60.9	57.6	59.0	61.3	61.8	66.1	Growing	Slower	
Pricing, year-to-year	58.9	70.0	79.7	78.8	84.6	79.0	80.9	80.4	Growing	Slower	
6-Month Outlook -February	Higher Same Lower 50% 18% 32%										

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** 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 continued to improve in February. The seasonally adjusted February FDI (53.0) showed further m/m improvement (January 51.4) for the second consecutive month. The seasonally adjusted sales index accelerated to 54.9 vs. 50.0 last month, which drove the overall improvement in the FDI. Of note, the improvement in the sales index was driven mainly by the seasonal adjustment factor, as the percentage of respondents seeing better-than-expected sales actually decreased vs. last month, although this is not usual given February is normally a seasonally weaker month. Pricing was again stable m/m for a large majority of respondents.

February FLI downticks. The seasonally adjusted FLI decreased to 48.9 (January 50.9), as a lower employment index and higher inventory levels among respondents weighed on the index. January's FLI represented the first expansionary reading since April 2019; with Coronavirus supply chain concerns seemingly mounting, the FLI returned below 50, implying additional moderation in growth could be ahead. Potential early supply chain impacts from the Coronavirus most noticeably manifested in the form of a significant uptick in the percentage of respondents seeing slower supplier deliveries compared to last month (see graph below).

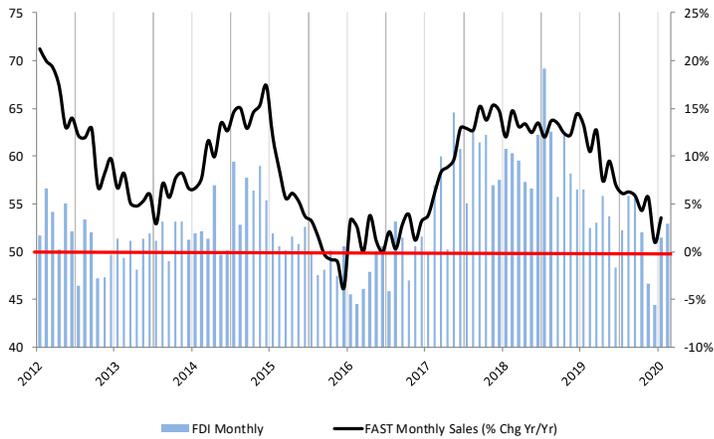
Hiring sentiment also a bit weaker. Sentiment around hiring turned slightly more pessimistic m/m, as only 18% of respondents characterized the pace of hiring as having picked up vs. January (compared to 27% last month), while another 61% indicated the pace was stable sequentially. Looking at the broader economy, the January jobs report was stronger than anticipated with 225,000 additions vs. economist expectations of +158,000. The unemployment rate ticked slightly higher to 3.6% due to an increase in the labor force participation rate. Manufacturing employment continued its recently slump with another decrease of 12,000 jobs m/m. The February jobs report is slated to be released on March 6 where economists forecast 175,000 job additions.

Respondent commentary mixed. Fewer qualitative comments were received this month but the overall tone of the comments was uneven. One respondent attributed weaker-than-expected February results and expected lower activity six months from now to Coronavirus impacts. Another respondent took a more bullish view on expectations for the second half of the year noting, "Most economic sources expect a pickup in the 2nd half which [explains] the future activity optimism." Looking to the next six months, the outlook was essentially unchanged compared to January, with an uptick in those expecting higher activity (50% vs. 33% in January) offset by a nearly equal amount now expecting lower activity (32% vs. 17% last month).

Fastenal reported +3.6% overall January daily sales growth, solidly above our +1.7% estimate. Sales growth to manufacturing customers accelerated nearly 2.5% m/m, while non-residential construction end market growth increased 3% sequentially. Overall organic growth of +3.5% significantly improved vs. +0.9% in December. Fastener sales specifically fared slightly worse than the overall, however, with sales increasing 1.3% y/y (December +1.9%). February daily sales growth will be reported on March 5. We are expecting daily sales growth of +3.8%, slightly below what normal seasonality/our days-adjusted benchmark would imply as we assume moderately weaker underlying market conditions, consistent with the m/m deceleration seen in the February ISM.

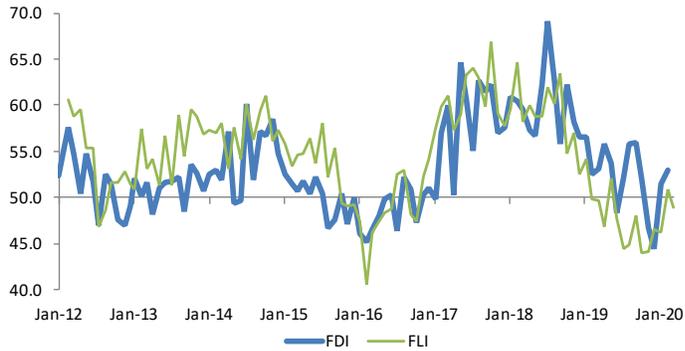
FCH Sourcing Network noted a marked uptick in organic search traffic for fastener inventory items as the month progressed, which could indicate the onset of supply chain disruptions caused by the extended Chinese New Year break and delays surrounding the Corona virus pandemic.

Fastener Distributor Index (FDI); Seasonally Adjusted

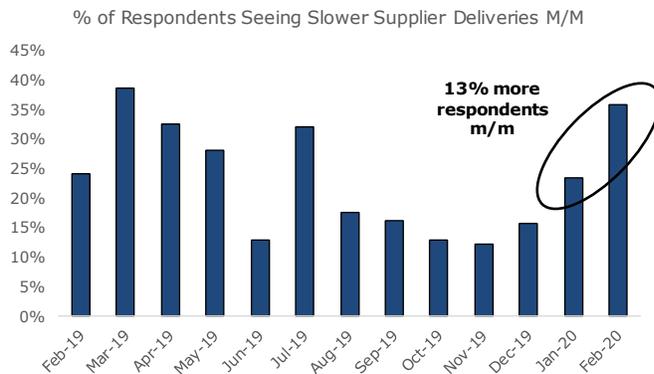


Source: Baird, FCH Sourcing Network, Company reports

1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)



Source: Baird, FCH Sourcing Network



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 3/4/2020.

Fastenal Company (FAST-\$34.85-Neutral)
 W.W. Grainger Inc. (GWW-\$292.03-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$63.69-Neutral)
 (See recent research reports for more information)



Robert W. Baird & Co. Incorporated makes a market in the securities of FAST, GWW, and MSM.

Robert W. Baird & Co. Incorporated and/or its affiliates have been compensated by MSC Industrial Direct Co., Inc. for non-investment banking securities related services in the past 12 months.

Robert W. Baird & Co. Incorporated ("Baird") and/or its affiliates expect to receive or intend to seek investment-banking related compensation from the company or companies mentioned in this report within the next three months. Baird may not be licensed to execute transactions in all foreign listed securities directly. Transactions in foreign listed securities may be prohibited for residents of the United States. Please contact a Baird representative for more information.

Investment Ratings: Outperform (O) - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months. **Neutral (N)** - Expected to perform in line with the broader U.S. equity market over the next 12 months. **Underperform (U)** - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

Risk Ratings: L - Lower Risk – Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings. **A - Average Risk** – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. **H - Higher Risk** – Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. **S - Speculative Risk** – High growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

Valuation, Ratings and Risks. The recommendation and price target contained within this report are based on a time horizon of 12 months but there is no guarantee the objective will be achieved within the specified time horizon. Price targets are determined by a subjective review of fundamental and/or quantitative factors of the issuer, its industry, and the security type. A variety of methods may be used to determine the value of a security including, but not limited to, discounted cash flow, earnings multiples, peer group comparisons, and sum of the parts. Overall market risk, interest rate risk, and general economic risks impact all securities. Specific information regarding the price target and recommendation is provided in the text of our most recent research report.

Distribution of Investment Ratings. As of February 28, 2020, Baird U.S. Equity Research covered 724 companies, with 59% rated Outperform/Buy, 40% rated Neutral/Hold and 1% rated Underperform/Sell. Within these rating categories, 11% of Outperform/Buy-rated and 4% of Neutral/Hold-rated companies have compensated Baird for investment banking services in the past 12 months and/or Baird managed or co-managed a public offering of securities for these companies in the past 12 months.

Analyst Compensation. Research analyst compensation is based on: (1) the correlation between the research analyst's recommendations and stock price performance; (2) ratings and direct feedback from our investing clients, our institutional and retail sales force (as applicable) and from independent rating services; (3) the research analyst's productivity, including the quality of such analyst's research and such analyst's contribution to the growth and development of our overall research effort; and (4) compliance with all of Baird's internal policies and procedures. This compensation criteria and actual compensation is reviewed and approved on an annual basis by Baird's Research Oversight Committee. Research analyst compensation is derived from all revenue sources of the firm, including revenues from investment banking. Baird does not compensate research analysts based on specific investment banking transactions.

A complete listing of all companies covered by Baird U.S. Equity Research and applicable research disclosures can be accessed at <http://www.rwbaird.com/research-insights/research/coverage/research-disclosure.aspx>. You can also call 800-792-2473 or write: Robert W. Baird & Co., Equity Research, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.

Analyst Certification

The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

Disclaimers

Baird prohibits analysts from owning stock in companies they cover.

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

Other Disclosures

The information and rating included in this report represent the research analyst's views based on a time horizon of 12 months, as described above, unless otherwise stated. In our standard company-specific research reports, the subject company may be designated as a "Fresh Pick", representing that the research analyst believes the company to be a high-conviction investment idea based on a subjective review of one or more fundamental or quantitative factors until an expiration date specified by the analyst but not to exceed nine months. The Fresh Pick designation and specified expiration date will be displayed in standard company-specific research reports on the company until the occurrence of the expiration date or such time as the analyst removes the Fresh Pick designation from the company in a subsequent, standard company-specific research report. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst's understanding of the individual client's objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the research analyst considers relevant to the client. As such, these perspectives and strategies may differ from the research analyst's views contained in this report.

Baird and/or its affiliates may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific

research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird's standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the research analyst's ratings and recommendations contained in more broadly disseminated standard research reports. Baird disseminates its research reports to all clients simultaneously by posting such reports to Baird's password-protected client portal, <https://bol.rwbaird.com/Login> ("BairdOnline"). All clients may access BairdOnline and at any time. All clients are advised to check BairdOnline for Baird's most recent research reports. After research reports are posted to BairdOnline, such reports may be emailed to clients, based on, among other things, client interest, coverage, stock ownership and indicated email preferences, and electronically distributed to certain third-party research aggregators, who may make such reports available to entitled clients on password-protected, third-party websites. Not all research reports posted to BairdOnline will be emailed to clients or electronically distributed to such research aggregators. To request access to Baird Online, please visit <https://bol.rwbaird.com/Login/RequestInstLogin> or contact your Baird representative.

Dividend Yield. As used in this report, the term "dividend yield" refers, on a percentage basis, to the historical distributions made by the issuer relative to its current market price. Such distributions are not guaranteed, may be modified at the issuer's discretion, may exceed operating cash flow, subsidized by borrowed funds or include a return of investment principal.

United Kingdom ("UK") disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.

The contents of this report may contain an "investment recommendation", as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). This report does not contain a "personal recommendation" or "investment advice", as defined by the Market in Financial Instruments Directive 2014/65/EU ("MiFID"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.

This material is distributed in the UK and the European Economic Area ("EEA") by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority ("FCA") in the UK.

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within Articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as "relevant persons"). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated. There is no intention to update this report in future. Where, for any reason, an update is made, this will be made clear in writing on the research report. Such instances will be occasional only.

Please note that this report may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months. Information and details regarding previous recommendations in relation to the financial instruments or issuer referred to in this report are available at https://baird.bluematrix.com/sellside/MAR_action.

Robert W. Baird Limited or one of its affiliates may at any time have a long or short position in the company or companies mentioned in this report. Where Robert W. Baird Limited or one of its affiliates holds a long or short position exceeding 0.5% of the total issued share capital of the issuer, this will be disclosed separately by your Robert W. Baird Limited representative upon request.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Robert W. Baird Limited and Robert W. Baird & Co. Incorporated have in place organisational and administrative arrangements for the prevention, avoidance, and disclosure of conflicts of interest with respect to research recommendations. Robert W. Baird Limited's Conflicts of Interest Policy, available [here](#), outlines the approach Robert W. Baird Limited takes in relation to conflicts of interest and includes detail as to its procedures in place to identify, manage and control conflicts of interest. Robert W. Baird Limited and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. Robert W. Baird & Co. Incorporated's policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Robert W. Baird & Co. Incorporated's research analysts certify on a quarterly basis that such research reports accurately reflect their personal views.

This material is strictly confidential to the recipient and not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Robert W. Baird Limited is exempt from the requirement to hold an Australian financial services license and is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.
