



# CFA Institute

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## **CFA Institute Research Challenge**

Hosted by

**CFA Society of Minnesota  
University of Minnesota Duluth**

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The CFA Institute Research Challenge is a global competition that tests the equity research and valuation, investment report writing, and presentation skills of university students. The following report was submitted by a team of university students as part of this annual educational initiative and should not be considered a professional report.

### Highlights

We initiate a **Buy** recommendation on Fastenal ("FAST", "the Company", "the Business", or "the Firm") with a 2018 price target of **\$64**, implying 16% upside potential.

#### Fastenal's Advanced Technical Based Distribution Model and Product Mix give the Company an Idiosyncratic Market Position Insulating it from Shifting Channel Dynamics.

Recent evolution in the Industrial Distribution industry has resulted in business-to-business ("B2B") customers preferring distributors who can add value beyond product delivery. We feel Fastenal's shifting business model provides them significant insulation from E-commerce competitors. E-commerce competitors provide attractive services for infrequently purchased products that require little handling post-delivery. We feel Fastenal differentiates itself from E-commerce competition due to its value-added services beyond product delivery. Especially for B2B customers, as these customers require frequent product purchasing and benefit immensely from FAST's advanced inventory management solutions. FAST has capitalized on this trend by growing Vending and Onsite initiatives, which at this point, are just scratching the surface. The Firm currently has around 68,000 vending machines and 555 Onsite locations. Management believes the market is capable of supporting 1.7 million vending machines and 15,000 Onsite locations. As Fastenal continues to execute on these growth initiatives, the Company will continue to differentiate itself from competitors, and shield sales from prevailing headwinds.

#### Fastenal is Favorably Positioned to Capitalize on Customer Consolidation

In recent years, customers have been consolidating Maintenance, Repair, and Operating supplies spending with larger distributors to capture pricing power and efficiency. Fastenal's inventory management solutions have become increasingly attractive to its end users by providing reduced costs and improving efficiencies. These initiatives get the Firm closer to the customer, and is an effective way to provide a differentiated and "sticky" business model, producing synergistic relationships with customers that will allow FAST to take incremental market share from its smaller competitors.

#### Strong Free Cash Flow Generation Securing Stellar Balance Sheet Position

Despite serving highly cyclical end markets, Fastenal has been able to preserve strong Free Cash Flow ("FCF") throughout the business cycle. We anticipate the Firm will use its strong cash flow to respond to Industrial Production demand and generate consistent shareholder value through dividends and share repurchases. The Company's strong FCF has allowed it to maintain an industry leading balance sheet. In particular, we believe FAST's under-leveraged balance sheet provides the Company significant opportunity to expand its economic moat by acquiring firms with a similar value-adding service approach.

#### Accommodative Monetary & Fiscal Policy Positively Impacting the Manufacturing Sector

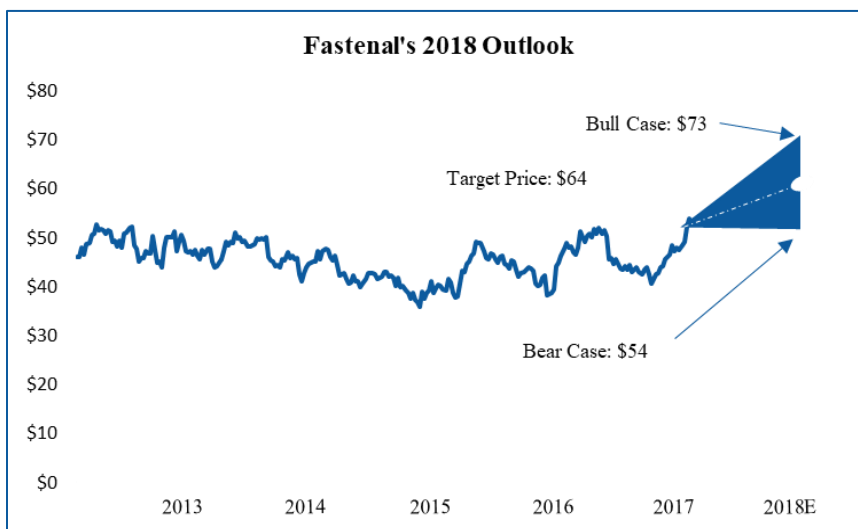
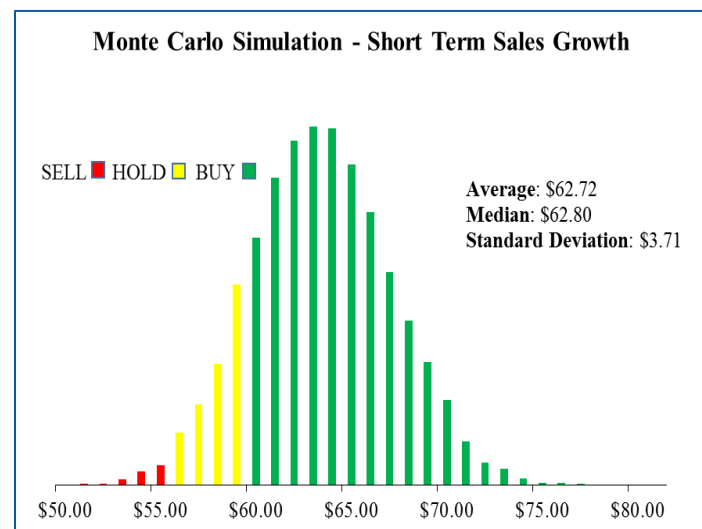
Historically, FAST's revenues have been consistent with Industrial Production trends as industrial demand tends to track Fastenal's most common end markets. Fastenal continues to see higher demand in Heavy Machinery, General Industrial, and Transportation as 72 of the Firm's top 100 customers increased spending in 3Q17 vs. 68 in 2Q17. We expect higher demand from Fastenal's end markets to continue throughout 2018 due to heightened global production and consumption, increased government spending on infrastructure, and expanding business investments, subsequently driving just over 10% revenue growth for Fastenal. In addition, FAST has one of the highest concentration of sales in the U.S., resulting in high effective tax rates. Overall, we believe the Industrial Distribution industry will benefit from these factors, but we believe the tailwinds will further magnify FAST's Free Cash Flow based off its high U.S. sales concentration and its business model.

Key Statistics (12/20/17)	
52 Week Range	\$39.79-\$55.91
Market Value	15,831 M
Enterprise Value	16,139 M
Diluted Shares Outstanding	287.4 M
Dividend Yield	2.3%
Float	99.3%
Top 10 Institutional Holders	34.0%
Analyst Coverage	19
Beta	0.88
Number of Stores- Sept '17	2418 (-5.0% YOY)
Onsite Locations- Sept '17	555 (+47.6% YOY)
Vending Locations- Sept '17	69,058 (9.9% YOY)
Financial Metrics (Sept '17 LTM)	
Gross Margin	49.7%
Operating Margin	20.2%
Net Margin	12.7%
EPS	\$1.88
ROA	20.3%
ROE	27.5%
Cash Ratio	0.37
Current Ratio	5.36
Total Debt	\$440 M
EBITDA	\$261 M
P/E	24.2x
EV/EBITDA	13.6x
Price/Book	6.5x
Price/Sales	3.1x

Sources: FactSet, Company Data

Weighted Valuation		
Valuation Method	Weighting	Price
DCF	50.0%	\$ 62.32
Dividend Discount Model	25.0%	\$ 65.72
EV/EBITDA	12.5%	\$ 61.84
P/E	12.5%	\$ 69.21
<b>Price Target</b>		<b>\$ 63.97</b>

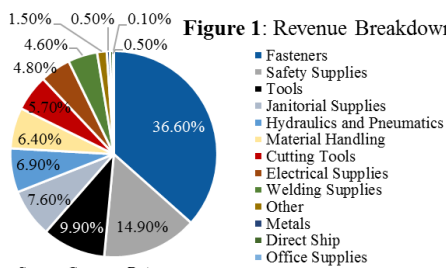
Source: Company Data, Team Projections



## Business Description

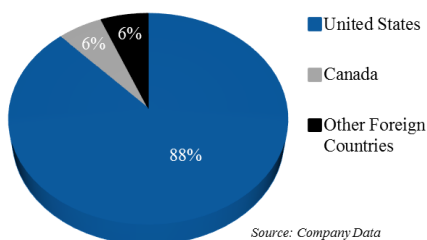
Founded as a partnership in 1967 and incorporated in 1968, Fastenal is a North American leader in the wholesale distribution of Industrial and Construction supplies employing over 19,000 people worldwide. FAST distributes products through a network of 14 distribution centers, 38 subsidiaries, and 2,503 company-owned branches. Headquartered in Winona, Minnesota, FAST offers 12 product lines: Fasteners, Safety Supplies, Tools, Janitorial Supplies, Hydraulics and Pneumatics, Material Handling, Cutting Tools, Electrical Supplies, Welding Supplies, Direct Ship, Office Supplies, and Metals (Figure 1). The majority of transactions are B2B, though smaller “walk-in” retail businesses are offered, designed to supply local environments. FAST’s customers are primarily in the Manufacturing and Non-Residential Construction market. The Manufacturing market consists of Original Equipment Manufacturers (“OEM”) and Maintenance, Repair and Operations (“MRO”), while the Non-Residential Construction market includes General, Electrical, Plumbing, Sheet metal, and Road contractors. FAST sells more than 380,000 products to over 400,000 active accounts in 21 different countries, operating in four geographic regions; Africa and Middle East, Americas, Asia Pacific, and Europe (Figure 2). By 2022, we anticipate the Company will generate revenues of \$6.8B (Figure 3).

Figure 1: Revenue Breakdown



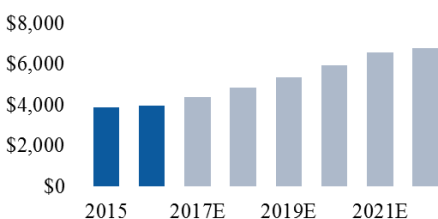
Source: Company Data

Figure 2: Geographic Revenues



Source: Company Data

Figure 3: Total Revenue



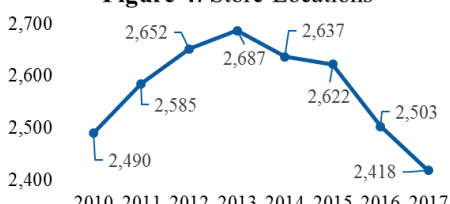
Source: Company Data, Team Estimates

Table 1: Employee Headcount

Division	2014	2015	2016	2017
Store and Onsite	66.7%	67.3%	66.1%	65.7%
Non-Store-Selling	7.3%	7.5%	8.0%	13.5%
Selling Subtotal	74.1%	74.8%	74.1%	79.2%
Distribution	16.9%	16.7%	17.3%	12.4%
Manufacturing	3.4%	3.2%	3.0%	3.0%
Administrative	5.6%	5.3%	5.5%	5.5%
Non-Selling Total	25.9%	25.2%	25.9%	20.8%
Total Employees	18,417	20,746	19,624	20,242
Total	100.0%	100.0%	100.0%	100.0%

Source: Company Data

Figure 4: Store Locations



Source: Company Data

### Local Store Service

Fastenal’s business model focuses on “Growth through Customer Service” by putting FAST locations close to the customer and providing efficient means of supplying a broad range of products and services in a timely manner. In late 2015, management introduced the Customer Service Project 2016, or (“CSP 16”), where the Company invested heavily to upgrade 2,000 stores and consolidate around \$54M of inventory. The project was developed to improve same-day service capability and allow local teams to expand their customer base. Management has long believed that the North American market is capable of supporting 3,500 stores, but it is unlikely the Company will pursue that level of expansion under CSP 16. Total number of stores decreased by 4.5% since the implementation of CSP 16 (Figure 4). The Company operates five variations of selling locations: (1) a “Traditional Store” which operates as a brick-and-mortar platform selling to a wide variety of customers while offering a large selection of products. (2) An “Overseas Store” that focuses on manufacturing customers who require fastener products outside of the United States and Canada. FAST has built an overseas business by moving with its customers and then establishing hubs and connections. The international market is growing exponentially with more opportunities than FAST has resources (Holden Lewis). In 2016, the Company opened four net new stores; closing one and opening five. (3) A “Strategic Store Account” is a store that is geographically positioned to sell to multiple large accounts in a market. (4) “Strategic Account Site” similar to a Strategic Account Store in terms of proximity to the customer, these Strategic Account Sites operate within an already established store rather than from a unique location. (5) “Onsite Location” is a selling unit located within or near a customer’s facility, selling products solely to that customer. We believe success is directly attributed to Fastenal’s ability to offer customers a full line of products and services from convenient locations, with speed and efficiency.

### FAST Solutions

Fastenal offers unique services called FAST solutions (“Fastenal Automated Supply Technology”) helping to manage customer costs, increase efficiency, and build stronger relationships. The Company has leveraged these solutions to reduce non-selling headcount, while keeping total headcount relatively stable (Table 1). FAST Solutions include Industrial Vending, Onsite, and Bin Stock Solutions.

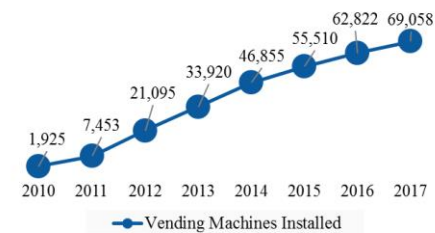
### Industrial Vending

Industrial Vending is a very simple idea; sell products in vending machines at customer locations. This initiative has been an important driver for Fastenal’s business since its re-introduction in 2008, providing customers with 24/7 point of use, hands free replenishment systems, and detailed usage reporting, resulting in a significant reduction in Fastenal’s and its customer’s consumption and spending. Vending has proven its effectiveness in strengthening customer relations and helping to streamline the Business’s extensive store network. Most products sold through vending machines were from the non-fastener line. With over 23 different vending devices, Fastenal offers the most diverse portfolio of machines, enabling customers the ability to offer a multitude of different products within each device. Fastenal’s best-selling machine, the FAST 5000, is a coil machine that represents approximately 40% of installed units with \$2,000 estimated monthly revenue per machine. The number of vending machines installed has grown at a 5.6% CAGR over the past eight years, and through 2017, the Company has 69,058 installed (Figure 5). Each machine costs between \$4,000 and \$10,000 and is depreciated over seven years with most machines lasting longer. Inventories for vending machines are held on FAST’s balance sheet until each item is vended, thereby reducing costs and improving working capital for the customer. Believed to have a “first mover” advantage in vending, FAST has invested heavily to keep a competitive position. These services have been widely adopted by customers resulting in a 10.1% increase in Fastenal’s occupancy expense from 2015 with approximately 66% of the occupancy expense related to Industrial Vending. The Firm also has an exclusive partnership with APEX technologies to develop the most advanced IT systems helping the machines achieve an astonishing 3.1% daily sales growth. Management sees vending as an important growth driver of its business and plans on growing the installed base over time.

### Onsite

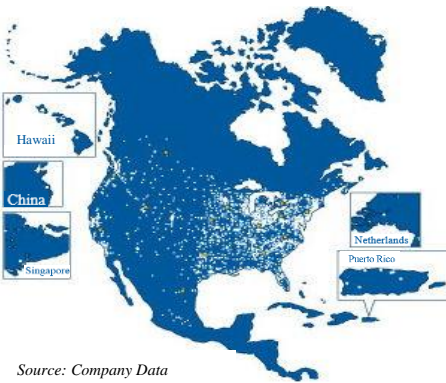
Onsite is another important driver of FAST’s business, providing a strategic advantage to large customers by bringing inventory experts, products, and solutions to customer locations resulting in cost savings and productivity growth throughout the business. FAST currently supports 555 Onsite locations mainly in the United States. Onsite locations are unique, offering cost savings for both FAST and its customers. Onsite locations have proven to reduce Fastenal’s labor costs by around 40%, while allowing the customer to reallocate sales personnel to other areas of the business. Occupancy costs are also reduced, on average FAST spends around 5% of sales on occupancy, but with Onsite it is usually zero. Onsite streamlines the distribution process too, eliminating unnecessary stops that would drive up fuel and labor costs. These savings allow FAST to pass on lower prices to customers, creating better relationships. In 2016, Fastenal produced over \$500M in Onsite sales and generated hundreds of thousands of dollars in cost savings at every facility.

**Figure 5: Vending Machines Installed**



Source: Company Data

**Figure 6: Fastenal Locations**



Source: Company Data

**Bin Stock Solutions**

Bin Stock Solutions provide FAST customers with inventory solutions that automate process controls by providing 24/7 continuous inventory monitoring, real-time inventory visibility, and automatic replenishments. FAST offers a variety of manual and electronic Bin Stock Solutions to ensure the customer always has the right amount of product whenever and wherever needed. There are more than 38,000 customer bin stock programs, each tailored to meeting customer needs for delivery, service, and control.

**Distribution Strength**

Fastenal has the largest distribution fleet in the industry with 350+ semis and more than 6,500 total delivery vehicles. The Company’s eleven domestic distribution centers are located in Minnesota, Indiana, Ohio, Pennsylvania, Texas, Georgia, Washington, California, Utah, North Carolina, and Kansas. Additionally, FAST has three internationally located distribution centers in Ontario, Canada; Alberta, Canada; and Nuevo Leon, Mexico. These 14 distribution centers span over 3.5M square feet supplying the Firm’s 2,500 branches worldwide (Figure 6). The distribution centers in Indiana and California serve as the “master” hubs supporting Fastenal’s other distribution centers with a broader selection of products, while also supplying their own geographic location. Nine of the distribution centers currently have Automated Storage and Retrieval Systems (“ASRS”), which allow larger quantities of products to be picked with greater speed and accuracy. All distribution locations are expected to have ASRS by 2020. Over 85% of all picking activity takes place in these distribution locations. Fastenal has distinguished its business from competitors by leveraging the largest distribution network of centrally located stores and frequent deliveries that facilitate prompt and efficient distribution of products.

**Custom Manufacturing**

Fastenal is also a leader in custom manufacturing. FAST currently operates six manufacturing facilities in the U.S and two overseas, employing over 70,000 people. These facilities make the unavailable parts available by providing local branches with the specific products their customers need. FAST has created an extensive manufacturing network, customizing products through hot forging, cold forming, precision machining, vacuum heat treatment, threading, waterjet cutting, quench and temper treating, fabrication and welding, pipe bending, and electrical discharge machining (“EDM”). FAST is part of an exclusive group of eighteen manufacturers licensed to manufacture alloy and carbon steel bolting products for the oil and gas industry.

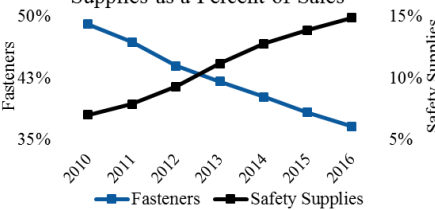
**Fasteners**

Fastener sales have been the cornerstone of FAST’s operations since inception in 1967, selling more than 60,000 different products internationally. The Fastener product line consists of two broad categories: threaded fasteners, such as bolts, nuts, screws, studs, and related washers; and miscellaneous supplies and hardware, such as various pins and machinery keys, concrete anchors, metal framing systems, wire rope, struts, rivets, and related accessories. Threaded fasteners are used in most manufactured products and building projects, and are pivotal in the maintenance and repair of machines and properties. Given the high transaction cost of sourcing and supplying, the Fastener product line is the highest gross margin division of the Company. Fastenal’s devotion to its customers allows for a large deal of customization for each fastener, causing variations in product mix geographically, but can adversely affect gross margins. We see evidence of this in 2016 where gross margins decreased to 49.6% compared to 50.4% in 2015. Fastener sales constituted 40.5%, 38.3%, and 36.6% of net sales in 2014, 2015, and 2016, respectively.

**Safety Supplies**

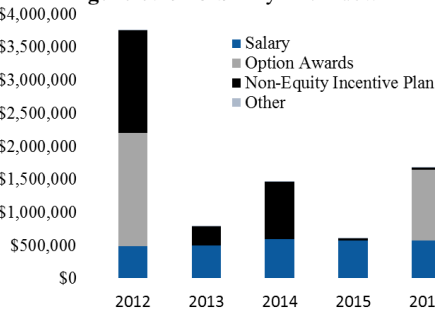
First introduced in 1999, the Safety Supplies product line has grown significantly to offer more than 28,000 products, ranging from hand protection products to gas detection and accessories. With 14.9% of total sales in 2016, Safety Supplies is the second largest product line after fasteners. Going forward, management predicts that non-fastener products represent a larger market opportunity than fasteners (Figure 7).

**Figure 7: Fasteners and Safety Supplies as a Percent of Sales**



Source: Company Data

**Figure 8: CEO Salary Breakdown**



2012-2015: Mr. Oberton Salary; 2016: Mr. Florness Salary  
Source: Company Data

**Figure 9: 2016 Management Compensation**



Source: Company Data

**Corporate Governance**

**Daniel L. Florness (54), President & Chief Executive Officer Since 2016**

Prior to being named CEO in 2016, Mr. Florness served as Fastenal’s CFO beginning in 1996. Before joining Fastenal, Mr. Florness was employed at KPMG Peat Marwick LLP as a Senior Manager. Mr. Florness has been a director since 2016.

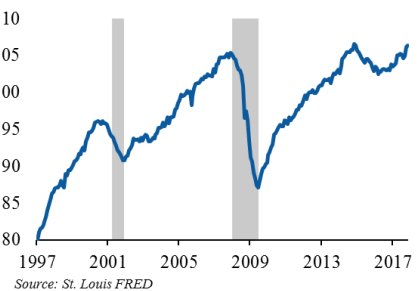
**Holden Lewis (48), Executive Vice President & Chief Financial Officer Since 2016**

Mr. Lewis joined Fastenal in 2016 as the CFO. Previously, Mr. Lewis was an Equity Research Analyst within the Industrial Distribution industry for various investment banks including Rauscher Pierce, CIBC World Markets, Oppenheimer and Co., and BB&T Capital Markets.

**Compensation**

Compensation for executive management is determined by the Compensation Committee using past performance, expected performance, experience, historical compensation levels, and executive pay of the peer group (Appendix I). Compensation is broken up into four categories: base salary, quarterly incentives, long-term incentives, and other compensation. Base salary is typically set below market median as Fastenal has a “pay for performance” philosophy. Quarterly incentives are based on pre-tax income for all named executives except for the Chief Financial Officer and the Chief Accounting Officer, whose incentives are based on net earnings. Management only receives the incentive if the target exceeds the previous year. Long-term incentives are awarded by granting stock options to employees based off an employee’s contribution to the Company including, but not limited to, an employee’s responsibilities for revenue and profits, special skills, and length of service. Stock options were granted every five years until Fastenal started making annual grants to employees in 2015. Other compensation includes contributions to 401(K) accounts. Figure 8 displays how CEO compensation has been broken down over the past five years and Figure 9 compares Mr. Florness’s salary breakdown to Fastenal’s other named executives in 2016. More information regarding management and compensation can be found in Appendix I.

**Figure 10: Industrial Production Index**



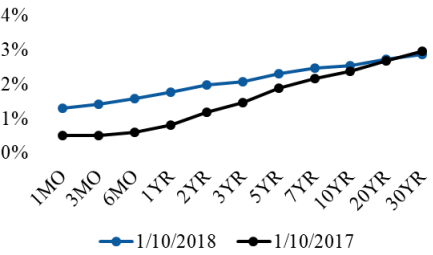
Source: St. Louis FRED

## Industry Overview

### Industrial Wholesale and Distribution

The Industrial Wholesale and Distribution industry is a globally connected landscape with sub-sectors including: Maintenance, Repair, and Operations (“MRO”) distributors, Industrial Machinery and Equipment distributors, Electrical apparatus, Equipment and wiring supplies distributors, and coal and metal distribution. The North American market, which is the largest segment, is highly fragmented and is estimated to have total sales of \$140B per year while the Global Industrial Wholesale and Distribution market represented \$560B in sales in 2016. This industry is characterized by heavy end market consolidation, increased investments in technology, and strong correlation to the macroeconomic environment. Competition is fierce within the industry, forcing Industrial Distribution companies to improve customer service, cut prices, and offer free shipping to encourage customer to buy their products. This is also a seasonal industry with lower sales in winter months due to slower demand from building and manufactured products, and higher sales during summer months with an increase in farming and infrastructure spending.

**Figure 11: Yield Curve**

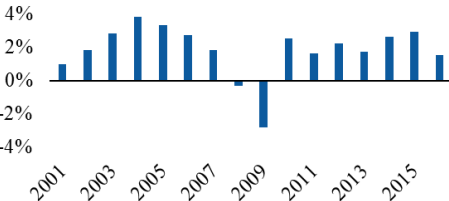


U.S. Department of the Treasury

### Macroeconomics

The global economy continues to expand, marked by low inflation and tightening labor markets. World GDP was expected to grow at a moderate annual rate of 3.6% in 2017. US GDP is forecasted to grow at 2.5% in 2017 (Figure 12) and 2018, with median projections for GDP growth in 2019 and 2020 slightly lower, at 2.1% and 2.0%, respectively. Demand for Industrial distribution companies is dependent on the level of activity in Industrial Production, as increased output in manufacturing, mining, electric and gas industries require more purchases of supplies from companies like Fastenal to continue operations. With Industrial Production serving as one of the best metrics to determine the state and trajectory of the economy, firms must be aware of any changes in end-markets in order to maintain market share. The U.S. Industrial Production Index is currently around all-time highs, registering 106.39 for November 2017, an increase of 3.35% year over year (Figure 10). The growth has been driven by new housing starts, automotive production, manufacturing growth, and total machinery production. We expect this trend to continue into 2018 due to heightened global production, increased government spending on infrastructure and defense, and expanding business investments. To maximize profitability in the industry, firms depend on innovative product selection and efficient operations. Large companies have economies of scale in advertising and sales programs, while small companies can compete more effectively by specializing sub-industries, end-user applications, geographical areas, or by offering special services.

**Figure 12: Real GDP Growth (% Change YOY)**

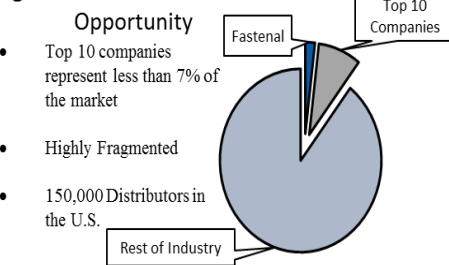


Source: St. Louis FRED

### Fiscal Stimulus - U.S. Tax Cuts and Jobs Act

In recent months, lawmakers succeeded in passing a tax reformation bill called the U.S Tax Cuts and Jobs Act that lowers business and individual tax rates, modernizes the U.S international tax rules and simplifies the tax law. As a result, Corporations will benefit from a tax cut from 35% down to 21% for taxable years beginning December 31, 2017. In addition to lowering the tax rate, taxpayers will be able to expense up to \$1 million of the cost of qualifying property in the first five years with phase-outs beginning at \$2.5 million, rather than to recover such costs through depreciation. The bill limits the deductibility of interest expenses to 30% of the businesses taxable income, repeals the work opportunity tax credit, modifies various energy-related deductions and credits, modifies the taxation on foreign income, and imposes an excise tax on certain payments from domestic corporations to foreign related entities. Overall, the tax bill will give corporations excess funds that will pass to their bottom line, but is projected to expand the federal deficit by \$1.5 trillion over the next ten years. The tax bill could have several important implications in the Industrial Distribution industry. Primarily, there could be an increased amount of mergers and acquisitions within the industry as larger firms now have more capital to exercise. Firms could also use available resources to streamline the business or payout shareholders through dividends or stock repurchases. Finally, corporations could see more incentives for keeping their businesses domestic instead of opening stores abroad. We believe that the entire Industrial Distribution industry will benefit greatly from tax reform. However, we believe that Fastenal is better positioned than its competitors because over 85% of the Company’s sales are generated in the United States compared to W.W. Grainger’s 77% domestic revenues. A statutory tax rate of 21% would give FAST a 17.4% increase in earnings per share in 2018 compared to EPS with no tax relief.

**Figure 13: Fastenal's Market Opportunity**

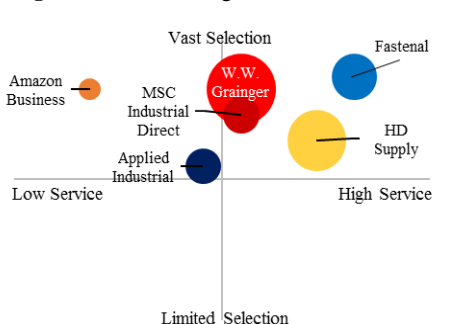


Sources: FactSet, Team Estimations

### Margin Pressures

The Industrial Wholesale and Distribution market relies heavily on the ability to maintain margins throughout the business. As E-commerce has slowly penetrated the industry, pricing has remained important. E-commerce firms have the advantage of cutting costs, making it difficult for other businesses to maintain price structure without losing customers. Larger distribution companies, like W.W. Grainger, and many others have resorted to reducing prices for frequently ordered items in order to remain competitive with other online retailers. Price will always be an important consideration in customer decisions, but as E-Commerce has progressed, customers have begun to value product availability, and specialized services. Fastenal provides superior service and has a first mover advantage in inventory management, providing the Firm with more leeway than traditional distributors when it comes to pricing. Advances in technology have also impacted margins dramatically. Though implementation costs can be high, new technologies such as Industrial Vending, bin stock programs, E-business solutions, and Onsite locations have allowed industrial distribution companies to leverage sales, general, and administrative costs to increase operating margins.

**Figure 14: Positioning Matrix**

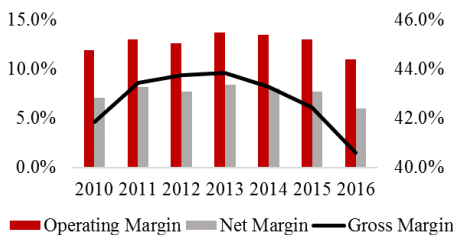


Source: Team Estimations

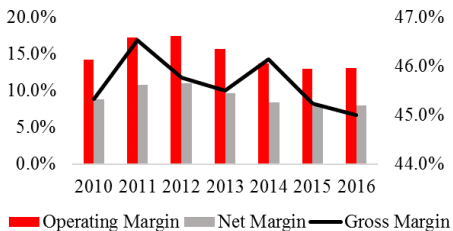
### Competitive Landscape

#### Positioning Matrix

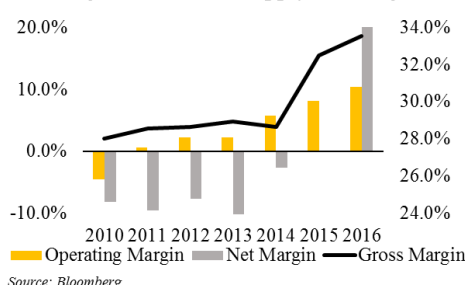
Our positioning matrix is a graphical representation of where FAST and its competitors fit in the Industrial Distribution industry. It is a comparison of product selection and level of service amongst these companies. As a result of Amazon’s entrance into the market, the industry is moving towards frequently purchased products. However, FAST has a very diverse product selection compared to its competitors as well as its custom manufacturing and inventory management, which affords the Company a competitive moat. Level of service is also higher for FAST due to its extensive geographical footprint. FAST provides innovative inventory solutions to small local customers as well as large national accounts, which the competitors cannot match. FAST continues to align its superior level of service based on the Company’s “**Growth through Customer Service**” business model.

**Figure 15: W.W. Grainger**

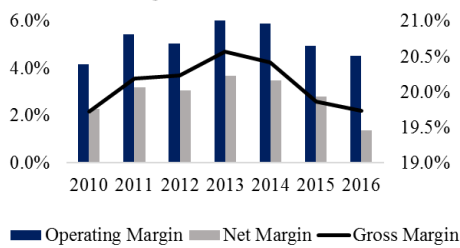
Source: Bloomberg

**Figure 16: MSC Industrial**

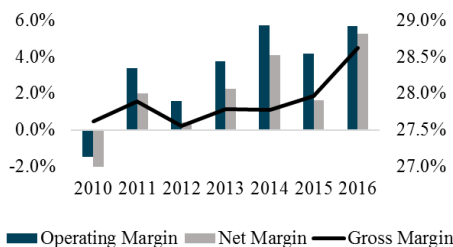
Source: Bloomberg

**Figure 17: H.D. Supply Holdings**

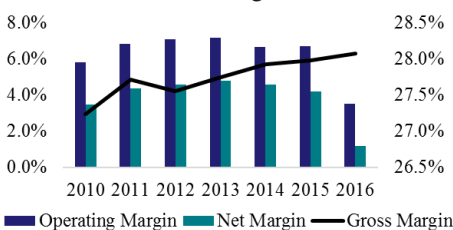
Source: Bloomberg

**Figure 18: WESCO**

Source: Bloomberg

**Figure 19: Ferguson**

Source: Bloomberg

**Figure 20: Applied Industrial Technologies**

Source: Bloomberg

**W.W. Grainger, Inc. ("GWW" or "Grainger"):** W.W. Grainger, Inc. operates as a distributor of MRO supplies and other related products and services through local branches, catalogs and E-commerce. GWW is primarily focused in North America, with a presence in Asia, Europe and Latin America. The company's industrial supplies and fasteners competes with those sold by Fastenal. GWW has a five-year Sales CAGR of 4.6%, five-year average gross margin of 42.5%, operating margin of 13.4%, and net margin of 7.5%. The company was formed in 1928, is headquartered in Lake Forest, Illinois, and has a market cap of \$11.3 billion.

**Our Take:** Grainger's plan to escalate price cuts to increase market share in an increasingly competitive market, coupled with a growing threat from online rivals could pose a risk to Grainger's operating margins as it is more vulnerable to E-commerce threats compared to Fastenal. Grainger's business is far more general and commoditized than Fastenal, which thrives through its superior level of customer service, custom manufacturing, and geographical footprint. This means that GWW could end up trapped in a race to the bottom dollar price with Amazon, especially given its focus on large accounts.

**MSC Industrial Direct Co., Inc. ("MSM"):** MSC Industrial Direct Co., Inc. operates as a distributor of industrial supplies used for MRO. The company's products include tools, abrasives, janitorial and other supplies. MSM's products compete with FAST's tools, supplies and accessories product lines. MSM has a five-year Sales CAGR of 4.2%, five-year average gross margin of 45.3%, operating margin of 13.9%, and net margin of 8.4%. The company was founded in 1941, is headquartered in Melville, New York, and has a market cap of \$4.5 billion.

**Our Take:** Although MSM's more technical based, valued-added business model protects them from shifting channel dynamics, we believe the company's exposure to highly cyclical end markets (i.e. metalworking) will dampen profitability compared to Fastenal over the long-term, as FAST is not overly exposed to any particular end-market.

**HD Supply Holdings, Inc. ("HDS" or "HD Supply"):** HD Supply Holdings, Inc. is an industrial distributor of construction, industrial products, and value-added services in North America. The company's segments include: Facilities Maintenance, Construction & Industrial-White Cap, and Corporate. It serves contractors, government entities, maintenance professionals, home builders, and general industrial. HDS has a five-year Sales CAGR of 1.1%, five-year average gross margin of 28.4%, operating margin of 7.6%, and net margin of 0.7%. The company was founded in 1974, is headquartered in Atlanta, Georgia, and has a market cap of \$6.6 billion.

**Our Take:** HD Supply remains highly levered compared to other industrial distributors. We believe this factor will reduce HD Supply's ability to effectively combat significant headwinds facing the industry and its ability to counteract cyclical demand.

**Wesco International INC. ("WCC" or "Wesco"):** Wesco International Inc. is a distributor of electrical, industrial, communications MRO and OEM products, construction materials, advanced supply chain management, and logistics services and focuses primarily on North American markets. WCC has a five-year Sales CAGR of 3.7%, five-year average gross margin of 19.4%, operating margin of 5.3%, and net margin of 2.9%. The company was founded in 1993, is headquartered in Pittsburgh, Pennsylvania, and has a market cap of \$3.1 billion.

**Our Take:** Over the years, Wesco has been highly involved in M&A. We view Wesco's aggressive acquisition strategy as risky and an attempt to offset less than impressive organic sales growth compared to Fastenal's more conservative approach.

**Ferguson PLC ("FERG" or "Ferguson"):** Ferguson PLC is a wholesale supplier of commercial and residential plumbing supplies. The company operates as a distributor of commercial and residential plumbing supplies, PVF (pipes, valves, and fittings), waterworks, industrial, and HVAC/R products in the United States, Caribbean, Puerto Rico, and Mexico. FERG has a five-year Sales CAGR of 2.6%, five-year average gross margin of 27.8%, operating margin of 5.9% and, net margin of 3.6%. The company was founded in 1953, is headquartered in Newport News, Virginia, and has a market cap of \$13.3 billion.

**Our Take:** Ferguson recently changed its name from Wolsley in 2017 in order to focus more on its U.S. markets. This makes the company more susceptible to downturns in the U.S. economy especially since the company moved its operations from the Nordic region.

**Applied Industrial Technologies ("AIT"):** Applied Industrial Technologies Inc., operates as a manufacturer and distributor of industrial parts including OEM products in addition to providing engineering, designing, and systems integration for industrial, customized mechanical, and fluid power applications in North America, Australia, New Zealand, and Singapore. AIT has a five-year Sales CAGR of 1.8%, five-year average gross margin of 26.9%, operating margin of 6.8%, and net margin of 4%. The company was founded in 1923, is headquartered in Cleveland, Ohio, and has a market cap of \$2.4 Billion.

**Our Take:** AIT plans to increase profitability through ongoing acquisitions, diligent marketing projects and solid sales. However, we believe a sudden fall in market share due to stiff industry rivalry and consolidation of suppliers' and customers' in the industry might prove to be detrimental to AIT's financial performance.

**Amazon.com, Inc. ("AMZN") and E-Commerce Competition:** In 2015, Amazon restructured its Amazon Supply division into Amazon Business, the B2B facing segment of the global E-commerce giant. The unit offers custom pricing to a multitude of customers. Amazon's Direct-to-Consumer ("DTC") sales threaten the business model of the companies in the industrial wholesale industry, which previously relied on shipping large amounts of inventory to brick-and-mortar stores and manufacturers for third party resale or corporate use. Yet, online sales channels by nature remove the middleman, this is evident by the closing of hundreds of stores nationwide by industrial distributors, providing affirmation that the existing companies in the industry have had to adapt to the E-commerce threat. Amazon has the scale and global E-commerce model which could be detrimental to wholesale distributors who rely heavily on online sales, as Amazon has the luxury of yielding minimal margins as they charge lower prices. However, we believe Amazon's B2B model lacks Fastenal's specialized service model which has enabled Fastenal to establish itself a competitive 'moat' that is challenging for Amazon and other online retailers to penetrate.

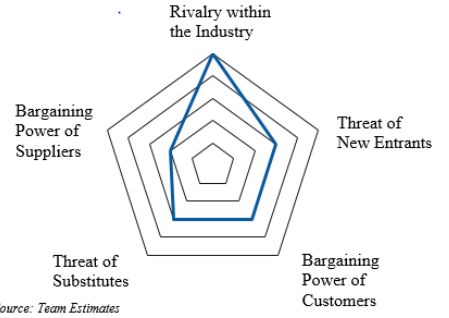
**Our Take:** Although we believe the potential threat posed by Amazon should not be forgotten, we feel Amazon's decision to hold very little inventory, and its inability to match Fastenal's product knowledge and outstanding inventory

**Figure 21: Amazon's Business to Business Model**



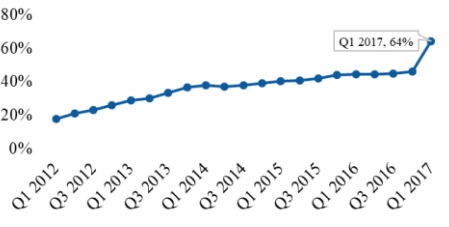
Source: Amazon

**Figure 22: Porter's Five Forces (Appendix II)**



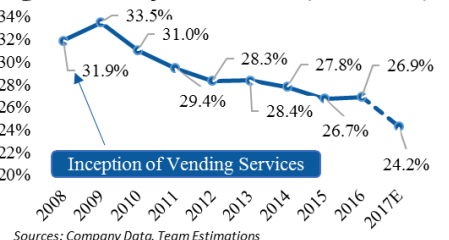
Source: Team Estimates

**Figure 23: Sales to Customers with Vending (% of Sales)**



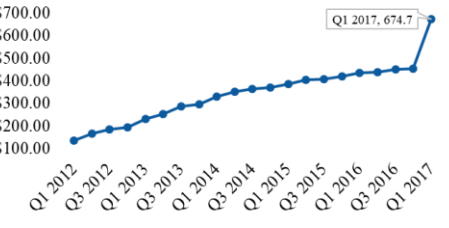
Source: Bloomberg

**Figure 24: Adjusted SG&A (% of Sales)**



Sources: Company Data, Team Estimations

**Figure 25: Quarterly Vending Sales (In Millions)**



Source: Bloomberg

management solutions will prevent Amazon from gaining significant market share in the Industrial Distribution industry because though Amazon may be able to replicate Fastenal's products, the Business will remain out of reach as Amazon will encounter difficulty in duplicating Fastenal's hands-on specialized service model, which insulates FAST from the Amazon threat.

**Regional and Local Competition:** Though larger companies in this industry benefit from scale-driven advantages, the market is still very fragmented and faces competition from smaller local and regional distributors that lack the large scale and extensive footprint, but offers more convenience for its customers. However, Fastenal provides superior personalized customer service, an extensive distribution network, and closer geographical proximity, which gives the Company significant scale advantages over local competition.

**Table 2: Competitive Analysis**

Company	Market Value (MM)	Sales Growth (5-year CAGR)	Gross Margin (5-year Avg.)	EBITDA Margin (5-year Avg.)	Net Margin (5-year Avg.)	P/E (LTM)	EV/EBITDA	Long-Term Debt (MRQ)
FAST	\$15,637	7.4%	50.9%	7.7%	13.2%	29.3	16.4	\$432
GWV	\$13,206	4.6%	42.5%	3.8%	7.5%	28.3	11.8	\$2,270
MSM	\$5,178	4.2%	45.3%	-0.3%	8.4%	23.0	13.0	\$201
HDS	\$7,149	1.1%	28.4%	12.3%	0.7%	131.7	11.5	\$2,087
WCC	\$3,046	3.7%	19.4%	-0.5%	2.9%	17.2	11.5	\$1,368
FERG	\$13,667	2.6%	27.8%	8.8%	3.6%	17.5	11.7	\$835
AIT	\$2,692	1.8%	26.9%	2.2%	4.0%	19.8	13.3	\$285.2

Source: FactSet

As of January 11, 2018

**Investment Summary**

**Fastenal's Advanced Technical Based Distribution Model and Product Mix give the Company an Idiosyncratic Market Position Insulating it from Shifting Channel Dynamics**

In recent years, the Industrial Distribution industry has been driven by a change in customer purchasing behavior. The emergence of E-commerce has forced firms to close branches, restructure businesses, and increase technological investments. Yet, pressure from online competition is limited to frequently ordered products that require limited support and service. Unlike most distributors, Fastenal is minimally dependent on walk-in customers to drive sales; in fact, only 15% of store sales are generated from walk-in customers. The remaining 85% of sales are generated from B2B transactions. Fastenal's Vending and Onsite initiatives have been the Firm's primary growth drivers and expects 250-300 additional Onsite signings in 2017. These initiatives have become increasingly attractive to national account customers. Large customers value Fastenal's store-based approach because this business model offers a quick and convenient method for procuring fasteners and other MRO products, while also reducing shipping costs. Fastenal's shift to a more service based business model creates a wider moat that is challenging for less customer focused companies to penetrate. End markets are shifting toward Fastenal's service based approach, leading to the dilution of competitor's advantage, enabling Fastenal to increase its attractiveness as a value-added business partner. Although the Company has been aggressive in implementing these new initiatives, FAST Solutions are just scratching the surface of their potential and are beginning to gain traction. FAST has approximately 68,000 vending machines and 555 Onsite locations. The Onsite program had record signings in 3Q17 putting the Firm on track for 275-300 signings in 2017. Fastenal's execution in its Vending and Onsite initiatives make it an industry leader when it comes to Inventory Management Services. Fastenal's services have become extremely attractive to customers by reducing consumption, purchase orders, and product handling with reliable 24-hour product availability (Appendix XV). These initiatives drive revenue growth from increased volume and elevate operating margins through SG&A expense savings, as the amount of employees' necessary to manage these programs is far less than its traditional model. The value added through these programs foster higher customer retention rates, something that is difficult to attain in the fragmented and commoditized Industrial Distribution market. Fastenal will begin to see stronger top-line growth, and operating margin performance from leveraging SG&A expense savings as Fastenal continues to execute on these new initiatives.

**Fastenal is Favorably Positioned to Capitalize on Customer Consolidation**

The Company operates in a highly fragmented market, which allows smaller distributors to compete (50 of the largest companies only generate 50% of industry revenue). A large chunk of Fastenal's competition comes from small local and regional distributors. In recent years, however, customers have been consolidating their MRO spending with larger distributors to leverage their purchasing power and efficiency. This plays into Fastenal's strategy perfectly, as it is one of the largest industrial distributors in the U.S. and spans the entire country with approximately 2,500 stores. Fastenal's global sourcing and preferential pricing from suppliers lowers the Company's expenses and allows them to supply an ever-expanding product portfolio to its customers. Additionally, we feel its Inventory Management Solutions provide significant benefits to customers by improving supply chain and operational efficiency, while reducing costs. These solutions also get the Firm closer to the customer, which is an effective way of providing differentiated and 'sticky' service that is very difficult for competitors to replicate. Ultimately, FAST's business model produces synergistic relationships with customers that will allow FAST to take incremental market share from its smaller competitors.

**Complimentary Capital Allocation Strategy**

As Industrial Production approaches all-time highs, a favorable capital structure is essential for Industrial Distributors to maintain market share. FAST and its peers may be forced to undergo more intensive capital spending in order to capitalize on growing Industrial Production. As of 3Q17, FAST carried a Net Debt-to-EBITDA ratio of 0.3x while its closest competitor, W.W. Grainger had a Net Debt-to-EBITDA ratio of 1.4, illustrating FAST's ability to sustain operations while remaining less levered. With a less-levered balance sheet, Fastenal has been able to preserve strong FCF estimated at \$703M in 2017 despite serving highly cyclical end markets. Fastenal's healthy FCF provides the Firm with financial flexibility, allowing FAST to fulfill growth related expenditures while simultaneously returning cash to shareholders. As

**Table 3: Net Debt Position**

Fastenals Position	Net Debt on FAST B/S	Net Debt/ EBITDA	Industry
Too Levered	\$ 2,400.00	2.44x	Max Multiple
	\$ 2,200.00	2.24x	
	\$ 2,000.00	2.03x	
"The Leverage Safe Zone" Max New Debt: \$1.4B	\$ 1,800.00	1.83x	Industry Avg.
	\$ 1,600.00	1.63x	
	\$ 1,400.00	1.42x	
	\$ 1,200.00	1.22x	
	\$ 1,000.00	1.02x	
	\$ 800.00	0.81x	
Current Position	\$ 400.00	0.41x	Minimum Multiple
	\$ 200.00	0.20x	
	\$ -	0.00x	

Source: Team Estimations

FCF continues to grow, FAST has been able to avoid undertaking a less preferable, levered capital structure, implying that an increase in capital expenditure would be attainable without altering current business objectives. Aside from capital expenditures, FAST has the ability to sustain its 2.3% dividend yield, paying out roughly 61% of FCF while carrying a 69.3% dividend payout ratio and potentially increasing shareholder value through additional share repurchases. Subsequently, due to recent levels of capital structure, we feel FAST has a unique opportunity to provide additional shareholder value through moat-widening acquisitions, allowing the Company to solidify its position within the Industrial Distribution industry. The reason we feel this opportunity is unique is due to FAST’s conservative balance sheet leverage and the acquisition friendly economic environment driven by tax reform. In this scenario, we believe FAST would be able to further entrench its service based model into the B2B end market, shielding from E-commerce risks, and accelerating top-line sales growth. Many competitors have opted to compete with Amazon directly while FAST strives to align itself with its service based business model, mitigating competition with E-commerce giants. As Fastenal attempts to differentiate itself from online competition, a way the Firm can do this is by acquiring firms with similar business models in adjacent product segments in industries carrying attractive margins. According to Morgan Stanley’s US Industrial Distributors 3Q17 review, some of the end markets with the strongest pricing power include Elevators and Escalators, Transformers, Packaging Machinery, Welding Equipment, and HVAC / R Equipment. With the significant pricing power these end markets have, we believe that FAST would benefit immensely from acquiring a service based firm in one of these end markets. This could ultimately lead to FAST becoming the most valuable partner in the B2B space, as customer consolidation continues to be a tailwind to FAST’s success.

- Financial Capabilities:** Due to our anticipation of future acquisitions, we set out to quantify Fastenal’s financial flexibility. As a result of our examination, we believe Fastenal could safely increase its debt position by \$1.4B at the very most. Our calculations resulted from increasing FAST’s Net Debt-to-EBITDA position to closely reflect the average of the Industrial Distribution Industry. Its most levered competitors are W.W. Grainger and HD Supply with respective Net Debt-to-EBITDA levels of 1.5x and 2.3x. FAST currently carries a 0.3x Net Debt-to-EBITDA multiple, leaving plenty of room to increase leverage, subsequently accelerating growth through acquisitions while remaining confident in the Firm’s solvency. We outline the “Leverage Safe Zone” in Table 3, where we believe FAST’s Net Debt position is effective for growth, but also financially safe.
- The Ideal Acquisition (Figure 26):** We believe an “ideal” target would be a company that sells products which can’t be shipped directly to the customer, but instead requires onsite installation and routine product maintenance. We do not believe companies like Amazon can compete with this strategy, especially if Fastenal must constantly go onsite and maintain the product. Routine product maintenance provides an additional advantage by generating a steady stream of cash flows. An example might be Hudson Technologies. Hudson Technologies is a refrigerant services company providing innovative solutions to recurring problems within the refrigeration industry. The company’s products and services are primarily used in Commercial Air Conditioning, Industrial Processing and Refrigeration Systems, and include Refrigerant and Industrial Gas Sales, Refrigerant Management Services consisting primarily of reclamation of refrigerants and RefrigerantSide® services performed at the customer’s site. In addition, the company’s SmartEnergy OPS™ service is a web-based real time continuous monitoring service applicable to a facility’s refrigeration systems and other energy systems. The company’s Chiller Chemistry® and Chill Smart® services are also predictive and diagnostic service offerings. Hudson Technologies currently carries a \$250M market cap, which according to our calculations is well within FAST’s investable capital, even if FAST has to pay a premium. However, the point in making these acquisitions is not to make an instant financial impact, but is to protect Fastenal from online competition. Fastenal has made similar acquisitions in the past, for example, its acquisition of Av-Tech, a company that specializes in the distribution and fulfillment of off-the-shelf and hard to find products. Another example is its acquisition of Mansco where Fastenal moved into the furniture business. These acquisitions are non-trivial to Fastenal as they give the Firm a presence in a market where it has not meaningfully contributed in the past while providing the acquired firm with additional tools to expand and better serve its existing customer base. We believe Fastenal’s industry leading balance sheet gives them significant financial freedom with which to go out and make moat-widening acquisitions of companies like Hudson Technologies.

**Figure 26: The Ideal Acquisition**

Characteristics
Service Based
Technologically Advanced
Culture of Customer Service
Shielded From E-commerce
Financially
Strong Balance Sheet
Growth in Sales
Healthy Margins
Free Cash Flow Generation
Industry
Elevators & Escalators
Transformers
Welding Equipment
HVAC/R Equipment

Source: Team Estimations

**Table 4: DCF Calculation**

FAST: DCF Calculation	
Terminal Value	\$ 11,413.71
Total Present Value	\$ 18,983.67
Cash	\$ 98.48
Debt / Lease	\$ 1,778.59
Equity Value	\$ 17,911.74
Shares	287.4
Implied Share Price	\$ 62.32

Source: Company Data, Team Estimations

**Table 5: Terminal Value**

Terminal Value Calculation	
FCF - 2026 Value	\$ 1,362.02
WACC	6.51%
Long Term ROIC	6.51%
Terminal Value Growth Rate	2.50%
<b>Terminal Value</b>	<b>\$ 21,445.15</b>

Source: Company Data, Team Estimations

**Valuation**

**Valuation Techniques**

Our 12-month price target of \$64 was derived from a combination of intrinsic and multiples valuation methods. Our intrinsic valuation methods consist of a Discounted Cash Flow (“DCF”) and a 2-stage Dividend Discount Model while our multiples valuation approaches include a Price-to-Earnings (“P/E”) multiple and an Enterprise Value-to-Earnings Before Interest Tax Depreciation and Amortization (“EV/EBITDA”) multiple, ultimately implying FAST is undervalued by approximately 16%.

**Ten-Year DCF model**

In calculating our price target, we place the most weight on our DCF model due to our confidence in our FCF predictions (Table 4). The natural sensitivity of a DCF model requires us to pay close attention to detail. As a result, we conducted numerous sensitivity analysis calculations to key metrics such as Terminal Value, Weighted Average Cost of Capital (“WACC”), Revenue Growth, COGS-to-Sales, SG&A-to-Sales, and Operating Tax Rate (Appendix VI). Our inputs are highly dependent on historical performance, the economic outlook, management’s sales growth expectations, and FAST’s ability to maintain / grow market share. Certain key metrics, WACC, Revenue Projections, Terminal Value and Operating Tax Rate are explained in greater detail below.

**Weighted Average Cost of Capital**

Due to the inherent sensitivity of discounted cash flows, WACC assumptions are an important, delicate factor. Within our valuation, we used a WACC of 6.5% (Table 6). The key assumption, Cost of Equity, was determined with beta calculated using the Carhart Four-Factor model, taking into consideration size, value, and momentum effects. To calculate beta, we ran a regression against these factors and market return, resulting in statistical significance being achieved among all factors at the 3% level (Appendix VII). Estimated market return of 7.5% was determined using the Dividend Discount Model of the S&P ETF, with an assumed 5.5% dividend growth rate, LTM dividend of \$4.96, and a current price of

**Table 6: WACC Assumptions**

FAST: WACC Assumptions	
<b>Equity Assumptions</b>	
Cost of Equity	7.04%
Beta	0.89
RF Rate	3.00%
Market Return	7.49%
Estimated Size premium	1.16%
Estimated Value Premium	2.61%
Estimated Momentum premium	6.26%
Capital Structure Portion of Equity	89.95%
<b>Debt Assumptions</b>	
Cost of Debt	2.35%
Capital Structure Portion of Debt	10.05%
Tax Rate (2018 Expected)	26.30%
<b>WACC</b>	<b>6.51%</b>

Sources: FactSet, Treasury.gov

**Figure 27: Sensitivity Analysis - Tax**

Operating Price	Tax Rate	
21% Corporate Rate	25.00%	\$ 63.43
	26.30%	\$ 62.32
	27.00%	\$ 61.72
	28.00%	\$ 60.87
	29.00%	\$ 60.01
	30.00%	\$ 59.16
	31.00%	\$ 58.30
	32.00%	\$ 57.45
	33.00%	\$ 56.59
	34.00%	\$ 55.74
	35.00%	\$ 54.88
	36.00%	\$ 54.03
Current	37.17%	\$ 53.03
	38.00%	\$ 52.32

Sources: FactSet, Team Calculations

**Table 7: Dividend Discount Model**

Two Stage Dividend Model	
2016 Payout Method	Dividend + Repurchase
2016 Payout	\$ 1.40
<b>Short term Values</b>	
Growth Rate Method	Sustainable dividend 2016
Growth Rate	7.91%
Cost of Equity	9.03%
Number of high growth years	3
<b>Long Term Values</b>	
Growth Rate Method	Sustainable total 2016
Growth Rate	4.83%
Cost of Equity	7.04%
<b>Pricing</b>	
Two-stage Gordon Model Price	\$ 65.72
Current Share Price	\$ 55.09
Misvaluation	19.30%

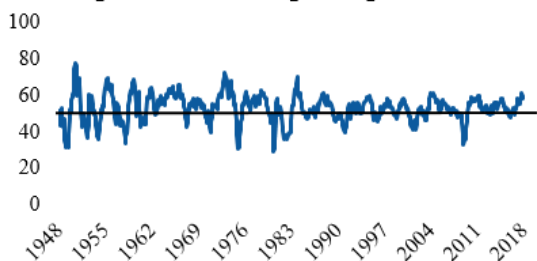
Sources: Company Data, Team Estimations

\$276.12. We projected the risk-free rate at 3%. We used a 3% risk-free rate because we found that it represented a conservative approach in the current rising interest rate environment. We based this off looking at the 10-year Treasury Rate of 2.6% (1/10/2018), predicted 2-3 rate hikes in 2018, resulting at an estimated 3% 10-year Treasury Rate. When capitalizing leases onto the balance sheet at 2.4% with a useful life of 10 years, FAST experienced a substantial change in capital structure from 97% equity to 88% equity. Lease capitalization is necessary due to the substantial similarities with debt and operating leases and the Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU") requiring operating leases to be capitalized, starting December 15, 2018. To further understand the impact WACC has on our valuation, we performed a sensitivity analysis incorporating different WACC assumptions at 25 basis point intervals to discover a 31% price variation using of range of WACC from 5.75% to 7.25% (Appendix X).

**Revenue**

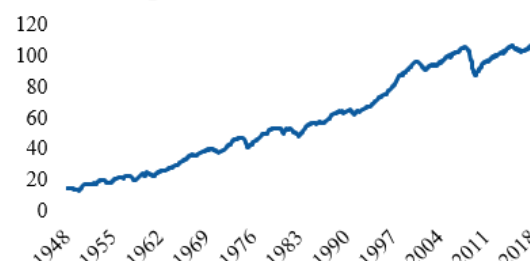
Fastenal's sales have grown 43.2% from 2011-2016 representing a five-year CAGR of 7.5%. We projected out FAST sales to grow at 10.7% for 2017-2019 based on a regression analysis of sales growth against the prior year of Industrial Production, GDP growth, and Construction Put in Place from 1988-2016 (Appendix VII). This allowed us to use these indicators' current values to project out Fastenal's sales since these regressors are leading indicators of Fastenal's sales. Our projections were slightly bullish based off YTD sales growth and the current positive Economic Outlook, more specifically around Industrial Production. Year over year in quarters 1, 2 and 3 of 2017, FAST has grown sales 6.2%, 10.6%, and 11.8%, respectively. Although FAST's sales are seasonal, we see this tailwind continuing, making our bullish projection realistic. Overall, economic strength is a very reliable leading indicator of sales based on Fastenal's business model capitalizing when Industrial Production (Figure 29) and Manufacturing (Figure 28) are expanding. Aside from economic strength, we predict Fastenal's sales will grow based off its ability to provide supplies and inventory management at competitive prices and FAST's capability to expand market share. With growth in Fastenal's Onsite, national accounts, and Vending lines, the Company is able to make up for the slowing growth within its Fastener line, at the expense of contracting gross margins. Management states, based off its financial models, sales to grow between 8-12%, while consensus projects sales growth of 10.6%.

**Figure 28: Purchasing Managers Index**



Source: FactSet

**Figure 29: Industrial Production**



Source: FactSet

**Terminal Value**

When estimating the continuing value of the Firm, we valued the cash flow in the final year with a perpetual growth rate. Due to the extreme impacts terminal value has on intrinsic value calculations, we used modest assumptions to ensure realistic value of the Firms continuing operations (Table 5). A reasonable assumption is that beyond 2026 Fastenal's Net Present Value ("NPV") of projects will be zero, assuming Return on Invested Capital ("ROIC") will equal Fastenal's WACC. The terminal value growth of Fastenal was stated at 2.5%, reasonably in line with the long-term expected growth in GDP. We did not use a multiple approach to calculate terminal value due to a large weighting of an extremely sensitive metric included in calculating the intrinsic value being based off a multiple assumption.

**Operating Tax Assumptions**

Due to the GOP Tax Plan being signed by President Donald J. Trump, coming to fruition January 1, 2018 with a 21% Corporate Tax Rate, we found it very useful to run a sensitivity analysis based off FAST's operating tax rate to see the effects of the new plan (Figure 27). Ultimately, we discovered this would result in an increased upside potential of 17% when compared to an absence of a new Corporate Tax Rate. FAST benefits strongly due to the large concentration of U.S. sales, placing FAST in the top tier of its peers regarding tax rate tailwinds.

**Dividend Discount Model**

The Two-Stage Dividend Discount Model was also a valuable framework to estimate Intrinsic Value for FAST at \$65.72, implying a 23% under valuation (Table 7). Within the first stage of the Dividend Discount Model, the short-term growth rate was set equal to the sustainable dividend calculation for 2016 of 7.9%, while Cost of Equity was computed using the Fama-French three-factor model, as this was the highest Cost of Equity among all our equity cost calculations. Within the second stage, the growth rate is a much more modest 4.8%, computed from the sustainable total payout of \$1.40 (share repurchases + dividends) for 2016. The long-term Cost of Equity was 7%, computed from the Carhart Four-Factor Model as this is seen as a more reasonable long-term trend due to it taking into consideration size, value and momentum effects. We used different Cost of Equity measures within the Two-Stage Model due to the positive correlation of Cost of Equity and the dividend growth rate. In other words, as the growth rate decreases we expect the Cost of Equity to also decrease.

**Multiples Valuation**

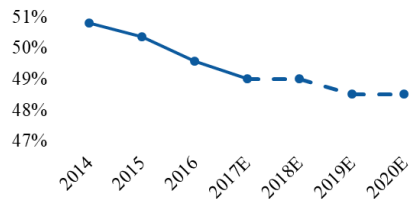
Our multiples valuation returned a modestly bullish price target as we assumed Fastenal will remain to trade at a premium and have strong Earnings and EBITDA growth based off of Fiscal Policy tailwinds and the overall manufacturing industry. Fastenal trades at 24.2x earnings (Industry Average: 24.1x) and 13.6x EBITDA (Industry Average 15.4x), both within the last 7 years of historical multiples, where FAST's P/E ranged between 23.1x and 33.3x and EV/EBITDA ranged between 13.2x and 20.6x. We predicted FAST to trade at 25x earnings and 16x EV/EBITDA. With pro-forma

**Table 8: Multiples Valuation**

Price Target - 2018		
P/E Method	EV/EBITDA	
P/E 25.00x	EV/EBITDA	16.00x
EPS \$ 2.77	EBITDA Per Share	\$ 4.16
	Enterprise Value Per Share	\$ 66.50
	PLUS: Cash Per share	\$ 1.05
	LESS: Debt Per Share	\$ 5.71
<b>Price \$69.21</b>	<b>Price</b>	<b>\$ 61.84</b>

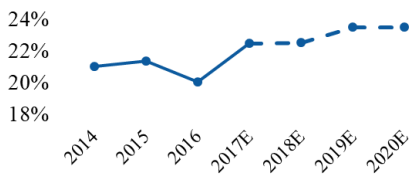
Sources: FactSet, Team Estimations

**Figure 30: Gross Profit Margin**



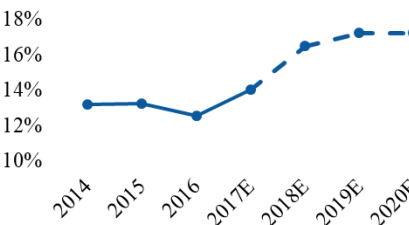
Sources: Company Data, Team Estimations

**Figure 31: Operating Profit Margin**



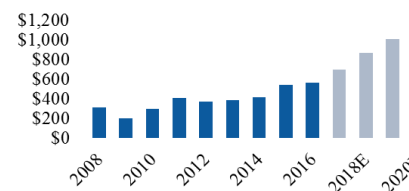
Sources: Company Data, Team Estimations

**Figure 32: Net Profit Margin**



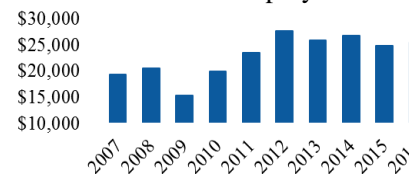
Sources: Company Data, Team Estimations

**Figure 33: Free Cash Flow**



Sources: Company Data, Team Estimations

**Figure 34: Net Income Per Employee**



Source: Company Data

projections of EPS and EBITDA per share at \$2.77 and \$4.16, respectively, we ultimately arrived at a multiples valuation of about \$65. See Table 8 for full multiples valuation information.

## Financial Analysis

**Table 9: Selected Financials**

Operating Performance	2014	2015	2016	2017E	2018E	2019E
Gross Profit Margin	50.82%	50.37%	49.59%	49.00%	49.00%	48.50%
EBITDA Margin	22.99%	23.58%	22.69%	24.76%	24.76%	25.76%
Net Profit Margin	13.18%	13.27%	12.58%	14.04%	16.49%	17.24%
Short Term Liquidity						
Current Ratio	4.22	4.46	6.24	6.18	6.36	6.55
Accounts Receivable Turnover	8.08	8.26	7.93	8.09	8.09	8.09
Inventory Turnover	2.11	2.10	2.01	2.07	2.07	2.07
Long Term Solvency						
Net Debt to EBITDA	-0.03	0.27	0.30	0.23	0.20	0.16
Total Debt to Equity	0.05	0.20	0.20	0.18	0.15	0.13
Interest Coverage Ratio	858.65	265.75	122.20	214.54	237.48	274.55
Return Analysis						
Return on Equity	25.70%	28.51%	25.78%	28.13%	31.74%	31.86%
Return on Assets (Including Capitalized leases)	13.96%	13.62%	12.44%	13.84%	16.07%	16.85%
ROIC (Including Capitalized leases)	14.42%	14.28%	12.78%	14.64%	17.18%	18.24%
Per Share Metrics						
Earnings Per Share (Diluted)	\$ 1.66	\$ 1.76	\$ 1.72	\$ 2.13	\$ 2.77	\$ 3.21
Dividends Per Share (Diluted)	\$ 1.00	\$ 1.12	\$ 1.20	\$ 1.24	\$ 1.62	\$ 1.87
Free Cash Flow Per Share	\$ 1.43	\$ 1.88	\$ 1.98	\$ 2.43	\$ 3.02	\$ 3.52

Sources: Company Data, Team Estimations

### Margin Analysis

Since 2013, Fastenal has seen a 262-basis point contraction in gross margins to 49.07% in 3Q17 (Figure 30) mainly attributable to revolution in its product mix. Ultimately, FAST is seeing higher margin items, like Fasteners, percent of total sales decrease while lower gross margin items, like Safety Supplies, increase as a percent of sales. Management states contracting gross margins will be a trend going forward based on the success FAST is seeing in sales growth in other areas of its business. Safety Supplies has seen a five-year CAGR of 22.0% but has recently slowed to 9.8% year over year growth. Fasteners have experienced a five-year CAGR of 2.3% and has decreased by 2.3% year over year. We expect gross margin pressure to persist until 2018, decreasing to 48.5% thereafter. Fastenal's five-year average operating margin of 21.0% has remained fairly steady with some minor contractions in 2016. In 2016, operating margin (Figure 31) came in at 20.1% with its most recent quarter yielding 20.2%, a ten-basis point improvement year over year. 2Q17 has seen 72 basis points of expansion year over year reaching 21.1%. The recent quarters of expansion in operating margins is most attributable to operating and administrative expenses increasing at a slower rate than sales growth over the last two quarters due to its evolving product mix and other growth drivers. Net margins (Figure 32) have fluctuated similarly to operating margins. Fastenal carries a three-year average operating tax rate of 37.2%. Fastenal will benefit immensely from the restructured tax plan coming into effect in 2018, ultimately arriving at an operating tax rate of 26.3%, when taking into consideration all tax expenses. With a 26.3% operating tax rate, we expect Fastenal to see a 17.4% increase in earnings per share when compared to FAST's historical tax rate. Due to FAST's high U.S. Sales concentration, FAST's tax benefit is greatly magnified when compared to its peers.

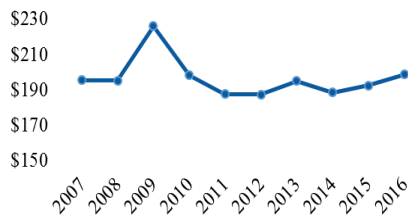
### Free Cash Flow

Fastenal has experienced a five-year CAGR in FCF of 6.7% (Figure 33). See Appendix IV for information regarding how FCF was calculated. More recently, from 2015 to 2016 we have seen FCF grow at a slower rate, mainly due to acquisitions over this period. We expect the entire industry's FCF to receive a strong tailwind from the positive outlook on Industrial Production and the recently passed 21% corporate tax rate. FAST will further magnify this tailwind due to the evolution in its business model shifting to a structure that focuses on improving operating margins. Operating margin expansion directly translates into FCF growth acceleration. We see this further amplified with the corporate tax rate being reduced substantially. With the combination of the Industrial Production outlook and tax reform, we believe FAST will capitalize to the highest of levels, as these tailwinds significantly support FAST's business model. With this expansion in FCF, we expect Fastenal to further leverage and capitalize on its successful growth drivers, to give back to shareholders in the form of share repurchases and dividends and finally to seek synergistic acquisitions to further widen FAST's economic moat.

### Efficiency metrics

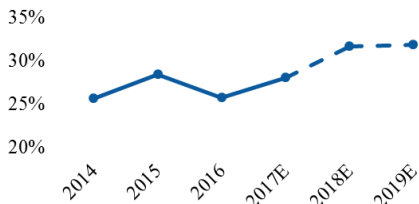
As of 2016, 74.1% of Fastenal's full-time equivalent ("FTE") employees were categorized as sales personnel. FAST puts all employees through extensive training programs at its Fastenal School of Business. This places FAST employees among the top tier in the Industrial Distribution industry, driving efficiencies and production. Fastenal is a strong believer in being a bottom-up company, meaning deriving its success from its employees, therefore FAST employees go through intense programs further enhancing employees understanding, expectations, and decision-making abilities. Net income per employee (Figure 34) is therefore a key metric to measure Fastenal's success. From 2009 until 2012, net income per employee has increased at a three-year CAGR of 22.0% as Fastenal saw robust growth coming out of the housing crash of 2007. From 2012 - 2016, we have seen a downward trend in net income per employee from \$27,767 to \$25,452 due to overall sales growth slowing. This tells us Fastenal currently has excess, fully trained, high caliber employees, especially considering FAST is undergoing consolidation of branches across the United States. This positions FAST to capitalize on

**Figure 35: Cash Cycle**



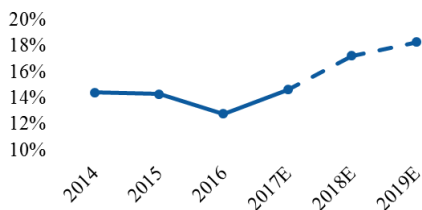
Source: Company Data

**Figure 36: Return on Equity**



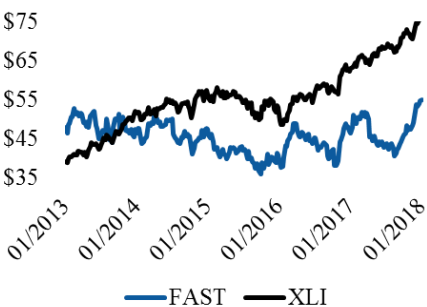
Sources: Company Data, Team Estimations

**Figure 37: ROIC**



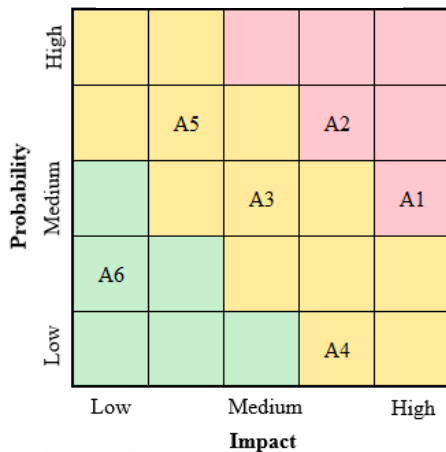
Sources: Company Data, Team Estimations

**Figure 38: Share Price Movement**



Source: FactSet

**Figure 39: Risk Matrix**



Source: Team Estimations

improving Industrial Production and the overall U.S. economy. Inventory turnover is another key element to further comprehend Fastenal's business objective and model. Fastenal's five-year average of inventory turnover is 2.2x carrying on average 168.8 days of inventory on hand while its closest competitor, GWW, has a five-year average inventory turnover of 4.15x carrying on average 88.05 days of inventory on hand. Fastenal has large amounts of inventory on hand in order to serve its customer's effectively and efficiently, especially if one of Fastenal's customers ever run into an adverse event. Fastenal carries more risk doing this but ultimately carries a much more attractive, stronger customer centric business model. This also coincides with the concept of having a full-time employee workforce available when its most influential industry's take off and demand a greater amount of goods as its customer's grow. When looking at Fastenal's Cash Conversion Cycle ("CCC") (Figure 35), we see concerns as it lengthened by ten days since 2014, most attributable to days of inventory on hand (full trends in Appendix VII). Payables and sales outstanding remain in line with long run averages concluding the Company has reasonable accounts receivable guidelines for its customer's. FAST is also not allowing payables to build up to a risky amount and keeping cash on hand for a reasonable amount of time.

**Return Analysis**

To further understand Fastenal's returns, we conducted an in-depth DuPont analysis to provide clarity around FAST's Return on Equity ("ROE") (Figure 36). A recent market wide trend has been share repurchases. Aggressive share repurchases have skewed ROE making this metric unreliable in the scenario of a drastically changed capital structure. FAST has had a historically stable capital structure, resulting in a realistic and beneficial ROE. (Appendix X shows historical DuPont). Fastenal's ROE of 25.8% in 2016 and 27.5% in the trailing twelve months has been largely a product of an increase in the Firms Equity Multiplier, due to the introduction of debt in the last two years. Historically, Fastenal has carried a 5 year average ROE of 26.5%. Going forward, we believe ROE will be generated by an expansion in the Company's profit margin coupled with historically steady asset turnover and leverage. We feel ROIC provides a more in depth analysis of returns generated when taking into consideration current and long-term assets (Figure 37). In 2016, Fastenal expensed \$152.8M in operating leases. Due to the debt like characteristics of leases, we capitalized this onto the balance sheet with a useful life of 10 years at a value of \$1.4B. This affected Fastenal's ROIC by roughly 7%, ultimately resulting at a much more realistic ROIC for 2016 of 12.7%.

**Risks**

**Economic Downturns (A1)**

Fastenal's financial performance depends significantly on general economic conditions, including GDP, Industrial Production, non-residential construction, and manufacturing. Any material changes to the global economic outlook could adversely impact the Company's ability to generate top line growth. As interest rate policy normalization occurs, Fastenal's financial performance could be affected.

**Costs Outpacing Sales Growth (A2)**

FAST associates are expected to have a high level of product knowledge and provide superior customer service. To achieve the appropriate level of expertise, heavy investments in employee enhancement programs, incentive plans, competitive pay, and benefits are required to maintain a high level of job satisfaction. As unemployment reaches lower levels, the costs associated are expected to increase. FAST's growth initiatives such as Vending, Bin Stock, and Onsite require a large amount of capital to develop and maintain, if these costs outpace sales growth the Business could see significant margin contraction in the coming years.

**Increases in Commodity Prices/Inflation (A3)**

Increases in commodity prices or inflation could affect gross margins. Steel, for example, is a common material Fastenal purchases for the manufacturing division of the Company. An increase in the price of steel would make it more expensive for FAST to manufacture parts. Since most of Fastenal's large customers are under contract, FAST may not be able to pass the increase in input costs along to the customer. In addition, since many large customers have Blanket Purchase Agreements in place, FAST would not be able to immediately raise prices in an inflationary environment.

**Material Liabilities (A4)**

Fastenal has several Contact Purchase Agreements in place with large customers. Often, within these agreements, are terms and conditions specifically for that contract. Those terms may make FAST liable for any damages caused by a part FAST supplied or manufactured. Many of Fastenal's large customers, like utility companies, operate in industries where a defective part could cause catastrophic disasters. This would ultimately lead to a potentially large lawsuit and financial impact to the company.

**E-commerce (A5)**

The emergence of E-commerce has threatened traditional business models in the Industrial Distribution industry. If online-based distributors, like Amazon, were to gain market share, Fastenal could be forced to lower prices, placing pressure on margins. Even speculation around AMZN further focusing on supplying industrial products could have an adverse impact on the stock price in the short-term.

**Changes to Trade Policies (A6)**

A large amount of FAST's products are sourced outside of the U.S., specifically, Asia. The new administration has created some amount of uncertainty surrounding the current trade policies, and has expressed a desire for change. Fastenal has built its sourcing network around the current policies, and future changes could have a significant impact on sales, demand for products, and profit margins.

## **Appendix**

**I: Management**

**II: Porters Five Forces Analysis**

**III: Pro-Forma Financials**

**IV: Valuation**

**V: Scenario Analysis**

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**VII: Regression Analysis**

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**XIV: Stock Price with Calendar Events**

**XV: Inventory Management Solutions Case Studies**

**XVI: Financial Analysis of Selected Financials**

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## Appendix I: Management

### Leland J. Hein (56), Senior Executive Vice President- Sales Since 2014

Mr. Hein began his career with Fastenal in 1985 serving in various sales leadership roles. In 2007, Mr. Hein was named as Executive Vice President-Sales, and from 2012 to 2014 served as President of Fastenal. Additionally, Mr. Hein served as COO and CEO for brief stints in 2015. Mr. Hein served on the Board from 2014-2016.

### Sheryl A. Lisowski (50), Treasurer, Chief Accounting Officer, & Controller Since 2016

Ms. Lisowski has been employed with Fastenal since 1994 serving in various roles with the finance and accounting teams. Ms. Lisowski has been Controller and Chief Accounting Officer since 2013 and assumed the role of Treasurer in 2016.

### Terry M. Owen (49), Senior Executive Vice President- Sales Operations Since 2016

Mr. Owen was named Regional Vice President in 2007 of the Texas and Mexico regions. After that, Mr. Owen served as Executive Vice President of E-business beginning in 2014 and Executive Vice President-Sales in 2015.

### Jeffery M. Watts (45), Executive Vice President- International Sales Since 2016

Prior to being named an executive in 2016, Mr. Watts served as Vice President-International Sales beginning in 2015. Starting in 2005 until 2015, Mr. Watts served as Regional Vice President of the Canadian region.

### Willard D. Oberton (58), Chairman of the Board and Director Since 2014

Mr. Oberton has been a director since 1999. Mr. Oberton started with Fastenal in 1980 and was Fastenal's CEO from 2002 through 2014, and on an interim basis from July 2015 through December 2015. Mr. Oberton also serves as a director for Donaldson Company ("DCI") and WinCraft, a privately held company.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation		Total (\$)
							Earnings (\$)	All Other Compensation (\$)	
<b>Daniel L Florness</b>	2016	577,500	-	-	1,066,950	32,713	-	2,733	1,679,896
President and	2015	430,000	-	-	139,995	387,424	-	4,379	961,798
Chief Executive Officer	2014	390,000	-	-	-	384,774	-	3,879	779,653
<b>Holden Lewis</b>	2016	120,002	-	-	-	26,109	-	108,139	254,250
Executive Vice President and Chief Financial Officer									
<b>Sheryl A. Lisowski</b>	2016	250,000	-	-	80,017	10,154	-	2,733	342,904
Controller, Chief Accounting	2015	200,000	-	-	306,245	71,746	-	4,379	582,370
Officer, and Treasurer	2014	150,000	-	-	-	76,956	-	3,879	230,835
<b>Leland J. Hein</b>	2016	439,167	-	-	533,475	2,617	-	2,733	977,992
Senior Executive Vice	2015	523,333	-	-	218,743	590,828	-	4,379	1,337,283
President - Sales	2014	486,875	-	-	1,076,625	433,783	-	3,879	2,001,162
<b>Terry M. Owen</b>	2016	430,000	-	-	266,733	20,936	-	2,733	720,402
Senior Executive Vice	2015	300,000	-	-	306,245	269,831	-	4,379	880,455
President - Sales Operations	2014	183,336	-	-	71,775	372,721	-	3,879	631,711
<b>Jeffery M. Watts</b>	2016		-	-	22,225	298,270	-	-	528,091
Executive Vice President - International Sales									

In 2016, Mr. Lewis was granted a relocation bonus of \$80,000 and received \$28,139 as a reimbursement for moving expenses which falls under other compensation.

Name	Earnings Type	Payout Percentage
<b>Mr. Florness</b>	Company-Wide Pre-Tax Earnings	1.25%
<b>Mr. Lewis</b>	Company-Wide Net Earnings	0.90%
<b>Ms. Lisowski</b>	Company-Wide Net Earnings	0.35%
<b>Mr. Hein</b>	Pre-Tax Earnings	1.00% / 0.10%
<b>Mr. Owen</b>	Company-Wide Pre-Tax Earnings	0.80%
<b>Mr. Watts</b>	Pre-Tax Earnings	2.40% / 0.35%

The table to the left shows how executive management is paid regarding bonuses. Management only receives the bonus if the listed earnings type exceeds that of the previous year. If the goal is met, Management receives the listed payout percentage applied to his/her salary as a bonus. If the goal is not met, Management receives no bonus.

## Board of Directors

### Board

The Board of Directors meets four times a year and is made up of ten Directors with an average tenure of 9.5 years. Of the ten Directors, seven are independent. Each Director is nominated by shareholders at the most recent annual meeting and serves a term that expires at the next regular shareholders' meeting. Mr. Daniel Johnson is the one exception as he was appointed as a Director by the Board of Directors in May 2016.

### Audit, Compensation, and Nominating Committee

The Audit Committee is made up of four independent directors, and is chaired by Mr. Dolan. The Audit Committee is responsible for overseeing management and the independent registered public accounting firm as well as reviewing the Company's policies and practices in regard to risk assessment and management. Over the past five years, the Audit Committee has met six times annually. The Compensation Committee is primarily responsible for overseeing and advising the Board on policies related to the compensation of executive officers and the Board of Directors with an emphasis on risk. The Compensation Committee is made up of four independent directors who have never been employed at Fastenal. Mr. Dolan also chairs this committee which has met between five and seven times per year, over the past five years. The Nominating Committee consists of three independent directors whose objective is to identify and recommend potential candidates to serve as directors and assess the current composition of the Board. Mr. Ancius is the chairman of the Nominating Committee which has met two to three times per year over the past five years.

### Compensation

Each non-employee director received an annual retainer of \$55,000 in 2016 and \$85,000 in 2017. In addition, each non-employee director, excluding Mr. Oberton, receives \$4,000 for each regular and special meeting of the board and each committee meeting. Mr. Oberton received a monthly retainer of \$30,000, in addition to his annual retainer, in 2016, but his monthly retainer was decreased to \$25,000 per month in 2017. Each employee director received an annual retainer of \$27,500 in 2016 and \$42,500 in 2017. Mr. Johnson was elected to the board effective May 24, 2016, and received a pro-rated retainer of \$27,500. Mr. Miller and Mr. Hein did not stand for re-election in 2016 and received a retainer of \$18,333 and \$9,167 respectively. The chair of the audit committee receives an additional annual retainer of \$25,000 while the chairs of the compensation and nominating committees receives an additional annual retainer of \$10,000 each.

Name	Board	Audit	Compensation	Nominating
Mr. Oberton	Chairman			
Mr. Ancius	X		X	Chairman
Mr. Dolan	X	Chairman	Chairman	X
Mr. Eastman (1)	X	X		X
Mr. Florness	X			
Mr. Hein (2)	X			
Ms. Heise	X		X	
Mr. Jackson	X	X		
Mr. Johnson (3)	X	X		
Mr. Miller (2)	X	X		X
Mr. Satterlee	X		X	
Ms. Wisecup	X			
<b>Number of 2016 Meetings</b>	4	6	5	2

(1) Mr. Eastman was appointed to serve as a member of the nominating committee effective May 24, 2016.

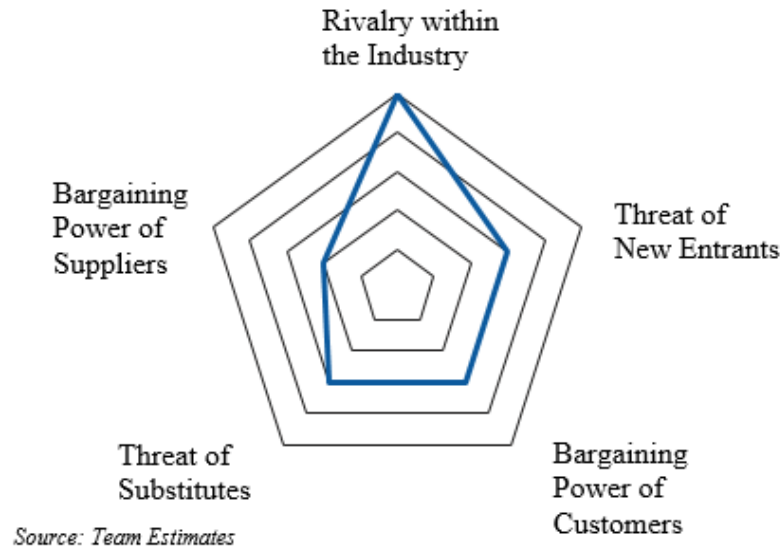
(2) Mr. Hein and Mr. Miller did not stand for reelection to the board of directors at the 2016 annual meeting. Mr. Miller served as a member of the audit and compensation committees until his retirement from the board effective April 19, 2016.

(3) Mr. Johnson was elected as a director by the board of directors on May 24, 2016, and was appointed to serve as a member of the audit committee effective the same day.

	2017 Peer Group Defined by Fastenal	
HD Supply Holdings, Inc.	MSC Industrial Direct Co., Inc.	W.W. Grainger, Inc.
Anixter International, Inc.	Applied Industrial Technologies, Inc.	Advanced Auto Parts, Inc.
Genuine Parts Company	The Sherwin-Williams Company	WESCO International, Inc.
	Tractor Supply Company	

*HD Supply Holdings, Inc. replaced Airgas, Inc. from the 2016 Peer Group*

## Appendix II: Porters Five Forces Analysis



### Porters Five Forces

#### Future Outlook as a whole:

Fastenal has done well within the Industrial Distribution industry to establish a competitive “moat”. It possesses significant power over both its customers and suppliers of its products. However, a small threat of new entrants exists within the Wholesale Industrial Distribution Industry. There are intense existing rivalries amongst the competition, but we believe FAST has been able to differentiate itself based on its innovative inventory management solutions. The threat of substitutes is moderate due to low-switching costs and interchangeable products.

#### Supplier Power: (Low) - 2

The bargaining power of FAST’s suppliers is extremely minimal due to the scale of the Company and the attraction of securing a supply contract with a large vendor like Fastenal. Fastenal receives countless inquiries from small and diverse businesses interested in learning how to generate more business, and ultimately become a Fastenal supplier. Fastenal leverages this interest by working to maximize procurement opportunities for these small and diverse businesses resulting in a highly fragmented supply chain. This virtually eliminates its dependence on single suppliers, suppressing any supply chain risks that may have otherwise existed. Fastenal holds additional power via its private label brands, referred to as ‘Fastenal Brands’ these private labels generate a considerable portion of net sales that further increases its independence from third-party suppliers.

#### Buyer Power: (Moderate) - 3

Historically, the Industrial Distribution industry has been highly competitive on price because of the commoditized products available for sale. However, the industry has begun to shift from competitive pricing with customers valuing product differentiation, specialized knowledge, and personalized service more. This certainly doesn’t eliminate buyer power, however, at the end of the day, customers want procurement to be as quick, and easy as possible. Fastenal’s innovative inventory management solutions provide a differentiated business model that promotes stickier relationships with customers less likely to fall apart. Fastenal’s Just-In-Time Systems, Kanban, point of use delivery systems, kitting analysis and custom packaging gives it slightly more leeway in pricing than its competitors because of its aforementioned superiority in service.

### **Competitive Rivalry: (High) - 5**

Competition is very high amongst existing companies within the industry. Fastenal faces intense competition with W.W. Grainger, WESCO, HD Supply, Applied Industrial Technologies, Ferguson PLC, and MSC Industrial. The market for Industrial Distribution is very saturated with no one company owning more than 5% of market share, and 52.81% of the revenue in MRO segment is concentrated within the top five players. However, we believe Fastenal's atypical business model has enabled the Company to differentiate through innovation and specialized customer service. Fastenal has its own "Fastenal School of Business" through which its employees learn the operational functions of a store while developing the knowledge and skills necessary to build strong relationships with customers. These skills make Fastenal's employees specialized and gives FAST a competitive advantage in the industry as none of its competitors have an internal college for specialized training. Ultimately, we believe increasing demand in the economy and excess industry capacity, combined with low variable costs and high fixed costs, will intensify rivalry.

### **Threat of Substitutes: (Moderate) - 3**

The threat of substitutes in the industry is high, because customers are free to switch retailers in pursuit of better product quality, e-commerce, and more convenient locations due to low switching cost, and interchangeable products. However, Fastenal has strong capabilities at sourcing, procurement, quality control, logistics and local customer service. Moreover, Fastenal's custom modification and manufacturing for its customers gives it an edge in the industry as Fastenal's products are harder to replace without having a large custom manufacturing sector. Fastenal also has added capabilities in Industrial Vending which gives FAST a structural advantage based on its superior customer service. Therefore, based on our analysis the risk of substitutes for Fastenal is moderate as quality and customer service is an important characteristic when customers are choosing a distributor.

### **Threat of New Entry: (Moderate) - 3**

The threat of new entrants in the industry is moderate. The existing companies in the industry are well established with significant capital expenditures needed to operate at a scale similar to Fastenal. To match Fastenal's geographic footprint of about 2,400 stores, 14 distributional facilities, and six manufacturing facilities would be a massive undertaking as Fastenal has established itself as one of the largest industrial distributors in United States, which creates a barrier of entry for any new companies who might be looking to enter the market. Moreover, mandates passed by Congress regulate the manufacturing process and ensure the products are of certain quality, creating an additional barrier new companies must meet in order to compete in the industry. As a large number of revenue in the industry is obtained through bidding on contracts, a new entrant would find it harder to compete as it will not be well known and customers will opt for brand loyalty and a well-established company as compared to a new comer. Although we believe the potential threat posed by Amazon should not be forgotten, we feel Amazon's decision to hold very little inventory, and its inability to match Fastenal's product knowledge and outstanding inventory management solutions will prevent Amazon from gaining significant market share in the Industrial Distribution industry. Therefore, we consider Amazon's entry into the industry as a less significant threat to FAST compared with other industry competitors because Fastenal's specialized service-based model has enabled the Company to establish a competitive "moat" that's challenging for Amazon and other online retailers to penetrate.

## Appendix III: Pro Forma Financials

Income Statement											
	2014	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E
<b>Net sales</b>	\$3,733.51	\$3,869.19	\$3,962.04	\$4,385.37	\$4,853.93	\$5,372.56	\$5,641.18	\$5,923.24	\$6,219.40	\$6,530.38	\$6,856.89
Cost of sales	\$ 1,836.10	\$ 1,920.25	\$ 1,997.26	\$ 2,236.54	\$ 2,475.50	\$ 2,766.87	\$ 2,905.21	\$ 3,050.47	\$ 3,202.99	\$ 3,363.14	\$ 3,531.30
<b>Gross profit</b>	<b>\$1,897.41</b>	<b>\$1,948.94</b>	<b>\$1,964.78</b>	<b>\$2,148.83</b>	<b>\$2,378.43</b>	<b>\$2,605.69</b>	<b>\$2,735.97</b>	<b>\$2,872.77</b>	<b>\$3,016.41</b>	<b>\$3,167.23</b>	<b>\$3,325.59</b>
<i>Gross Profit %</i>	50.82%	50.37%	49.59%	49.00%	49.00%	48.50%	48.50%	48.50%	48.50%	48.50%	48.50%
Operating and administrative expenses	\$ 1,110.78	\$ 1,121.59	\$ 1,169.47	\$ 1,162.12	\$ 1,286.29	\$ 1,343.14	\$ 1,410.30	\$ 1,480.81	\$ 1,554.85	\$ 1,632.59	\$ 1,714.22
Loss / gain on sale of property and equipment	\$ 0.96	\$ 1.41	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53
<b>Operating income</b>	<b>\$ 785.67</b>	<b>\$ 825.94</b>	<b>\$ 794.78</b>	<b>\$ 986.18</b>	<b>\$1,091.60</b>	<b>\$1,262.02</b>	<b>\$1,325.15</b>	<b>\$1,391.43</b>	<b>\$1,461.03</b>	<b>\$1,534.11</b>	<b>\$1,610.84</b>
<i>Operating Margin %</i>	21.04%	21.35%	20.06%	22.49%	22.49%	23.49%	23.49%	23.49%	23.49%	23.49%	23.49%
Interest income	\$ 0.76	\$ 0.37	\$ 0.39	\$ 0.49	\$ 0.96	\$ 1.31	\$ 1.73	\$ 2.86	\$ 4.05	\$ 5.30	\$ 6.61
Interest expense	\$ 0.92	\$ 3.11	\$ 6.50	\$ 4.60	\$ 4.60	\$ 4.60	\$ 4.60	\$ 4.60	\$ 4.60	\$ 4.60	\$ 4.60
<b>Earnings before income taxes (EBT)</b>	<b>\$ 785.51</b>	<b>\$ 823.20</b>	<b>\$ 788.67</b>	<b>\$ 982.07</b>	<b>\$1,087.96</b>	<b>\$1,258.74</b>	<b>\$1,322.28</b>	<b>\$1,389.70</b>	<b>\$1,460.48</b>	<b>\$1,534.81</b>	<b>\$1,612.85</b>
Income tax expense	\$ 293.28	\$ 309.66	\$ 290.25	\$ 366.28	\$ 287.45	\$ 332.44	\$ 349.26	\$ 367.26	\$ 386.17	\$ 406.02	\$ 426.86
<b>Net earnings</b>	<b>\$ 492.23</b>	<b>\$ 513.55</b>	<b>\$ 498.42</b>	<b>\$ 615.79</b>	<b>\$ 800.51</b>	<b>\$ 926.29</b>	<b>\$ 973.03</b>	<b>\$1,022.44</b>	<b>\$1,074.32</b>	<b>\$1,128.79</b>	<b>\$1,185.99</b>
<i>Net Margin %</i>	13.18%	13.27%	12.58%	14.04%	16.49%	17.24%	17.25%	17.26%	17.27%	17.29%	17.30%
Diluted Shares Outstanding (M)	297.3	292.0	289.2	289.2	289.2	289.2	289.2	289.2	289.2	289.2	289.2
Earnings Per Share	\$ 1.66	\$ 1.76	\$ 1.72	\$ 2.13	\$ 2.77	\$ 3.20	\$ 3.37	\$ 3.54	\$ 3.72	\$ 3.90	\$ 4.10
EBIT	\$ 785.67	\$ 825.94	\$ 794.78	\$ 986.18	\$ 1,091.60	\$ 1,262.02	\$ 1,325.15	\$ 1,391.43	\$ 1,461.03	\$ 1,534.11	\$ 1,610.84
<i>EBIT Margin %</i>	21.04%	21.35%	20.06%	22.49%	22.49%	23.49%	23.49%	23.49%	23.49%	23.49%	23.49%
Depreciation and Amortization	\$ 72.67	\$ 86.60	\$ 104.05	\$ 99.56	\$ 110.20	\$ 121.97	\$ 128.07	\$ 134.47	\$ 141.20	\$ 148.26	\$ 155.67
<b>EBITDA</b>	<b>\$ 858.34</b>	<b>\$ 912.54</b>	<b>\$ 898.83</b>	<b>\$1,085.74</b>	<b>\$1,201.80</b>	<b>\$1,383.99</b>	<b>\$1,453.22</b>	<b>\$1,525.90</b>	<b>\$1,602.23</b>	<b>\$1,682.36</b>	<b>\$1,766.51</b>
<i>EBITDA Margin %</i>	22.99%	23.58%	22.69%	24.76%	24.76%	25.76%	25.76%	25.76%	25.76%	25.76%	25.76%
Dividends	\$ 296.58	\$ 327.10	\$ 346.59	\$ 359.60	\$ 467.47	\$ 540.92	\$ 568.21	\$ 597.06	\$ 627.36	\$ 659.17	\$ 692.58
Repurchases	\$ 52.94	\$ 292.95	\$ 59.44	\$ 162.87	\$ 211.73	\$ 245.00	\$ 257.36	\$ 270.43	\$ 284.15	\$ 298.56	\$ 313.69
<b>Retained Earnings</b>	<b>\$ 142.70</b>	<b>\$ (106.51)</b>	<b>\$ 92.39</b>	<b>\$ 93.32</b>	<b>\$ 121.31</b>	<b>\$ 140.37</b>	<b>\$ 147.46</b>	<b>\$ 154.94</b>	<b>\$ 162.81</b>	<b>\$ 171.06</b>	<b>\$ 179.73</b>

Balance Sheet											
	2014	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E
<b>Assets</b>											
<b>Total current assets</b>	<b>\$1,583.27</b>	<b>\$1,664.78</b>	<b>\$1,720.77</b>	<b>\$1,986.04</b>	<b>\$2,255.70</b>	<b>\$2,572.50</b>	<b>\$2,941.05</b>	<b>\$3,328.35</b>	<b>\$3,735.33</b>	<b>\$4,162.97</b>	<b>\$4,612.32</b>
Cash and cash equivalents	\$ 114.50	\$ 129.02	\$ 112.74	\$ 220.42	\$ 302.80	\$ 399.37	\$ 659.91	\$ 933.80	\$ 1,221.69	\$ 1,524.30	\$ 1,842.35
Trade accounts receivable, net of allowance for doubtful accounts	\$ 462.08	\$ 468.38	\$ 499.72	\$ 542.24	\$ 600.18	\$ 664.30	\$ 697.52	\$ 732.40	\$ 769.02	\$ 807.47	\$ 847.84
Inventories	\$ 869.22	\$ 913.26	\$ 992.99	\$ 1,078.15	\$ 1,193.34	\$ 1,333.79	\$ 1,400.48	\$ 1,470.51	\$ 1,544.03	\$ 1,621.24	\$ 1,702.30
Deferred income tax assets	\$ 21.77	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Prepaid income taxes	\$ -	\$ 22.56	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91	\$ 12.91
Other current assets	\$ 115.70	\$ 131.56	\$ 102.42	\$ 132.34	\$ 146.48	\$ 162.13	\$ 170.23	\$ 178.74	\$ 187.68	\$ 197.07	\$ 206.92
<b>Total Long Term Assets</b>	<b>\$1,943.35</b>	<b>\$2,105.24</b>	<b>\$2,286.70</b>	<b>\$2,463.00</b>	<b>\$2,726.16</b>	<b>\$2,924.22</b>	<b>\$3,070.43</b>	<b>\$3,223.95</b>	<b>\$3,385.15</b>	<b>\$3,554.40</b>	<b>\$3,732.12</b>
Property and equipment, net	\$ 763.89	\$ 818.89	\$ 899.70	\$ 940.41	\$ 1,040.89	\$ 1,152.10	\$ 1,209.71	\$ 1,270.19	\$ 1,333.70	\$ 1,400.39	\$ 1,470.41
Capitalized Lease	\$ 1,167.52	\$ 1,237.56	\$ 1,338.59	\$ 1,481.61	\$ 1,639.92	\$ 1,721.91	\$ 1,808.01	\$ 1,898.41	\$ 1,993.33	\$ 2,093.00	\$ 2,197.65
Other assets, net	\$ 11.95	\$ 48.80	\$ 48.42	\$ 40.98	\$ 45.36	\$ 50.20	\$ 52.71	\$ 55.35	\$ 58.11	\$ 61.02	\$ 64.07
<b>Total assets</b>	<b>\$3,526.62</b>	<b>\$3,770.02</b>	<b>\$4,007.47</b>	<b>\$4,449.04</b>	<b>\$4,981.86</b>	<b>\$5,496.71</b>	<b>\$6,011.48</b>	<b>\$6,552.30</b>	<b>\$7,120.48</b>	<b>\$7,717.38</b>	<b>\$8,344.44</b>
<b>Liabilities</b>											
<b>Total current liabilities</b>	<b>\$ 375.35</b>	<b>\$ 373.17</b>	<b>\$ 275.64</b>	<b>\$ 321.25</b>	<b>\$ 354.45</b>	<b>\$ 392.79</b>	<b>\$ 411.90</b>	<b>\$ 431.97</b>	<b>\$ 453.05</b>	<b>\$ 475.18</b>	<b>\$ 498.41</b>
Current portion of debt	\$ 90.00	\$ 62.05	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48	\$ 10.48
Accounts payable	\$ 103.91	\$ 125.97	\$ 108.74	\$ 131.69	\$ 145.76	\$ 162.91	\$ 171.06	\$ 179.61	\$ 188.59	\$ 198.02	\$ 207.92
Accrued expenses	\$ 174.00	\$ 185.14	\$ 156.42	\$ 179.08	\$ 198.22	\$ 219.39	\$ 230.36	\$ 241.88	\$ 253.98	\$ 266.67	\$ 280.01
Income taxes payable	\$ 7.44	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Total Long Term Liabilities</b>	<b>\$1,236.05</b>	<b>\$1,595.56</b>	<b>\$1,798.73</b>	<b>\$1,938.51</b>	<b>\$2,105.08</b>	<b>\$2,196.23</b>	<b>\$2,287.07</b>	<b>\$2,382.44</b>	<b>\$2,482.59</b>	<b>\$2,587.74</b>	<b>\$2,698.15</b>
Capitalized Lease	\$ 1,167.52	\$ 1,237.56	\$ 1,338.59	\$ 1,481.61	\$ 1,639.92	\$ 1,721.91	\$ 1,808.01	\$ 1,898.41	\$ 1,993.33	\$ 2,093.00	\$ 2,197.65
Long-term debt	\$ -	\$ 302.95	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52	\$ 379.52
Deferred income tax liabilities	\$ 68.53	\$ 55.06	\$ 80.63	\$ 77.38	\$ 85.65	\$ 94.80	\$ 99.54	\$ 104.52	\$ 109.74	\$ 115.23	\$ 120.99
<b>Total Liabilities</b>	<b>\$1,611.40</b>	<b>\$1,968.73</b>	<b>\$2,074.38</b>	<b>\$2,259.76</b>	<b>\$2,459.54</b>	<b>\$2,589.02</b>	<b>\$2,698.97</b>	<b>\$2,814.42</b>	<b>\$2,935.64</b>	<b>\$3,062.92</b>	<b>\$3,196.57</b>
<b>Stockholders Equity</b>											
Preferred stock	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Common stock	\$ 2.96	\$ 2.90	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89	\$ 2.89
Additional paid-in capital	\$ 33.74	\$ 2.02	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36	\$ 37.36
Retained earnings	\$ 1,886.35	\$ 1,842.77	\$ 1,940.14	\$ 2,196.33	\$ 2,529.37	\$ 2,914.74	\$ 3,319.56	\$ 3,744.93	\$ 4,191.89	\$ 4,661.50	\$ 5,154.92
Accumulated other comprehensive loss / income	\$ (7.84)	\$ (46.40)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)	\$ (47.30)
<b>Total stockholders equity</b>	<b>\$1,915.22</b>	<b>\$1,801.29</b>	<b>\$1,933.09</b>	<b>\$2,189.28</b>	<b>\$2,522.32</b>	<b>\$2,907.70</b>	<b>\$3,312.51</b>	<b>\$3,737.88</b>	<b>\$4,184.84</b>	<b>\$4,654.46</b>	<b>\$5,147.87</b>
<b>Total liabilities and stockholders equity</b>	<b>\$3,526.62</b>	<b>\$3,770.02</b>	<b>\$4,007.47</b>	<b>\$4,449.04</b>	<b>\$4,981.86</b>	<b>\$5,496.71</b>	<b>\$6,011.48</b>	<b>\$6,552.30</b>	<b>\$7,120.48</b>	<b>\$7,717.38</b>	<b>\$8,344.44</b>

Cash Flow Statement											
	2014	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E
<b>Net cash provided by operating activities</b>	<b>\$ 499.39</b>	<b>\$ 546.94</b>	<b>\$ 514.00</b>	<b>\$ 627.55</b>	<b>\$ 780.83</b>	<b>\$ 890.56</b>	<b>\$ 1,036.39</b>	<b>\$ 1,087.76</b>	<b>\$ 1,141.70</b>	<b>\$ 1,198.33</b>	<b>\$ 1,257.80</b>
Net earnings	\$ 494.15	\$ 516.36	\$ 499.48	\$ 615.79	\$ 800.51	\$ 926.29	\$ 973.03	\$ 1,022.44	\$ 1,074.32	\$ 1,128.79	\$ 1,185.99
Adjustments to reconcile net earnings to net cash provided	\$ 5.24	\$ 30.58	\$ 14.52	\$ 11.76	\$ (19.68)	\$ (35.73)	\$ 63.37	\$ 65.32	\$ 67.38	\$ 69.54	\$ 71.81
Depreciation of property and equipment	\$ 72.15	\$ 86.07	\$ 103.53	\$ 99.56	\$ 110.20	\$ 121.97	\$ 128.07	\$ 134.47	\$ 141.20	\$ 148.26	\$ 155.67
Loss / gain on sale of property and equipment	\$ (0.96)	\$ (1.41)	\$ (0.53)	\$ (1.41)	\$ (1.41)	\$ (1.41)	\$ (1.41)	\$ (1.41)	\$ (1.41)	\$ (1.41)	\$ (1.41)
Bad debt expense	\$ 11.48	\$ 8.77	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55	\$ 8.55
Deferred income taxes	\$ 1.76	\$ 8.29	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57	\$ 25.57
Stock-based compensation	\$ 7.04	\$ 5.84	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10	\$ 4.10
Excess tax benefits from stock-based compensation	\$ (2.09)	\$ (3.39)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)	\$ (5.88)
Amortization of non-compete agreements	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53	\$ 0.53
Changes in operating assets and liabilities	\$ (84.65)	\$ (74.12)	\$ (121.34)	\$ (119.25)	\$ (161.33)	\$ (189.16)	\$ (96.16)	\$ (100.60)	\$ (105.27)	\$ (110.17)	\$ (115.32)
Trade accounts receivable	\$ (63.42)	\$ (20.61)	\$ (40.49)	\$ (51.07)	\$ (66.49)	\$ (72.68)	\$ (41.77)	\$ (43.43)	\$ (45.17)	\$ (47.00)	\$ (48.92)
Inventories	\$ (87.62)	\$ (47.83)	\$ (80.85)	\$ (85.16)	\$ (115.20)	\$ (140.45)	\$ (66.69)	\$ (70.02)	\$ (73.53)	\$ (77.20)	\$ (81.06)
Other current assets	\$ (7.51)	\$ (15.78)	\$ 29.14	\$ (29.91)	\$ (14.14)	\$ (15.65)	\$ (8.11)	\$ (8.51)	\$ (8.94)	\$ (9.38)	\$ (9.85)
Accounts payable	\$ 12.50	\$ 20.62	\$ (17.23)	\$ 22.95	\$ 14.07	\$ 17.16	\$ 8.15	\$ 8.55	\$ 8.98	\$ 9.43	\$ 9.90
Accrued expenses	\$ 25.26	\$ 11.14	\$ (28.72)	\$ 22.66	\$ 19.13	\$ 21.18	\$ 10.97	\$ 11.52	\$ 12.09	\$ 12.70	\$ 13.33
Income taxes	\$ 34.41	\$ (26.61)	\$ 15.54	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other	\$ 1.73	\$ 4.95	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29	\$ 1.29
<b>Net cash used in investing activities</b>	<b>\$ (188.78)</b>	<b>\$ (180.63)</b>	<b>\$ (188.09)</b>	<b>\$ (145.42)</b>	<b>\$ (265.53)</b>	<b>\$ (384.02)</b>	<b>\$ (453.62)</b>	<b>\$ (469.41)</b>	<b>\$ (439.16)</b>	<b>\$ (401.69)</b>	<b>\$ (421.52)</b>
Purchases of property and equipment	\$ (189.47)	\$ (155.17)	\$ (189.45)	\$ (146.78)	\$ (266.89)	\$ (385.38)	\$ (454.98)	\$ (470.76)	\$ (440.52)	\$ (403.05)	\$ (422.88)
Proceeds from sale of property and equipment	\$ 5.82	\$ 9.94	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51	\$ 6.51
Cash paid for acquisitions	\$ (5.58)	\$ (23.49)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net decrease / increase in marketable securities	\$ 0.45	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other	\$ (0.00)	\$ (11.91)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)	\$ (5.15)
<b>Net cash used in financing activities</b>	<b>\$ (249.73)</b>	<b>\$ (337.56)</b>	<b>\$ (340.87)</b>	<b>\$ (333.76)</b>	<b>\$ (460.44)</b>	<b>\$ (548.76)</b>	<b>\$ (545.21)</b>	<b>\$ (513.10)</b>	<b>\$ (467.60)</b>	<b>\$ (418.32)</b>	<b>\$ (381.29)</b>
Borrowings under credit facility	\$ 705.00	\$ 1,215.00	\$ 950.00	\$ 614.21	\$ 734.40	\$ 808.02	\$ 980.81	\$ 1,276.95	\$ 1,635.01	\$ 2,017.02	\$ 2,359.26
Payments against credit facility	\$ (615.00)	\$ (955.00)	\$ (920.00)	\$ (460.66)	\$ (550.80)	\$ (606.01)	\$ (735.61)	\$ (957.71)	\$ (1,226.26)	\$ (1,512.76)	\$ (1,769.45)
Proceeds from exercise of stock options	\$ 7.70	\$ 19.10	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27	\$ 29.27
Excess tax benefits from stock-based compensation	\$ 2.09	\$ 3.39	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88	\$ 5.88
Purchases of common stock	\$ (52.94)	\$ (292.95)	\$ (59.44)	\$ (162.87)	\$ (211.73)	\$ (245.00)	\$ (257.36)	\$ (270.43)	\$ (284.15)	\$ (298.56)	\$ (313.69)
Payments of dividends	\$ (296.58)	\$ (327.10)	\$ (346.59)	\$ (359.60)	\$ (467.47)	\$ (540.92)	\$ (568.21)	\$ (597.06)	\$ (627.36)	\$ (659.17)	\$ (692.58)
Effect of exchange rate changes on cash and cash equivalents	\$ (4.89)	\$ (14.23)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)	\$ (1.32)
Net increase / decrease in cash and cash equivalents	\$ 55.99	\$ 14.52	\$ (16.28)	\$ 147.05	\$ 53.54	\$ (43.54)	\$ 36.24	\$ 103.94	\$ 233.62	\$ 377.00	\$ 453.67
<b>Cash and cash equivalents at beginning of period</b>	<b>\$ 58.51</b>	<b>\$ 114.50</b>	<b>\$ 129.02</b>	<b>\$ 133.40</b>	<b>\$ 220.42</b>	<b>\$ 302.80</b>	<b>\$ 399.37</b>	<b>\$ 659.91</b>	<b>\$ 933.80</b>	<b>\$ 1,221.69</b>	<b>\$ 1,524.30</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 114.50</b>	<b>\$ 129.02</b>	<b>\$ 112.74</b>	<b>\$ 220.42</b>	<b>\$ 302.80</b>	<b>\$ 399.37</b>	<b>\$ 659.91</b>	<b>\$ 933.80</b>	<b>\$ 1,221.69</b>	<b>\$ 1,524.30</b>	<b>\$ 1,842.35</b>
Cash paid for interest	\$ (0.92)	\$ (3.10)	\$ (6.18)	\$ (4.60)	\$ (4.60)	\$ (4.60)	\$ (4.60)	\$ (4.60)	\$ (4.60)	\$ (4.60)	\$ (4.60)
Net cash received / paid for income taxes	\$ (257.51)	\$ (327.03)	\$ (248.33)	\$ (366.28)	\$ (287.45)	\$ (332.44)	\$ (349.26)	\$ (367.26)	\$ (386.17)	\$ (406.02)	\$ (426.86)

## Appendix IV: Valuation

<b>FAST: FCF Calculation</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>2020E</b>
<b>NOPLAT</b>	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
Add: Rent Expense	\$ 139.03	\$ 144.14	\$ 152.79	\$ 165.26	\$ 182.92	\$ 202.46	\$ 212.58
Less: Implied Interest Expense	\$ 27.39	\$ 29.03	\$ 31.40	\$ 34.76	\$ 38.47	\$ 40.39	\$ 42.41
Less: Depreciation of Capitalized Leased Assets	\$ 111.64	\$ 115.11	\$ 121.39	\$ 130.50	\$ 144.45	\$ 162.07	\$ 170.17
Adjusted NOPLAT	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
<b>NOPLAT</b>	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
Add: Depreciation and Amortization Expense	\$ 72.67	\$ 86.60	\$ 104.05	\$ 99.56	\$ 110.20	\$ 121.97	\$ 128.07
Less: Change in Networking Capital	\$ (39.29)	\$ (83.70)	\$ (153.51)	\$ (125.04)	\$ (168.51)	\$ (197.88)	\$ (97.18)
Less: Increase in current operating expense	\$ 174.81	\$ 81.51	\$ 55.99	\$ 170.64	\$ 201.71	\$ 236.22	\$ 116.29
Add: Increase in current operating liabilities	\$ 135.52	\$ (2.19)	\$ (97.52)	\$ 45.61	\$ 33.20	\$ 38.33	\$ 19.12
Less: Capital Expenditures	\$ 181.71	\$ 141.60	\$ 184.86	\$ 140.27	\$ 210.68	\$ 233.19	\$ 185.68
<b>FREE CASH FLOW</b>	\$ 423.88	\$ 547.63	\$ 572.06	\$ 703.94	\$ 872.59	\$ 1,016.83	\$ 1,016.26

<b>Discounting Cash Flows</b>		
Year	FCF	Present Value
2017E	\$ 703.94	\$ 660.91
2018E	\$ 872.59	\$ 769.18
2019E	\$ 1,016.83	\$ 841.55
2020E	\$ 1,016.26	\$ 789.67
2021E	\$ 1,067.09	\$ 778.49
2022E	\$ 1,120.47	\$ 767.46
2023E	\$ 1,176.51	\$ 756.60
2024E	\$ 1,235.36	\$ 745.88
2025E	\$ 1,297.14	\$ 735.32
2026E	\$ 1,362.02	\$ 724.91
Terminal Value	\$ 21,445.15	\$ 11,413.71
<b>Total Present Value</b>		\$ 18,983.67

<b>Assumptions</b>	
Terminal Value Growth Rate	2.50%
Discount Rate	6.51%

<b>Calculation</b>	
Midyear Adjustment Factor	1.032036623
Value of operations	\$ 19,591.85
Add: Value of Excess cash	\$ 98.48
<b>Total Enterprise Value</b>	<b>\$ 19,690.33</b>
Less: Debt	\$ 440.00
Less: Capitalized Lease	\$ 1,338.59
<b>Equity Value</b>	<b>\$ 17,911.74</b>
Diluted Shares Outstanding	287.40
<b>Price Per share</b>	<b>\$ 62.32</b>

## Appendix V: Scenario Analysis

Scenario Summary			
	Base Case	Bull Case	Bear Case
<b>Changing Cells:</b>			
Sales Growth	10.68%	13.00%	9.00%
WACC	6.51%	6.00%	7.00%
Terminal Value Growth Rate	2.50%	3.50%	2.00%
Price	\$ 62.32	\$ 72.67	\$ 53.56

## Appendix VI: Sensitivity Analysis

Terminal Value								
	\$ 62.32	4.00%	3.50%	3.00%	2.50%	2.00%	1.50%	1.00%
WACC	5.90%	\$ 70.59	\$ 70.36	\$ 70.12	\$ 69.89	\$ 69.66	\$ 69.42	\$ 69.19
	6.10%	\$ 67.90	\$ 67.68	\$ 67.46	\$ 67.24	\$ 67.02	\$ 66.80	\$ 66.58
	6.30%	\$ 65.39	\$ 65.18	\$ 64.97	\$ 64.76	\$ 64.55	\$ 64.34	\$ 64.13
	6.50%	\$ 63.04	\$ 62.84	\$ 62.64	\$ 62.44	\$ 62.23	\$ 62.03	\$ 61.83
	6.70%	\$ 60.83	\$ 60.63	\$ 60.44	\$ 60.25	\$ 60.06	\$ 59.87	\$ 59.68
	6.90%	\$ 58.74	\$ 58.56	\$ 58.38	\$ 58.20	\$ 58.02	\$ 57.83	\$ 57.65
	7.10%	\$ 56.78	\$ 56.61	\$ 56.43	\$ 56.26	\$ 56.09	\$ 55.91	\$ 55.74

COGS to Sales								
	\$ 62.32	48.00%	49.00%	50.00%	51.00%	52.00%	53.00%	54.00%
SGA to Sales	25.00%	\$ 63.23	\$ 63.03	\$ 62.83	\$ 62.63	\$ 62.43	\$ 62.24	\$ 62.04
	26.00%	\$ 63.02	\$ 62.82	\$ 62.62	\$ 62.43	\$ 62.23	\$ 62.03	\$ 61.83
	27.00%	\$ 62.82	\$ 62.62	\$ 62.42	\$ 62.22	\$ 62.02	\$ 61.82	\$ 61.63
	28.00%	\$ 62.61	\$ 62.41	\$ 62.21	\$ 62.01	\$ 61.82	\$ 61.62	\$ 61.42
	29.00%	\$ 62.40	\$ 62.20	\$ 62.01	\$ 61.81	\$ 61.61	\$ 61.41	\$ 61.21
	30.00%	\$ 62.20	\$ 62.00	\$ 61.80	\$ 61.60	\$ 61.40	\$ 61.21	\$ 61.01
	31.00%	\$ 61.99	\$ 61.79	\$ 61.59	\$ 61.40	\$ 61.20	\$ 61.00	\$ 60.80

Price		
	\$ 62.32	
Short Term Sales Growth	12.18%	\$ 65.10
	11.68%	\$ 64.16
	11.18%	\$ 63.23
	10.68%	\$ 62.31
	10.18%	\$ 61.40
	9.68%	\$ 60.50
	9.18%	\$ 59.61

## Appendix VII: Regression Analysis

<i>Carhart four-factor model</i>	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	0.013128587	0.00486555	2.69827382	0.007302959	0.003559661	0.022697514	0.003559661	0.022697514
Mrket_Prem	0.88649986	0.1163038	7.622277723	2.29732E-13	0.657768796	1.115230925	0.657768796	1.115230925
smb	0.404874618	0.157724279	2.566977134	0.010668071	0.094683185	0.715066052	0.094683185	0.715066052
hml	0.409542726	0.173460635	2.361012496	0.01876491	0.068403092	0.750682361	0.068403092	0.750682361
umd	-0.235972916	0.106677479	-2.21202186	0.027601379	-0.445772196	-0.026173636	-0.445772196	-0.026173636

<i>FAST: SALES PROJECTION</i>	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	-0.024211544	0.062920119	-0.384798131	0.703775856	-0.154072288	0.105649199	-0.154072288	0.105649199
Industrial Production	0.807581491	0.686508987	1.176359678	0.250987848	-0.60930342	2.224466402	-0.60930342	2.224466402
GDP Growth	4.89706486	1.572468151	3.114253766	0.004723083	1.651650106	8.142479615	1.651650106	8.142479615
Construction	-0.721312863	0.302093794	-2.387711627	0.025177505	-1.34480381	-0.09782192	-1.34480381	-0.097821917

## Appendix VIII: Cash Cycle

<i>FAST: CASH CYCLE</i>	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	LTM	Trend (2010-2017 LTM)
Days Inventory on Hand (DIO)	172.85	176.63	206.74	177.69	164.81	163.58	170.32	164.33	170.18	174.93	171.98	■
PLUS: Days Sales Outstanding (DSO)	39.47	37.53	43.41	38.95	40.15	41.39	43.15	42.84	43.89	44.59	50.49	■
= Operating Cycle	212.31	214.16	250.14	216.63	204.96	204.97	213.48	207.17	214.07	219.53	222.47	■
LESS: Days of Payables Outstanding (DPO)	16.61	18.71	24.05	18.19	17.24	17.44	18.44	18.54	21.45	20.71	21.80	■
= Cash Conversion Cycle	195.70	195.46	226.09	198.45	187.73	187.53	195.04	188.63	192.62	198.82	200.67	■

Sources: FactSet

## Appendix IV: Free Cash Flow Calculation

Free cash flow is calculated by adding non-cash expenses back to net operating profit less adjusted taxes (“NOPLAT”) and then subtracting the change in net working capital and capital expenditures. NOPLAT was calculated by multiplying operating income by one minus the operating tax rate.

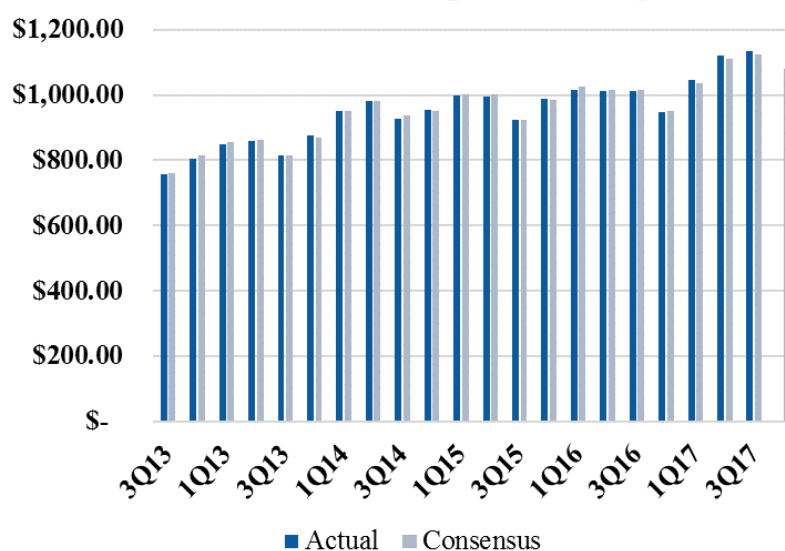
<i>FAST: FCF Calculation</i>	2014	2015	2016	2017E	2018E	2019E	2020E
<b>NOPLAT</b>	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
Add: Rent Expense	\$ 139.03	\$ 144.14	\$ 152.79	\$ 165.26	\$ 182.92	\$ 202.46	\$ 212.58
Less: Implied Interest Expense	\$ 27.39	\$ 29.03	\$ 31.40	\$ 34.76	\$ 38.47	\$ 40.39	\$ 42.41
Less: Depreciation of Capitalized Leased Assets	\$ 111.64	\$ 115.11	\$ 121.39	\$ 130.50	\$ 144.45	\$ 162.07	\$ 170.17
Adjusted NOPLAT	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
<b>NOPLAT</b>	\$ 493.63	\$ 518.94	\$ 499.36	\$ 619.61	\$ 804.56	\$ 930.16	\$ 976.69
Add: Depreciation and Amortization Expense	\$ 72.67	\$ 86.60	\$ 104.05	\$ 99.56	\$ 110.20	\$ 121.97	\$ 128.07
Less: Change in Networking Capital	\$ (39.29)	\$ (83.70)	\$ (153.51)	\$ (125.04)	\$ (168.51)	\$ (197.88)	\$ (97.18)
Less: Increase in current operating expense	\$ 174.81	\$ 81.51	\$ 55.99	\$ 170.64	\$ 201.71	\$ 236.22	\$ 116.29
Add: Increase in current operating liabilities	\$ 135.52	\$ (2.19)	\$ (97.52)	\$ 45.61	\$ 33.20	\$ 38.33	\$ 19.12
Less: Capital Expenditures	\$ 181.71	\$ 141.60	\$ 184.86	\$ 140.27	\$ 210.68	\$ 233.19	\$ 185.68
<b>FREE CASH FLOW</b>	\$ 423.88	\$ 547.63	\$ 572.06	\$ 703.94	\$ 872.59	\$ 1,016.83	\$ 1,016.26

## Appendix X: DuPont Analysis

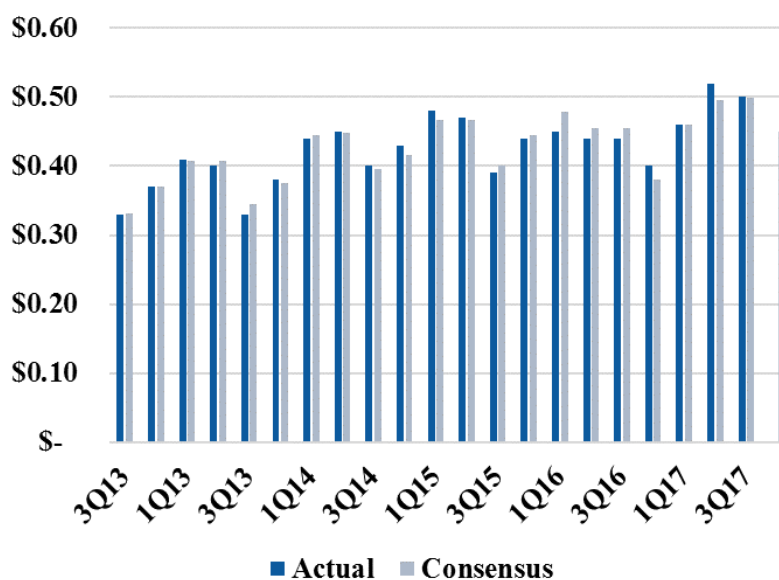
FAST: DuPont Analysis	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	LTM	Trend (2010-2017 LTM)
Profit Margin	11.28%	11.95%	9.55%	11.69%	12.94%	13.42%	13.49%	13.24%	13.35%	12.61%	12.73%	■
Times: Asset turnover	1.773	1.795	1.454	1.546	1.642	1.726	1.602	1.583	1.528	1.485	1.510	■
Times: Equity Multiplier	1.151	1.142	1.115	1.145	1.155	1.164	1.171	1.232	1.406	1.381	1.430	■
<b>ROE</b>	<b>23.03%</b>	<b>24.49%</b>	<b>15.48%</b>	<b>20.69%</b>	<b>24.53%</b>	<b>26.95%</b>	<b>25.31%</b>	<b>25.80%</b>	<b>28.67%</b>	<b>25.84%</b>	<b>27.49%</b>	■

## Appendix XI: Surprise History

### Revenue Surprise History



### EPS Surprise History



## Appendix XII: Pestle Analysis

### ENVIRONMENTAL

Environmental laws and regulations can make it difficult for the industry to obtain raw materials as Chinese authorities have enforced steel production cuts between mid-November and mid-March 2018 in an attempt to improve air quality in northern Chinese provinces during winter.

### POLITICAL

Current Administration's emphasis on American manufacturing, NAFTA uncertainty and possible restriction on imports of China Steel will adversely affect the Industrial Wholesale Distribution industry. Moreover, instability in the international markets can affect supply of FAST Products as Fastenal imports the fasteners from East-Asia.

### LEGAL

The companies in the industry face an intense scrutiny based on the Health & Safety and Labor laws as well as Quality control laws set by Congress.



### ECONOMIC

Exchange rates (USD-JPY-CAD) and a possible recession can affect the prices of FAST products. Furthermore, government expenditure changes will also affect future government contracts for FAST.

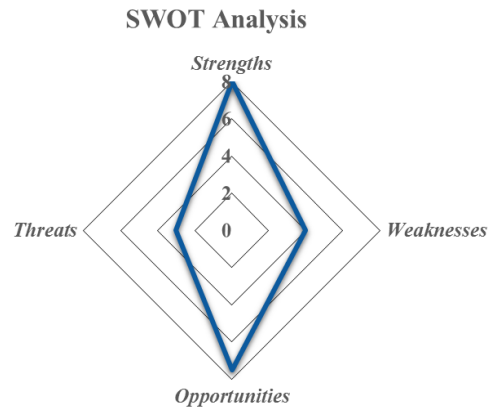
### TECHNOLOGICAL

Future R&D, technological innovations and further automation in the industry could affect FAST and its peers in the industry.

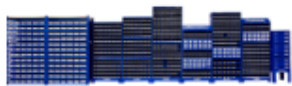
### SOCIO-CULTURAL

Aging population will affect workforce as the possible shortage of skilled labor will affect the industry negatively. Cultural barriers with international acquisitions can also pose challenges.

## Appendix XIII: SWOT Analysis



- One of the largest industrial distributors in United States
- Superior Customer Service
- Innovative Inventory Management
- Strong Sales and Distribution Network
- Specialized and skilled workforce
- Skilled and experienced Management



**S**

- Small e-commerce footprint
- Highly dependent on U.S Industrial Economy and vulnerable to negative consumer trends.
- Higher prices than competitors

**W**



**O**

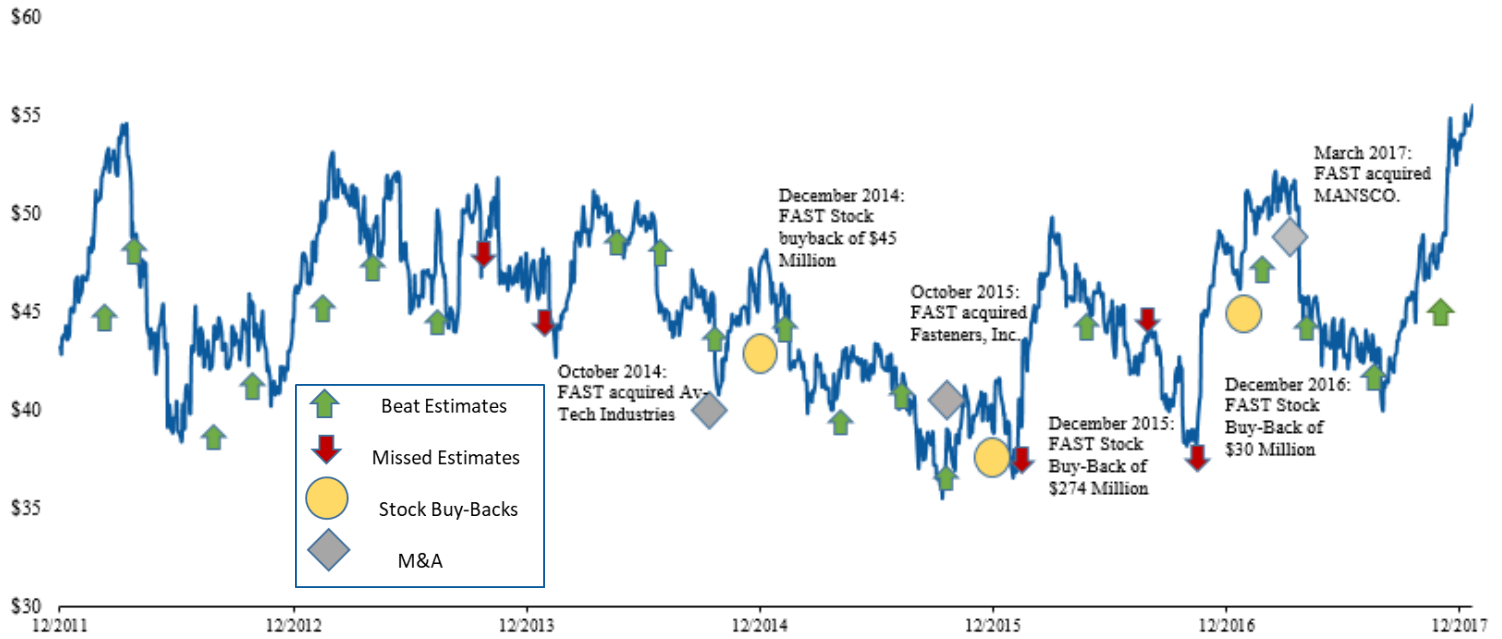
- International Expansion
- Increased vending operations, stores and on-site locations to further increase its geographic footprint as well as national accounts.
- Acquisitions (To increase market share and inventory management)
- Increased Technological Innovations can result in greater market share and revenue.

**T**



- Slowing industrial production in U.S/ Economic downturn/recession
- Geopolitical tensions might make it harder to obtain raw materials internationally.
- Small and regional distributors
- Potential Amazon presence in industry
- Low unemployment could make it challenging to find skilled labor
- Competitors lowering prices

## Appendix XIV: Stock Price with Calendar Events



Sources: Yahoo! Finance, FactSet, Company Data

## XV: Inventory Management Solutions Case Studies

### *In the Customer's Words...*

#### **TRIUMPH FABRICATIONS**

"[Fastenal allows] us to reallocate all of those resources so that we are focusing on the things that make us money – getting parts out to the customers on time. *We have that level of trust in that partnership that they're going to be there, right there with us, and have the products we need when we need them.*"

– Billie McMillian, Program Manager

#### **SMEAL FIRE APPARATUS CO.**

"It's made for a much more efficient process in terms of being able to take advantage of consolidated vendor managed inventory. *As a Chief Financial Officer, to me it's all about anywhere we can improve the top line and improve the bottom line, I'm going to be looking at those things; and Fastenal has helped us in that regard very much.*"

– Jeff Scherer, Chief Financial Officer

#### **CONROE MACHINE**

"Prior to Fastenal, we were issuing something like 500 safety glasses a month. It was an item that was completely out of control, which forced me to have to manage it myself. Through the vending system that Fastenal offered, Fastenal was able to put in dispensing controls so that I can have our safety glasses inventory regulated by person, by month. *It was a very easy way to take our 500 safety glasses a month down to 10 a month – and the right people are getting them.*"

– David Van De Walle, Quality, Health, Safety & Environmental Manager

#### **INFRASTRUCTURE & ENERGY ALTERNATIVES: IEA**

"[Fastenal] always said that when we need product, it'll be there, and they've never gone back on their word with that. They've always come to us with cost savings, profitability ideas, and technology. *Fastenal has impressed me, and I think They've impressed the whole company.*"

– Ryan Moran, Supply Chain Specialist

#### **GMI**

"We were using five cases of each size latex glove, but now we're only using what would be the equivalent of one case. When we looked at our old supplier, they used on average 200 to 300 sanding discs a week. We are now using 25 for the same amount of, if not increased, production. *With the machines, we've seen an average of \$4,000 a month savings, and with the low cost of investment, it was an instant return on our investment.*"

– Evan Brady, Purchasing Manager

#### **Food Industry: JBT Food Industries**

*Company Overview:* JBT Food Technologies is a global technology solutions provider to the food processing and air transportation industries. They design, manufacture, test, and service systems and products for customers. JBT's Sandusky, OH facility employs approximately 100 people, and its MRO "crib" is managed by Fastenal.

*The FAST Advantage: Key Business Results*

- Reduced "crib" travel/socializing time
- Management is able to check transaction reports daily
- Spending is reduced by \$1,500-\$2,000 a month, \$18,000-\$24,000 a year in just one facility (JBT's Sandusky, OH facility).

#### **Energy Industry: Sunflower Electric**

*Company Overview:* Sunflower Electric Power Corporation, Inc. provides bulk power supply to distribution cooperatives through its generation and transmission networks. It supplies power from gas-fired units, coal-fired units, and wind generation plants. Sunflower's Holcomb, KS facility is a 360 megawatt plant with 180 employees. More than 11,000 industrial supplies are used to operate and maintain the facility, many of which are supplied by Fastenal. In the past, each of these items were issued and tracked manually. To obtain supplies, mechanics and electricians had to create a request in the system, generate a ticket, and then carry the ticket to the central storeroom to retrieve the needed item. "We had a situation where workers were taken away from their jobs for significant periods of time to obtain common items like batteries or flashlights," said Gary Ratts, Manager of Supply Chain for Sunflower. "For some items, the labor cost was several times greater than the value of the part."

*The FAST Advantage: Key Business Results*

- Now, when workers need supplies, they simply approach the nearest machine, enter their ID, and select what's needed. The system tracks and reports the details of the transaction – who, what and when. "Everything still gets charged out, but now it takes literally 20 seconds," said Ratts.
- According to Ratts, the system has also eliminated administrative costs as well as inventory carrying costs. The local Fastenal store monitors the machines' inventory online and makes sure they're always filled at the appropriate levels, with no requisitions or purchase orders required by Sunflower. At the end of the month, they receive a single invoice from Fastenal for items that have been vended from the machines. "We no longer have to carry a bunch of extra inventory," added Ratts. "Everything is stocked in the machines, and we don't have to pay for it until we use it."
- Because of these improvements at the Holcomb facility, FAST 5000 machines have since been installed in three smaller Sunflower locations, each with approximately 15 to 20 employees – Garden City, KS; Dodge City, KS; and Great Bend, KS. According to Ratts, the implementation at each location has gone smoothly and the results have been positive.

*"With the machines, we've seen an average of \$4,000 a month savings, and with the low cost of investment, it was an instant return on our investment."*

## XVI: Financial Analysis of Selected Financials

**Table 9:** Selected Financials

Operating Performance	2014	2015	2016	2017E	2018E	2019E
Gross Profit Margin	50.82%	50.37%	49.59%	49.00%	49.00%	48.50%
EBITDA Margin	22.99%	23.58%	22.69%	24.76%	24.76%	25.76%
Net Profit Margin	13.18%	13.27%	12.58%	14.04%	16.49%	17.24%
Short Term Liquidity						
Current Ratio	4.22	4.46	6.24	6.18	6.36	6.55
Accounts Receivable Turnover	8.08	8.26	7.93	8.09	8.09	8.09
Inventory Turnover	2.11	2.10	2.01	2.07	2.07	2.07
Long Term Solvency						
Net Debt to EBITDA	-0.03	0.27	0.30	0.23	0.20	0.16
Total Debt to Equity	0.05	0.20	0.20	0.18	0.15	0.13
Interest Coverage Ratio	858.65	265.75	122.20	214.54	237.48	274.55
Return Analysis						
Return on Equity	25.70%	28.51%	25.78%	28.13%	31.74%	31.86%
Return on Assets (Including Capitalized leases)	13.96%	13.62%	12.44%	13.84%	16.07%	16.85%
ROIC (Including Capitalized leases)	14.42%	14.28%	12.78%	14.64%	17.18%	18.24%
Per Share Metrics						
Earnings Per Share (Diluted)	\$ 1.66	\$ 1.76	\$ 1.72	\$ 2.13	\$ 2.77	\$ 3.21
Dividends Per Share (Diluted)	\$ 1.00	\$ 1.12	\$ 1.20	\$ 1.24	\$ 1.62	\$ 1.87
Free Cash Flow Per Share	\$ 1.43	\$ 1.88	\$ 1.98	\$ 2.43	\$ 3.02	\$ 3.52

Sources: Company Data, Team Estimations

**Operating Performance:** Fastenal has recently experienced gross margin contraction mainly due to its product mix moving more toward the non-fastener line of business. FAST's 3 year average gross margin is 50.3%. Going forward, we projected this to fall to 49% for 2017 and 2018 and 48.5% thereafter. Fastenal does not disclose specific margins by product line but does mention that the Fastener line yields the best margin. In recent years, the Company's non-fastener line has been growing much faster than the Fastener line which has actually seen negative growth recently. Fastenal's 3 year average net profit margin has been 13.01%. In the future, we expect to see this expand aggressively mainly due to the new tax plan having instantaneous bottom line benefit.

**Short Term Liquidity:** FAST has a very attractive three-year average current ratio of 4.97x. Going forward, we anticipate this remaining attractive as FAST continues to generate strong Free Cash Flow and keep current liabilities under control. FAST has yielded a three-year average Inventory turnover ratio of 2.08x, but has recently seen this shorten due to increased levels of inventory. We believe this will remain above 2x with good inventory management efforts.

**Long Term Solvency:** Due to a relatively under-levered balance sheet FAST has when compared to its peers, FAST has great long term solvency. FAST's 2016 Net Debt-to-EBITDA value was 0.3x. In the future, we predict this number will become larger than it currently is due to our prediction of FAST making acquisitions to further widen its economic moat. When speaking with management, Holden Lewis mentioned, "With our current CEO being the prior CFO and our current CFO being a prior Wall Street analyst, we are not afraid of a reasonable amount of debt if the right opportunity presents itself." With that being said, we believe that management has the ideal mindset around leveraging a corporation.

**Return Analysis:** Fastenal has seen a three-year average ROE and ROIC (including Capitalized leases) of 26.7% and 13.8%, respectively. Going forward, we believe we will see ROE expand as FAST continues to expand its profit margin and potentially levers up the Business. We are also expecting ROIC to continue to expand as FAST continues to expand NOPLAT. The main drivers of this expansion will be from the new tax bill and a decrease in Operating and Administrative expenses as a percent of sales.

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