

Fastener Distributor Index – Report #120 December 2021

Written by R.W. Baird analyst David J. Manthey, CFA with Quinn Fredrickson, CFA 1/6/22



Key Takeaway:

The December seasonally adjusted Fastener Distributor Index (FDI) is **56.2**, moderately decelerated when compared with November, and driven primarily by a lower employment index. The Forward-Looking Indicator (FLI) was essentially unchanged at a very healthy **63.7** (compared to 2018/2019 average of 52.9). Respondent commentary focused on continued escalation in product and freight costs, which are pressuring margins, as well as supply chain delays. Overall, market conditions were mildly softer in December as tight labor markets and supply chain challenges combined to make it tougher for respondents to meet demand, which continues to remain strong.

Fastener Distribution Trends: December 2021

FASTENER DISTRIBUTION AT A GLANCE										
December 2021										
	----- Index Values -----									
	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Direction	Rate of Change
ISM PMI (Manufacturing)	58.7	61.1	60.8	61.1	59.9	59.5	60.6	61.2	Growing	Slower
FDI	56.2	57.6	56.1	54.2	55.4	59.6	55.8	61.8	Growing	Slower
FLI	63.7	64.0	64.5	69.5	73.0	65.3	71.1	76.0	Growing	Slower
(Other Metrics)										
Sales	75.7	76.6	58.5	62.3	66.7	74.4	71.4	72.2	Growing	Slower
Employment	54.7	63.6	65.2	54.8	53.8	61.3	62.9	70.3	Growing	Slower
Supplier Deliveries	79.7	78.8	75.8	87.1	90.4	87.1	82.3	93.2	Growing	Faster
Respondent Inventories	46.9	53.0	51.5	43.5	36.5	53.2	33.9	31.1	Declining	Faster
Customer Inventories	15.6	15.2	21.2	9.7	7.7	17.7	11.3	16.2	Declining	Slower
Pricing, month-to-month	85.9	83.3	84.8	83.9	90.4	87.1	91.9	86.5	Growing	Faster
Pricing, year-to-year	96.9	95.5	95.5	93.5	96.2	98.4	91.9	89.2	Growing	Faster
6-Month Outlook -December				Higher Same Lower						
				44% 50% 6%						

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 measure of current market conditions and sentiment derived from a monthly survey of North American, privately held fastener distributors, conducted by the **FCH Sourcing Network** 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:

FDI ends the year slightly weaker. The seasonally adjusted December FDI (56.2) saw a slight retrenchment m/m (November 57.6) as softer employment levels more than offset stronger selling conditions. Pricing accelerated slightly vs. November due to continued escalation in freight costs and product shortages. By all accounts, demand continued at a strong pace in December, with multiple respondents noting unusually strong seasonal sales results for the month of December. However, inflationary pressures and supply chain challenges continue to weigh on margins and respondents' sentiments, thereby weighing down the overall index.

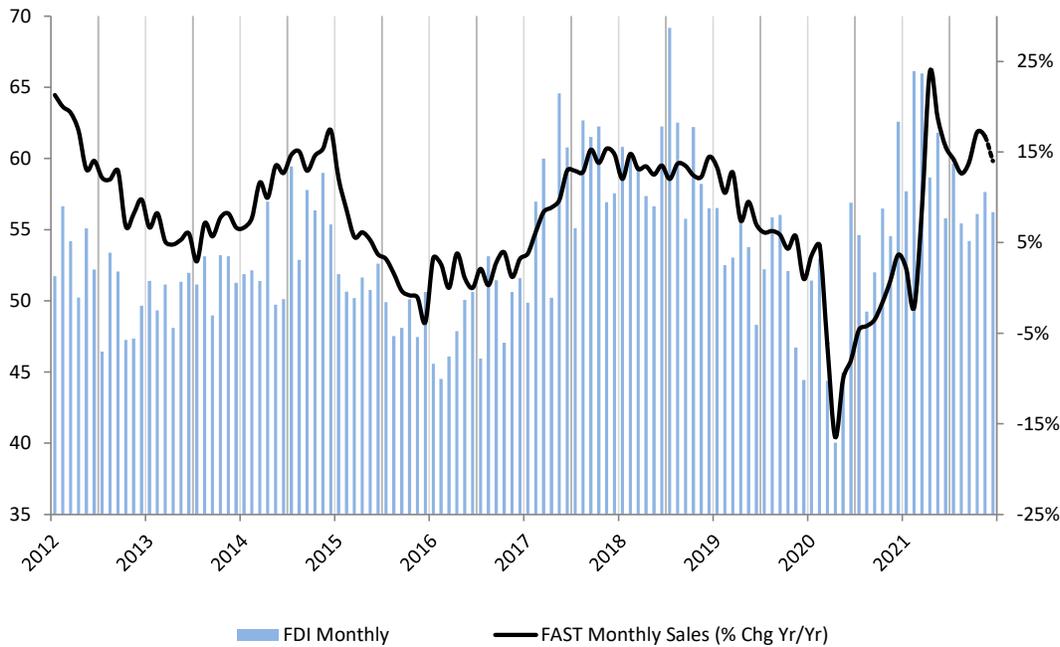
FLI essentially unchanged. The seasonally adjusted FLI came in at 63.7, nearly unchanged vs. the 64.0 reading last month. That said, the FLI has been on a mostly gradual downward descent since June as supply chain issues, inflationary concerns and labor challenges have led to less rosy forecasts of future activity. Relative to November, the FLI benefited from more bullish respondent inventory levels and a better six-month outlook, but these tailwinds were entirely offset by headwinds from a lower employment index. Regarding the six-month outlook, most respondents now expect similar or weaker activity levels over the next six months compared to today whereas in 1H21 a clear majority expected higher activity levels (~72% on average January-June). Given demand remains strong despite continued product availability and labor constraints, we believe the FDI could remain in solid growth mode for quite some time.

Employment dips again in December. The FDI employment index came in at 54.7 compared to 63.6 last month. There were less comments regarding labor shortages and hiring difficulties this month when compared with November, but the data undoubtedly indicates labor shortages remain an irritant in the fastener market. Conversely, the broader economy saw a significant improvement in hiring levels in December, albeit off a very weak November. 807,000 private sector jobs were added in December vs. ~400,000 expected by economists. The hard-hit leisure and hospitality sectors added the most jobs. The government's official jobs report for December is due on Friday (1/7) but the private sector report seemingly bodes well for the official report.

No relief in supply chain constraints; demand feedback remains positive. Respondents' top concerns continue to be 1) supply chain, and 2) inflationary cost pressures. Said one respondent, *"Still uncertainty as to production in the industry. Supply chain delays and now Covid exposures are causing more production delays."* Regarding cost pressures, one respondent indicated, *"Cost increases/margin erosion continues to weigh on the company and our customers."* Another participant said, *"Freight costs are out of control. Inflation is rampant in spite of what the government thinks."* That said, demand feedback continues to be nearly universally positive: *"This past December was our best one on record. Sales and quoting never slowed down between Christmas and New Year's."* Another respondent commented, *"December is typically slower than the rest of year but still was elevated compared to historic numbers."*

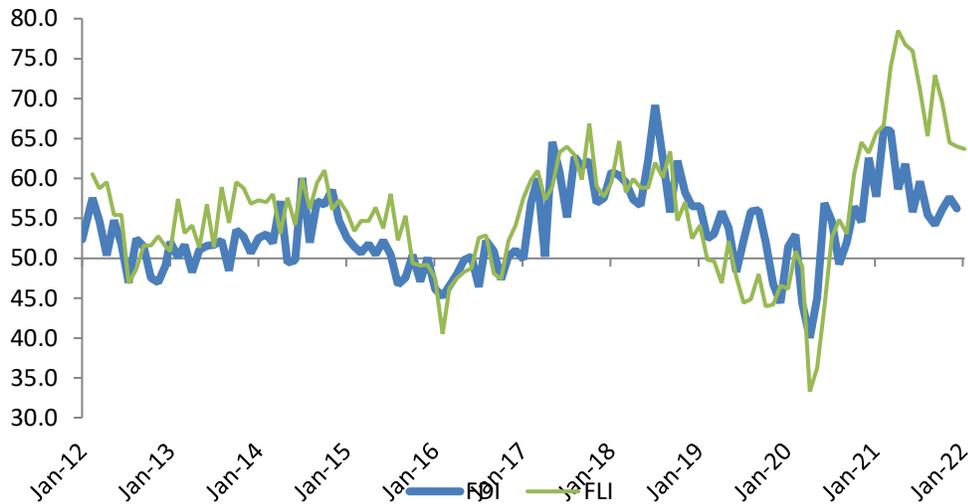
Fastenal's +13.2% overall November daily sales growth easily beat our +5.3% estimate. Safety sales were +0.4% y/y but further normalized as a percentage of sales closer towards pre-pandemic levels. Excluding safety products, underlying sales were +16.7% y/y, also nicely above our +7.8% estimate and normal seasonality. Turning to fasteners specifically, FAST's fastener sales were +23.7% y/y, slightly stronger m/m and consistent with the improvement seen in last month's FDI. Looking ahead to December daily sales which will be reported with 4Q21 results on January 19, we model overall daily sales +10.8% y/y, reflecting safety -1.0% and non-safety (including fasteners) +14.0%.

Fastener Distributor Index (FDI); Seasonally Adjusted



*FAST March 2020 – November 2021 Monthly Sales Presented as ex. Safety Products, December 2021 Baird ex. safety estimate
 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 1/5/2022.

Fastenal Company (FAST-\$61.54-Outperform)

W.W. Grainger Inc. (GWW-\$508.35-Outperform)

MSC Industrial Direct Co. Inc (MSM-\$83.75 -Outperform)

(See recent research reports for more information)



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