

Fastener Distributor Index – August 2020

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 9/4/20



Key Takeaway:

The seasonally adjusted Fastener Distributor Index (FDI) for August was **49.2**, implying relatively stable momentum with July (near a neutral 50 reading). Looking at the drivers of the overall m/m moderation in the FDI, a decrease in the sales index was the biggest drag on the overall index. Looking forward, the Forward-Looking Indicator (FLI) was relatively steady, staying in the ~53-54 range seen consistently over the past three months (August 53.3). Taking the FDI and FLI together, in our view, we believe this indicates August fastener market conditions showed relative stability in trends after several consecutive months of strong m/m improvement.

Fastener Distribution Trends: August 2020

FASTENER DISTRIBUTION AT A GLANCE												
August 2020												
	----- Index Values -----											
	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Direction	Rate of Change	
ISM PMI (Manufacturing)	56.0	54.2	52.6	43.1	41.5	49.1	50.1	50.9	47.2	Growing	Faster	
FDI	49.2	54.6	56.9	45.0	40.0	44.4	53.0	51.4	44.4	Declining	Faster	
FLI	53.1	54.8	52.6	43.9	36.2	33.3	48.9	50.9	46.2	Growing	Slower	
(Other Metrics)												
Sales	47.6	79.2	69.9	28.9	14.0	34.6	54.9	50.0	34.9	Declining	Faster	
Employment	46.1	44.3	56.6	40.0	26.8	27.0	48.2	56.7	45.3	Declining	Slower	
Supplier Deliveries	60.5	57.1	57.9	67.5	76.8	68.9	66.1	58.3	53.1	Growing	Faster	
Respondent Inventories	64.5	64.3	69.7	70.0	68.3	64.9	64.3	63.3	65.6	Growing	Faster	
Customer Inventories	40.8	42.9	47.4	48.8	47.6	48.6	41.1	41.7	43.8	Declining	Faster	
Pricing, month-to-month	52.6	58.6	52.6	47.5	59.8	50.0	50.0	58.3	60.9	Growing	Slower	
Pricing, year-to-year	65.8	67.1	60.5	61.3	67.1	60.8	58.9	70.0	79.7	Growing	Slower	
6-Month Outlook -August						Higher Same Lower						
						53% 24% 24%						

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:

August FDI shows steady momentum after two consecutive months of strong improvement. The seasonally adjusted August FDI (**49.2**) came in near a neutral reading of 50, suggesting August fastener markets were relatively stable with July. After two consecutive months of fairly sharp improvements in the FDI, naturally the rate of improvement stalled some in August. The seasonally adjusted sales index, specifically, was the main driver of this moderation (July FDI 54.6), as the sales index cooled to 47.6 off a very strong 79.2 last month. Pricing was also steady for most respondents m/m.

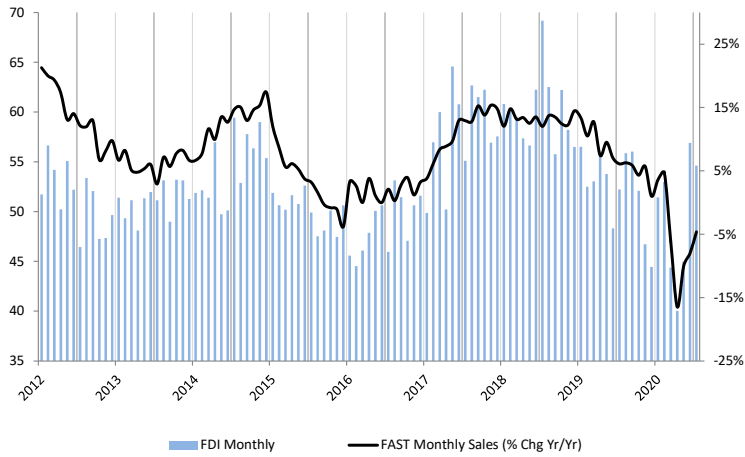
FI remains in a narrow band for third straight month. The seasonally adjusted FI was **53.1**, the third consecutive month of FI readings in the ~53-54 range. We view this as consistent with a market that continues to gradually improve modestly, albeit with the pace of improvement flattening out. Respondents again indicated they feel more optimistic than pessimistic about the six-month outlook on balance (however slightly less so than last month), while decreasing customer inventory levels could possibly signal a need for customer re-stocking in the future, a positive sign for future activity levels. Net, we believe the FDI should see continued modest expansionary readings in the near-term following the temporary dip this month to just below-50.

Stable hiring sentiment. The FDI employment index registered a 46.1 reading, a modest improvement from last month's 44.3. After an elevated month of hiring in June (presumably as additional customer facilities opened and lingering state/local government restrictions were eased), July and August have both been more stable months for hiring. Looking at the broader economy, while the unemployment rate is still elevated (8.4% as of August), we've now seen four consecutive months of better-than-expected job gains as businesses continue to re-open and demand gradually recovers, including +1.4 million jobs added in August. That said, the ongoing recovery in the employment situation (and the broader economy) remains on tenuous ground, subject to the trajectory of the virus and/or government shutdowns.

Respondent commentary slightly more positive on balance. We noticed more respondent commentary indicating higher levels of activity and an improved outlook than those expressing dissatisfaction with current activity levels. One respondent summarized it by saying, *"More activity,"* while another commented, *"Our fiscal year ended July 31st and we experienced a record year in sales, and in August 2020, we just had the highest dollar amount in sales in 13 months."* Lastly, others expressed frustration in being unable to secure enough labor (*"We need more humans in our business!"*), which we view as a positive sign that this particular respondent is struggling to keep up with demand, while another said, *"The best is yet to come."* More cautious commentary included: *"The slowing trend with incoming orders has us concerned concerning the next three months,"* and *"Down 25% from last year's August. Down 11% YTD compared to the same period last year. Very, very slow month."* Attitudes about expected activity levels over the next six months compared to today are more positive than negative on balance, however, with 53% of participants expecting higher activity levels and only 24% expecting lower.

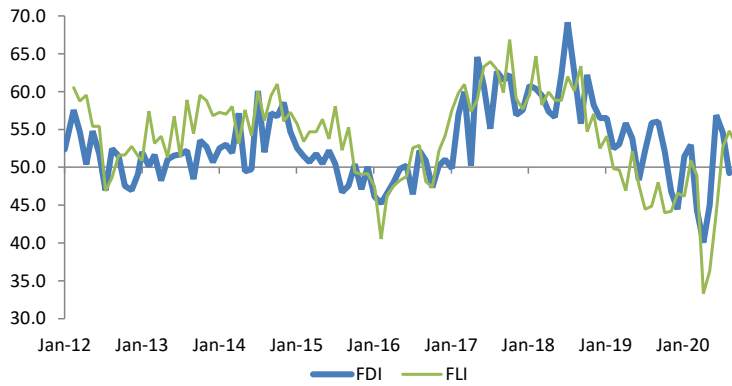
Fastenal reported 2.5% overall August daily sales growth vs. our +0.0% estimate, again boosted by significant demand for safety/PPE (+35% y/y). Excluding safety products, underlying sales were -4.2% y/y, showing modest m/m improvement vs. July's -4.6% y/y but coming in slightly below our -3.1% estimate. Similar to an FDI reading that indicated relatively stable fastener markets, FAST's fastener sales were stable m/m at -7.3% (July -7.5%). Looking forward, September safety product sales will likely continue to benefit from surge orders, although we are conservatively assuming m/m moderation (our September estimate is +10% y/y vs. August +35%). We expect underlying momentum in fastener products and other non-fastener products to continue to moderately improve, albeit offset by two additional selling days m/m relative to normal seasonality, which optically places downward pressure on daily sales growth rates. As such, we are modeling overall daily sales -3.7% in September, which will be reported with FAST's 2Q20 report (10/13).

Fastener Distributor Index (FDI); Seasonally Adjusted



*FAST March-August Monthly Sales Presented as ex. Safety Products
 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 9/4/2020.

Fastenal Company (FAST-\$47.02-Outperform)
 W.W. Grainger Inc. (GWW-\$360.12-Outperform)
 MSC Industrial Direct Co. Inc (MSM-\$67.07-Outperform)
 (See recent research reports for more information)



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