

Fastener Distributor Index – September 2018

Written by R.W. Baird analyst David J. Manthey, CFA 10/9/18



Key Takeaway:

The seasonally adjusted FDI for September was 55.8, decelerating m/m vs. August's 62.5 reading. Selling conditions decelerated more sharply, with the seasonally adjusted sales index coming in at 46.5 (vs. August 74.7). Qualitative commentary indicated fewer selling days this month and softer demand in some end markets weighed on September results, while respondents also expressed some unease about the 2019 outlook. The six-month outlook was also less bullish vs. recent trends, while the Forward-Looking Indicator came down vs. last month (54.7 vs. August 63.4).

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)**.

Key Points:

September FDI further retreats. The seasonally adjusted September FDI (55.8) decelerated vs. August's 62.5 reading, still strong in absolute terms but nonetheless meaningfully lower for the second straight month. In the September survey, just 22% of respondents indicated sales were "better" relative to seasonal expectations vs. 63% in August. This produced a seasonally adjusted sales index of 46.5 (August 74.7), the lowest recorded reading since October 2016. Of note, several respondents indicated having just 19 selling days this month was a headwind, potentially skewing overall results more negatively than daily sales growth might have reflected. Importantly, the seasonal adjustment factor for the FDI accounts for variations in the number of calendar days among months (i.e., September has 30 days vs. February 28), but not the number of selling days in any given year. With September ranging anywhere from 19-21 selling days historically, this year's 19 selling days in September was on the very low end of historical trends, which likely impacted FDI results. Positively, pricing remains higher among a large majority of respondents, with 85% seeing pricing gains y/y vs. 84% in August. The resulting FDI pricing index of 92.6 was essentially unchanged m/m. Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (70% of responses), while 19% believe customers' inventories are too low. This compares to 59% in line and 38% too low in August.

September FDI decelerates. The seasonally adjusted FDI came down m/m, registering 54.7 vs. 63.4 in August, mainly attributable to a lower employment index and a less bullish 6 month outlook. Nonetheless, a 54.7 reading suggests market conditions are likely to remain in growth mode (although the rate of growth could be stabilizing), and with four additional selling days in October relative to September, we would not be surprised to see the FDI rebound next month off of a low September base.

Manufacturing employment down slightly. Hiring sentiment was slightly lower this month among survey respondents. 30% of respondents saw higher employment levels in September relative to seasonal expectations vs. 38% in August, while 63% saw employment as in line (August 59%). The resulting FDI Employment Index was 61.1 vs. 67.2 last month. Meanwhile, the September US jobs report was a bit weaker than expected with +134,000 jobs added (~185,000 expected), though the unemployment rate dropped to a lower-than-expected 3.7% (August 3.9%). September's largest gains were registered in professional and business services, healthcare, and in transportation and warehousing. Manufacturing employment continues to trend upwards (+18,000 jobs in September), with most of the gains coming from durable goods manufacturing. As of September, total number of manufacturing jobs added over the past year stands at +278,000. Average hours per work week for manufacturing employees were just modestly lower at 40.8 hours.

Respondents express some caution in commentary. The overall tone of qualitative commentary was again more cautious this month, with respondents noting a softening in demand in September and some unease regarding 2019. For example, one respondent commented, "The tech industry in California has softened... We have had customers request in September a push out on deliveries." Several others commented on fewer selling days impacting results this month saying, "A 19 selling day month sure doesn't help." Regarding 2019, one survey participant said, "[We're] going with same on 6 month outlook, but ITR Economics, which is widely used in our industry, has been forecasting a slower 2019 so we will be waiting on their December report." Reflecting this, survey data this quarter pointed to less optimism regarding activity over the next six months, with just 26% of respondents expecting higher activity levels over the next six months and 52% expecting similar activity. For context, the percentage of respondents expecting higher activity had been steadily around ~50% over the past five months.

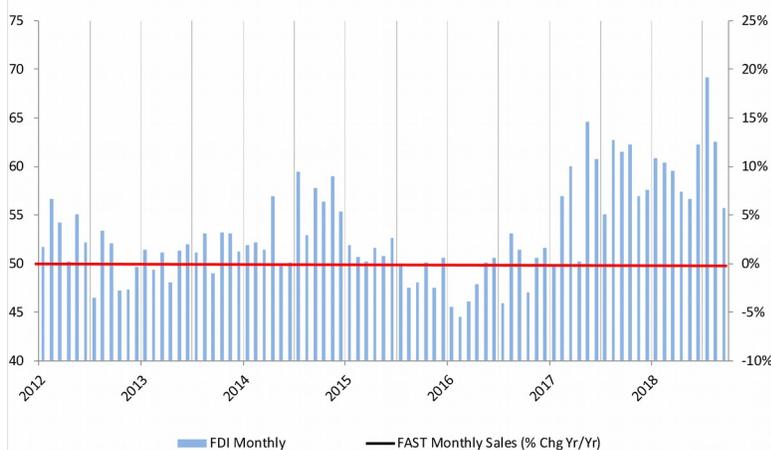
Fastenal reported +13.7% August daily sales growth, above our +12.0% estimate, reflecting sequential daily sales growth slightly above average historical m/m trends. Underlying "core" growth (excluding foreign exchange) was +14.1%, the 15th straight month of double-digit growth. Fasteners again saw solid growth at +10.8% y/y. Looking forward, we view the September FDI results as a somewhat mixed read-through for FAST September daily sales (reported on 10/10), and model +13.5% growth y/y. While reported weakening in underlying demand would be as much of a headwind for FAST as it was for FDI respondents, fewer selling days (which incrementally weakened the FDI this month) should conversely slightly benefit FAST's September daily sales growth due to statistical differences in the data sets (FAST presents **daily** sales growth vs. FDI is **overall** growth). Historically when a month has fewer selling days than is typical FAST daily sales growth tends to slightly exceed the long term m/m trend. With September 2018 having 19 selling days, which is on the lower end of the historical 19-21 range, this phenomenon is likely to produce a slightly higher m/m rate. Based on FDI data and other research inputs, we expect continued solid top-line trends across public industrial distributors through the remainder of 2018, with Fastenal y/y daily sales growth expected to remain in the double digits through year-end.

Fastener Distributor Index (FDI); Seasonally Adjusted

FASTENER DISTRIBUTION AT A GLANCE										
September 2018										
	----- Index Values -----								Directn	Rate of Change
	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb		
PMI (Manufacturing Sector)	59.8	61.3	58.1	60.2	58.7	57.3	59.3	60.8	Growing	Slower
FDI (Fastener Sector)	52.8	61.7	65.8	62.5	59.4	59.8	61.2	58.4	Growing	Slower
FDI (Seasonally Adjusted)	55.8	62.5	69.2	62.3	56.6	57.4	59.5	60.4	Growing	Slower
Sales (SA)	46.5	74.7	89.6	74.2	61.2	63.0	70.1	74.2	Declining	Faster
Forward- Looking (SA)	54.7	63.4	60.1	62.0	58.8	58.9	59.9	58.3	Growing	Slower
(Other Metrics; NSA)										
Employment	61.1	67.2	64.7	68.5	60.7	59.4	62.5	62.2	Growing	Slower
Supplier Deliveries	63.0	70.3	83.8	77.8	73.2	71.9	69.6	64.9	Growing	Slower
Respondent Inventories	59.3	59.4	55.9	50.0	57.1	53.1	60.7	59.5	Growing	Slower
Customer Inventories	46.3	32.8	39.7	33.3	37.5	37.5	35.7	40.5	Declining	Slower
Pricing, month-to-month	70.4	76.6	82.4	83.3	75.0	73.4	76.8	68.9	Growing	Slower
Pricing, year-to-year	92.6	92.2	89.7	90.7	87.5	89.1	85.7	78.4	Growing	Faster
6-Month Outlook - September				Higher	Same	Lower				
				26%	52%	22%				

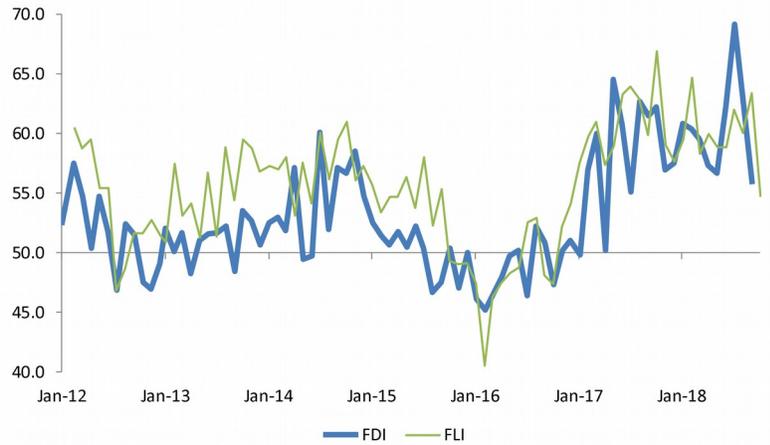
FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectatbns. A reading above 50 suggests the category outperformed expectatbns, while a reading below 50 suggests the category underperformed expectatbns.

Source: Baird, FCH Sourcing Network, Institute for Supply Management



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 10/9/2018.

Fastenal Company (FAST-\$56.68-Neutral)
 W.W. Grainger Inc. (GWW-\$345.89-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$84.83-Neutral)
 (See recent research reports for more information)





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