

Fastener Distributor Index – November 2017

By R.W. Baird analyst David Manthey, 12/6/17



Key Takeaway:

The seasonally adjusted FDI for November 2017 was 56.9 – moderating vs. October’s strong 62.2 reading but remaining well in expansionary territory overall. Similarly, selling conditions also decelerated slightly with the seasonally adjusted sales index coming in at a still strong 72.8 (October 80.1). Qualitative commentary on market conditions was a bit more mixed vs. recent trends with one respondent highlighting a strong backlog vs. prior year, while another expressed some skepticism on the sustainability of recent growth. The FDI Forward-Looking Indicator remained very positive, registering a seasonally adjusted reading of 57.7, but also came down modestly vs. October (59.1).

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)**.

November FDI decelerates but remains in expansionary territory. The seasonally adjusted November FDI (56.9) was down m/m (October 62.2), consistent with last month’s drop in the forward-looking indicator. In the November survey, 50% of respondents indicated sales were “better” relative to seasonal expectations – down vs. a record 73% in October but nevertheless still much improved vs. average 2016 levels (31%). Relative to historical seasonal readings in the month of November, this month’s seasonally adjusted sales index of 72.8 suggests selling conditions still remain very strong overall. Pricing was again a solid tailwind as 63% of distributors saw higher prices y/y (up slightly vs. 60% in October). This produced an FDI y/y pricing index of 78.1, a modest acceleration vs. last month’s 75.0 reading and 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 (75% of responses), while 25% see inventory levels as too low. This was relatively unchanged vs. October results of 80% and 20%, respectively.

FDI Forward-Looking Indicator again 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. The seasonally adjusted Forward-Looking Indicator decelerated for the second straight month in November to 57.7 vs. last month’s 59.1. For context, the Forward-Looking Indicator averaged 49.7 during 2016, but has averaged 61.0 year-to-date in 2017. Nevertheless, 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 lower m/m. Hiring sentiment was slightly lower m/m among survey respondents. 13% of respondents indicated employment was higher in November relative to seasonal expectations vs. 27% in October, while 81% saw hiring levels as in line with seasonal expectations (October 60%). This resulted in an FDI Employment Index of 53.1, down modestly vs. October's 56.7 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). November's US jobs report is expected to be released on 12/8/17.

November sentiment mixed. Qualitative responses on current market conditions were fewer than typical this month. That being said, survey commentary was a bit more split in tone. One respondent expressed skepticism that current strong growth is sustainable throughout 2018 saying, "While it feels like the ride up is never ending, [I] can't help but feel like it will run out by end of the 1st quarter 2018, level for a bit and then maybe fall off." Another respondent, on the other hand, noted strong backlog as a cause for optimism, saying, "[We're] maintaining a large backlog compared to [the] same time-frame last year." Quantitative survey data still points to a mostly positive outlook with 94% of respondents expecting higher or similar activity levels over the next six months.

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). 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 double-digits y/y for the remainder of 2017 and into 2018.

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

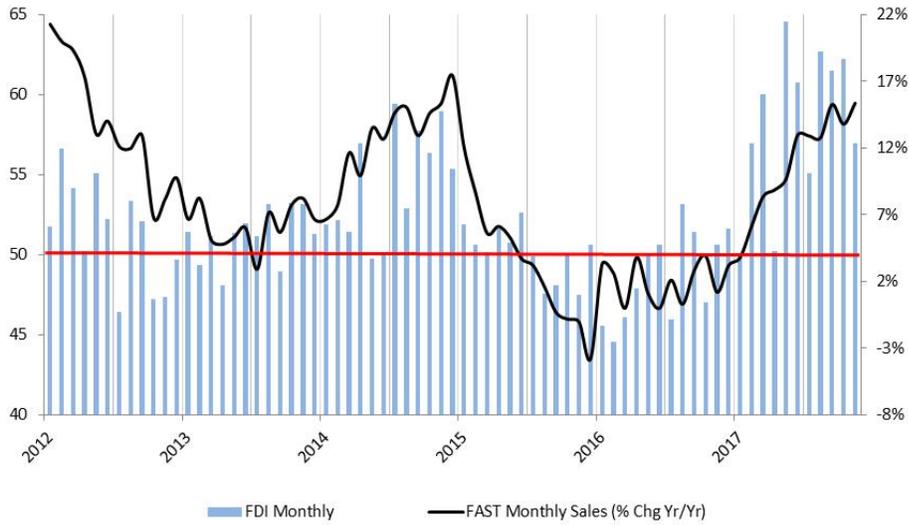
Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Fastener Distribution Trends: November 2017

FASTENER DISTRIBUTION AT A GLANCE										
November 2017										
	----- Index Values -----								Directiøn	Rate of Change
	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr		
PMI (Manufacturing Sector)	58.2	58.7	60.8	58.8	56.3	57.8	54.9	54.8	Growing	Slower
FDI (Fastener Sector)	55.9	61.3	57.6	61.0	52.9	60.5	66.3	53.7	Growing	Slower
FDI (Seasonally Adjusted)	56.9	62.2	61.5	62.7	55.1	60.8	64.6	50.2	Growing	Slower
Sales (SA)	72.8	80.1	77.3	77.1	69.8	86.6	79.6	43.8	Growing	Slower
Forward- Looking (SA)	57.7	59.1	66.9	59.9	62.9	64.0	63.3	58.9	Growing	Slower
(Other Metrics; NSA)										
Employment	53.1	56.7	57.1	62.1	53.3	68.0	73.6	57.4	Growing	Slower
Supplier Deliveries	68.8	65.0	69.6	65.2	65.0	64.0	72.2	66.2	Growing	Faster
Respondent Inventories	53.1	51.7	48.2	62.1	51.7	52.0	58.3	52.9	Growing	Faster
Customer Inventories	37.5	40.0	37.5	39.4	35.0	32.0	36.1	38.2	Declining	Faster
Pricing, month-to-month	64.1	63.3	73.2	72.7	65.0	52.0	59.7	60.3	Growing	Faster
Pricing, year-to-year	78.1	75.0	83.9	78.8	76.7	66.0	75.0	73.5	Growing	Faster
					Higher	Same	Lower			
6-Month Outlook - November					47%	47%	6%			
<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>										

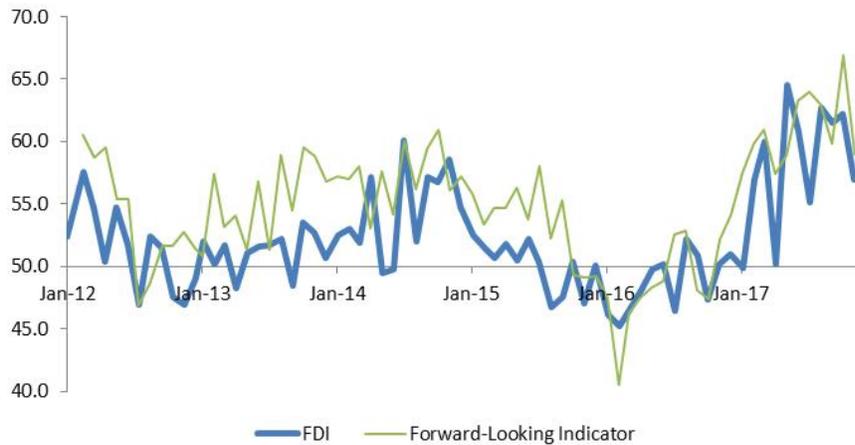
Source: Robert W. Baird & Co., [FCH Sourcing Network](#), Institute for Supply Management

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

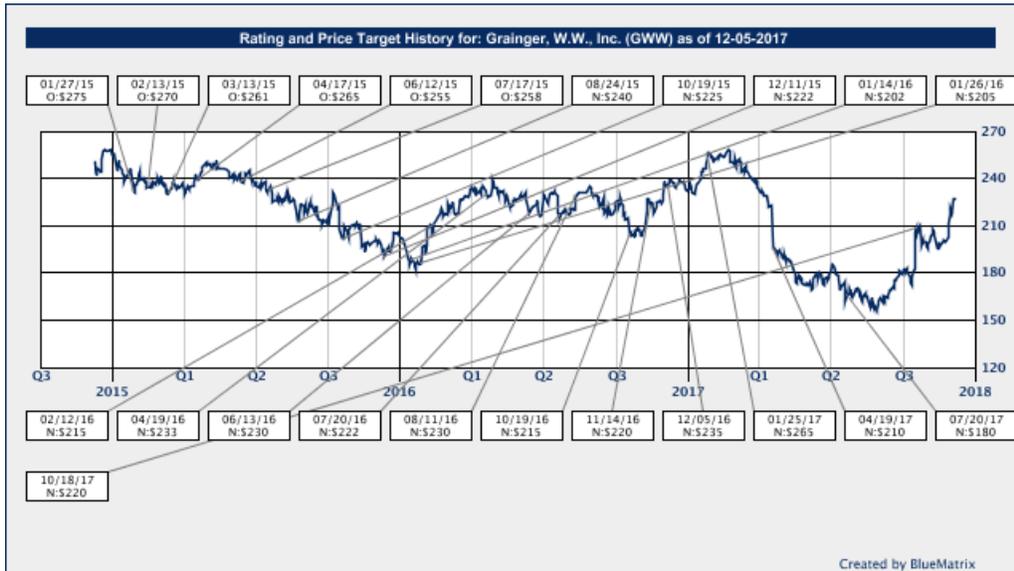
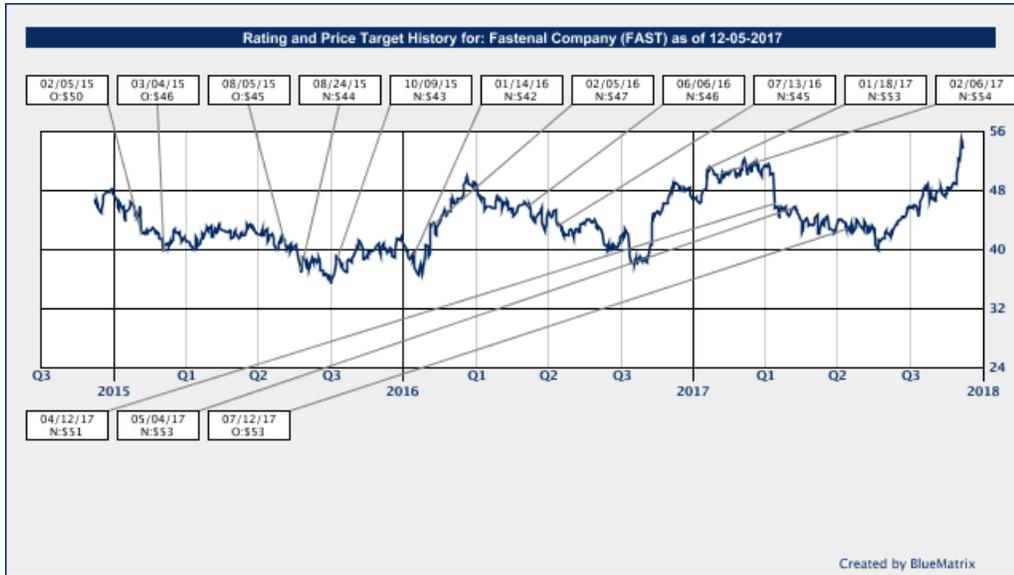
All stock prices below are as of 12/6/2017.

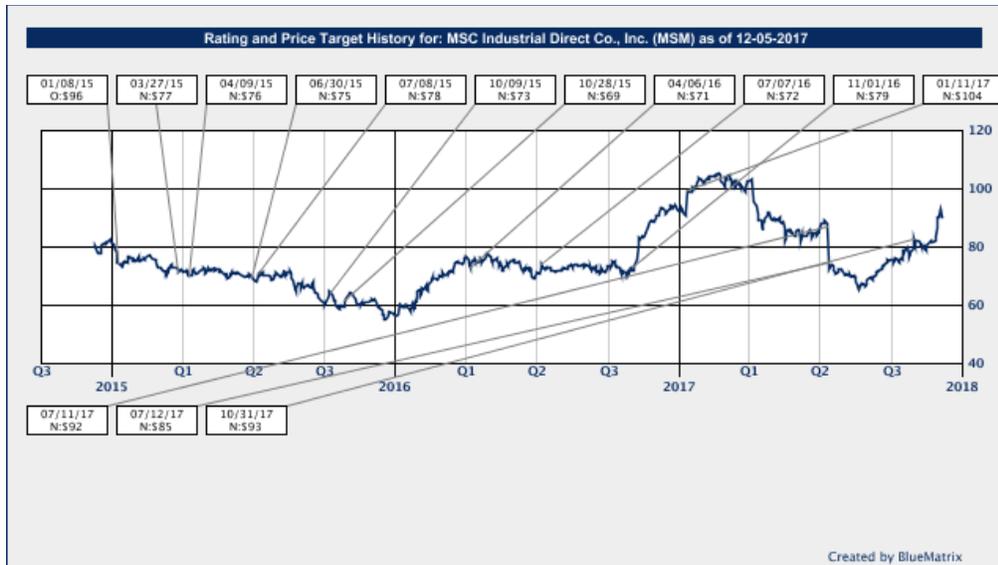
Fastenal Company (FAST-\$53.38-Outperform)

W.W. Grainger Inc. (GWW-\$221.53-Neutral)

MSC Industrial Direct Co. Inc (MSM-\$89.52-Neutral)

(See recent research reports for more information)





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