



# Fastenal Company (FAST)

Updated January 29<sup>th</sup>, 2019 by Eli Inkrot

## Key Metrics

<b>Current Price:</b>	\$60	<b>5 Year CAGR Estimate:</b>	8.6%	<b>Volatility Percentile:</b>	70.8%
<b>Fair Value Price:</b>	\$56	<b>5 Year Growth Estimate:</b>	7.0%	<b>Momentum Percentile:</b>	80.0%
<b>% Fair Value:</b>	107%	<b>5 Year Valuation Multiple Estimate:</b>	-1.3%	<b>Growth Percentile:</b>	65.2%
<b>Dividend Yield:</b>	2.9%	<b>5 Year Price Target</b>	\$78	<b>Valuation Percentile:</b>	32.5%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	40.0%

## Overview & Current Events

Fastenal began in 1967 when Bob Kierlin and four friends pooled together \$30,000 to open the first store. The original intent was to dispense nuts and bolts via vending machine, but it would take a few decades before that idea got off the ground. The company went public in 1987, and today provides fasteners, tools and supplies to its customers via 2,227 public branches, 894 active Onsite locations and over 81,000 industrial vending devices. The \$17 billion market cap company employees over 21,600 people and generates nearly \$5 billion in annual sales.

On January 17<sup>th</sup>, 2019 Fastenal reported fourth quarter and full year 2018 results ending December 31<sup>st</sup>, 2018. For the quarter the company reported net sales of \$1.231 billion, a 13.2% increase compared to the year ago period, driven by higher unit sales and slightly higher product pricing. Net earnings for Q4 totaled \$168.8 million, a 10.7% increase, with earnings-per-share coming in at \$0.59 against \$0.53 previously. For the year, Fastenal reported revenue of \$4.965 billion, an increase of 13.1%. Net earnings totaled \$751.9 billion compared to \$578.6 billion in 2017 (a 29.9% increase), driven by revenue growth and a substantial benefit from tax reform (a 23.8% rate versus 33.7% in 2017). Earnings-per-share equaled \$2.62 against \$2.01 previously, a 30.5% year-over-year increase.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$0.62	\$0.90	\$1.21	\$1.42	\$1.51	\$1.67	\$1.77	\$1.73	\$2.01	\$2.62	<b>\$2.80</b>	<b>\$3.92</b>
<b>DPS</b>	\$0.36	\$0.41	\$0.65	\$0.74	\$0.80	\$1.00	\$1.12	\$1.20	\$1.28	\$1.54	<b>\$1.72</b>	<b>\$2.04</b>
<b>Shares</b>	297	295	295	297	297	296	290	289	288	287	<b>286</b>	<b>285</b>

From 2008 through 2018, Fastenal has grown earnings-per-share by an average compound rate of 10.6% per annum. This was driven by a variety of factors, including sales basically doubling over this period, an improvement in margins and most recently as a result of tax reform.

Fastenal is in the midst of a transformation from the traditional public branches leading the business to on-site locations and vending devices heading the growth story (public store count topped out in 2014 and has since been declining, while on-site and vending have increased materially). We believe this is a prudent move, establishing stickier relationships with customers. This is especially true since only about 15% of the company's business is from walk-in customers while the remaining 85% is business-to-business.

On the flip side, the large, national accounts that the company is pursuing are tougher for margins, but this should be made up for in incremental volume. Moreover, the company is exposed to a fair amount of cyclicality as over half of the business is in construction and heavy manufacturing.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/E</b>	28.6	27.9	28.2	31.7	32.3	27.9	23.2	25.3	23.3	20.0	<b>21.4</b>	<b>20.0</b>
<b>Avg. Yld.</b>	2.0%	1.6%	1.9%	1.6%	1.6%	2.1%	2.7%	2.7%	2.7%	2.9%	<b>2.9%</b>	<b>2.6%</b>

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*



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Over the past decade shares of Fastenal have traded hands with an average P/E ratio of 26 to 27 times earnings. Even during the depths of the recession, shares did not trade below 15 times earnings. And since 2010 you would be hard pressed to find shares trading under 20 times earnings. Fastenal, it seems, has always traded at a premium valuation as compared to your typical security.

This premium has implications on the shareholder return side, as the dividend yield will remain average (even with an elevated payout ratio) and share buybacks do not look particularly attractive. (The last time a meaningful number of shares were retired was in 2015, when the company took on debt to buy shares that had dropped from 28 times earnings down to 21 or 22.)

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	58%	46%	54%	52%	53%	60%	63%	69%	64%	56%	61%	52%

Fastenal has a first mover competitive advantage in its industrial vending and on-site locations, creating a very sticky and well-attuned customer relationship with high switching costs. Moreover, the company's scale allows for the company to continue on its growth path, adjusting to business preferences and reliably delivering needed goods.

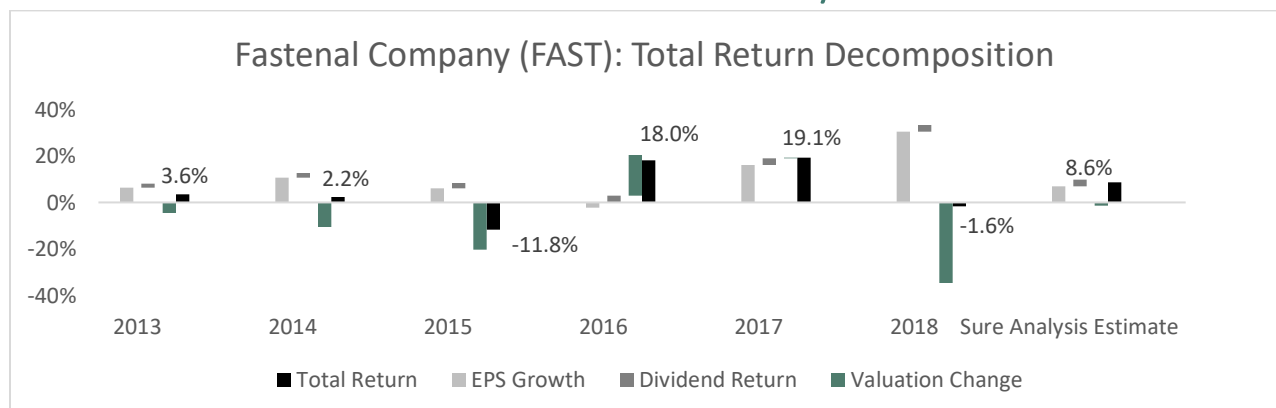
During the last recession, Fastenal reported earnings-per-share of \$0.78, \$0.96, \$0.62 and \$0.90 for the 2007 through 2010 period. Moreover, the dividend kept on increasing during this time. While we note some cyclical possibilities in the construction industry, thus far the company has proven itself to be well prepared to survive the financial storm.

As of the most recent report Fastenal had \$2.3 billion in current assets (mainly comprising of inventory) and \$3.3 billion in total assets against \$437 million in current liabilities and \$1.0 billion in total liabilities. Total debt stood at \$500.0 million as compared to underlying annual earnings power nearing \$800 million. We do note that the dividend payout ratio is elevated, but we believe this is reasonable considering the strong financial position.

## Final Thoughts & Recommendation

Fastenal has proven itself to be a great business, with earnings and dividends growing consistently over the years. Moreover, the company is executing moves to better cement itself as a go-to supplier. It's the sort of business that you would be proud to own. However, on the security side you have to get comfortable with the elevated valuation. If growth falls off at some point, this could be a lasting negative should the valuation fall to a more "typical" level. We are enthused about the quality of the business and future growth prospects, but we are not overly excited about the security's intermediate-term investment merits. Although we recognize that this view could prove too cautious should shares return to say 25+ times earnings, we are not willing to make that sort of speculation at this juncture.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	1930	2269	2767	3134	3326	3734	3869	3962	4391	4965
<b>Gross Profit</b>	983	1175	1434	1615	1719	1897	1949	1965	2164	2399
<b>Gross Margin</b>	50.9%	51.8%	51.8%	51.5%	51.7%	50.8%	50.4%	49.6%	49.3%	48.3%
<b>SG&amp;A Exp.</b>	687	745	859	941	1007	1111	1122	1170	1283	1400
<b>D&amp;A Exp.</b>	40	41	45	54	64	73	87	104	127	138
<b>Operating Profit</b>	297	430	575	673	712	787	827	795	881	999
<b>Operating Margin</b>	15.4%	18.9%	20.8%	21.5%	21.4%	21.1%	21.4%	20.1%	20.1%	20.1%
<b>Net Profit</b>	184	265	358	421	449	494	516	499	579	752
<b>Net Margin</b>	9.6%	11.7%	12.9%	13.4%	13.5%	13.2%	13.3%	12.6%	13.2%	15.1%
<b>Free Cash Flow</b>	254	167	148	258	210	310	395	330	465	498
<b>Income Tax</b>	113	165	217	254	265	293	310	290	295	235

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	1327	1468	1685	1816	2076	2359	2532	2669	2911	3322
<b>Cash &amp; Equivalents</b>	165	144	118	80	59	114	129	113	117	167
<b>Accounts Receivable</b>	214	270	339	372	414	462	468	500	608	714
<b>Inventories</b>	508	557	646	715	784	869	913	993	1093	1279
<b>Total Liabilities</b>	137	186	226	255	303	444	731	736	814	1019
<b>Accounts Payable</b>	53	60	74	78	91	104	126	109	148	194
<b>Long-Term Debt</b>	0	0	0	0	0	90	365	390	415	500
<b>Shareholder's Equity</b>	1191	1283	1459	1560	1773	1915	1801	1933	2097	2303
<b>D/E Ratio</b>	0	0	0	0	0	0	0.2	0.2	0.2	0.2

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	14.0%	19.0%	22.7%	24.0%	23.1%	22.3%	21.1%	19.2%	20.7%	24.1%
<b>Return on Equity</b>	15.8%	21.5%	26.1%	27.9%	26.9%	26.8%	27.8%	26.7%	28.7%	34.2%
<b>ROIC</b>	15.8%	21.5%	26.1%	27.9%	26.9%	26.2%	24.8%	22.2%	23.9%	28.3%
<b>Shares Out.</b>	297	295	295	297	297	296	290	289	288	287
<b>Revenue/Share</b>	6.51	7.70	9.35	10.55	11.17	12.56	13.25	13.70	15.23	17.29
<b>FCF/Share</b>	0.85	0.57	0.50	0.87	0.70	1.04	1.35	1.14	1.61	1.73

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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