

FASTENAL CO  
Form 10-Q  
October 18, 2012  
Table of Contents

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2012, or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-16125

FASTENAL COMPANY

(Exact name of registrant as specified in its charter)

Minnesota 41-0948415  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
2001 Theurer Boulevard 55987-0978  
Winona, Minnesota (Zip Code)  
(Address of principal executive offices)  
(507) 454-5374  
(Registrant's telephone number, including area code)  
Not Applicable  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer

Non-accelerated Filer  (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Edgar Filing: FASTENAL CO - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

Class	Outstanding at October 9, 2012
Common Stock, par value \$.01 per share	296,321,832

---

Table of Contents

FASTENAL COMPANY  
INDEX

	Page No.
<u>Part 1 Financial Information:</u>	
<u>Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011</u>	<u>1</u>
<u>Consolidated Statements of Earnings for the nine months and three months ended September 30, 2012 and 2011</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income for the nine months and three months ended September 30, 2012 and 2011</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011</u>	<u>4</u>
<u>Notes to Consolidated Financial Statements</u>	<u>5</u>
<u>Management's discussion and analysis of financial condition and results of operations</u>	<u>11</u>
<u>Quantitative and qualitative disclosures about market risk</u>	<u>27</u>
<u>Controls and procedures</u>	<u>27</u>
<u>Part II Other Information:</u>	
<u>Legal Proceedings</u>	<u>28</u>
<u>Risk Factors</u>	<u>28</u>
<u>Exhibits</u>	<u>28</u>

---

Table of Contents

## PART I—FINANCIAL INFORMATION

## Item 1. Financial Statements

## FASTENAL COMPANY AND SUBSIDIARIES

## Consolidated Balance Sheets

(Amounts in thousands except share information)

	(Unaudited)	
	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 195,603	117,676
Marketable securities	27,228	27,165
Trade accounts receivable, net of allowance for doubtful accounts of \$6,054 and \$5,647, respectively	411,033	338,594
Inventories	675,828	646,152
Deferred income tax assets	13,064	16,718
Other current assets	100,134	89,833
Total current assets	1,422,890	1,236,138
Property and equipment, less accumulated depreciation	483,935	435,601
Other assets, net	12,886	13,209
Total assets	\$ 1,919,711	1,684,948
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 84,882	73,779
Accrued expenses	123,179	111,962
Income taxes payable	7,955	2,077
Total current liabilities	216,016	187,818
Deferred income tax liabilities	39,317	38,154
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized	—	—
Common stock, 400,000,000 shares authorized, 296,307,832 and 295,258,674 shares issued and outstanding, respectively	2,963	2,953
Additional paid-in capital	53,038	16,856
Retained earnings	1,589,381	1,424,371
Accumulated other comprehensive income	18,996	14,796
Total stockholders' equity	1,664,378	1,458,976
Total liabilities and stockholders' equity	\$ 1,919,711	1,684,948

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

## FASTENAL COMPANY AND SUBSIDIARIES

## Consolidated Statements of Earnings

(Amounts in thousands except earnings per share)

	(Unaudited)		(Unaudited)	
	Nine months ended		Three months ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net sales	\$2,376,342	2,069,055	802,577	726,742
Cost of sales	1,152,639	992,061	388,202	349,361
Gross profit	1,223,703	1,076,994	414,375	377,381
Operating and administrative expenses	708,322	642,817	238,814	222,257
(Gain) loss on sale of property and equipment	(266	) 183	(158	) (101
Operating income	515,647	433,994	175,719	155,225
Interest income	357	318	117	94
Earnings before income taxes	516,004	434,312	175,836	155,319
Income tax expense	194,184	163,854	66,516	58,521
Net earnings	\$321,820	270,458	109,320	96,798
Basic net earnings per share	\$1.09	0.92	0.37	0.33
Diluted net earnings per share	\$1.08	0.91	0.37	0.33
Basic weighted average shares outstanding	295,964	294,994	296,238	295,144
Diluted weighted average shares outstanding	297,084	295,763	297,179	295,895

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

FASTENAL COMPANY AND SUBSIDIARIES  
 Consolidated Statements of Comprehensive Income  
 (Amounts in thousands)

	(Unaudited) Nine months ended September 30,		(Unaudited) Three months ended September 30,	
	2012	2011	2012	2011
Net earnings	\$321,820	270,458	109,320	96,798
Other comprehensive income (loss), before tax:				
Foreign currency translation adjustments	4,154	(5,295)	4,598	(8,016)
Change in marketable securities	46	134	56	(40)
Other comprehensive income (loss), before tax	4,200	(5,161)	4,654	(8,056)
Income tax (expense) benefit attributable to other comprehensive income	(1,579)	1,946	(1,759)	3,037
Other comprehensive income (loss), net of tax	2,621	(3,215)	2,895	(5,019)
Comprehensive income	\$324,441	267,243	112,215	91,779

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

## FASTENAL COMPANY AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(Amounts in thousands)

	(Unaudited)	
	Nine months ended	
	September 30,	
	2012	2011
Cash flows from operating activities:		
Net earnings	\$321,820	270,458
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of property and equipment	39,153	32,441
(Gain) loss on sale of property and equipment	(266)	) 183
Bad debt expense	7,240	6,591
Deferred income taxes	4,817	1,134
Stock based compensation	3,450	2,925
Excess tax benefits from stock based compensation	(8,957)	) —
Amortization of non-compete agreements	445	445
Changes in operating assets and liabilities:		
Trade accounts receivable	(79,679)	) (97,533)
Inventories	(29,676)	) (60,780)
Other current assets	(10,301)	) (13,848)
Accounts payable	11,103	26,365
Accrued expenses	11,217	12,156
Income taxes	14,835	18,163
Other	3,895	(4,519)
Net cash provided by operating activities	289,096	194,181
Cash flows from investing activities:		
Purchase of property and equipment	(88,323)	) (92,479)
Proceeds from sale of property and equipment	1,102	2,886
Net (increase) decrease in marketable securities	(63)	) 5,016
(Increase) decrease in other assets	(122)	) 301
Net cash used in investing activities	(87,406)	) (84,276)
Cash flows from financing activities:		
Proceeds from exercise of stock options	23,785	7,706
Excess tax benefits from stock based compensation	8,957	801
Payment of dividends	(156,810)	) (150,414)
Net cash used in financing activities	(124,068)	) (141,907)
Effect of exchange rate changes on cash	305	(643)
Net increase (decrease) in cash and cash equivalents	77,927	(32,645)
Cash and cash equivalents at beginning of period	117,676	143,693
Cash and cash equivalents at end of period	\$195,603	111,048
Supplemental disclosure of cash flow information:		

Cash paid during each period for income taxes	\$184,166	145,358
---	-----------	---------

The accompanying notes are an integral part of the consolidated financial statements.



Table of ContentsFASTENAL COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS(Amounts in thousands except share and per share information and where otherwise noted)  
September 30, 2012 and 2011  
(Unaudited)

## (1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Fastenal Company and subsidiaries (collectively referred to as the Company, Fastenal, or by terms such as we, our, or us) have been prepared in accordance with United States generally accepted accounting principles for interim financial information. They do not include all information and footnotes required by United States generally accepted accounting principles for complete financial statements. However, except as described herein, there has been no material change in the information disclosed in the notes to consolidated financial statements included in our consolidated financial statements as of and for the year ended December 31, 2011. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-6, Comprehensive Income (Topic 820). This accounting standard update eliminates the option to present components of other comprehensive income as part of the statement of equity and requires the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. It also requires presentation on the face of the financial statements of reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. This accounting standard update became effective beginning in our first quarter of fiscal 2012. In December 2011, the FASB issued ASU No. 2011-12 which indefinitely defers the guidance related to the presentation of reclassification adjustments only. The adoption of this accounting standard update resulted in financial statement presentation changes only.

Stock split – On April 19, 2011, our board of directors declared a two-for-one stock split with respect to our common stock. This stock split became effective at the close of business on May 20, 2011. All historical share and per share amounts in this report have been adjusted to reflect the impact of this stock split.

## (2) Marketable Securities

We follow a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to measurements involving unobservable inputs (Level 3). The three levels of the fair value hierarchy are as follows:

• Level 1 inputs are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

• Level 2 inputs include other inputs that are directly or indirectly observable in the marketplace.

• Level 3 inputs are unobservable inputs which are supported by little or no market activity.

The level in the fair value hierarchy within which a fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the placement in the fair value hierarchy of assets that are measured at fair value on a recurring basis at period end:

September 30, 2012:	Total	Level 1	Level 2	Level 3
Common stock	\$360	360	—	—
Government and agency securities	26,868	26,868	—	—
Total available-for-sale securities	\$27,228	27,228	—	—



Table of ContentsFASTENAL COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share and per share information and where otherwise noted)

September 30, 2012 and 2011

(Unaudited)

December 31, 2011:	Total	Level 1	Level 2	Level 3
Common stock	\$320	320	—	—
Government and agency securities	26,845	26,845	—	—
Total available-for-sale securities	\$27,165	27,165	—	—

September 30, 2011:	Total	Level 1	Level 2	Level 3
Common stock	\$295	295	—	—
Government and agency securities	25,908	25,908	—	—
Total available-for-sale securities	\$26,203	26,203	—	—

There were no transfers between levels during the three and nine month periods ended September 30, 2012 and 2011. As of September 30, 2012, December 31, 2011, and September 30, 2011, our financial assets that are measured at fair value on a recurring basis consisted of common stock and debt securities. The government and agency securities have a maturity of twelve months.

Marketable securities, all treated as available-for-sale securities at period end, consist of the following:

September 30, 2012:	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Common stock	\$197	163	—	360
Government and agency securities	26,868	—	—	26,868
Total available-for-sale securities	\$27,065	163	—	27,228

December 31, 2011:	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Common stock	\$197	123	—	320
Government and agency securities	26,851	—	(6 )	26,845
Total available-for-sale securities	\$27,048	123	(6 )	27,165

September 30, 2011:	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Common stock	\$198	97	—	295
Government and agency securities	25,850	58	—	25,908
Total available-for-sale securities	\$26,048	155	—	26,203

The unrealized gains and losses recorded in accumulated other comprehensive income and the realized gains and losses recorded in earnings were immaterial during the periods reported in these consolidated financial statements.

(Continued)

6

Table of Contents

## FASTENAL COMPANY AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share and per share information and where otherwise noted)

September 30, 2012 and 2011

(Unaudited)

Future maturities of our available-for-sale securities consist of the following:

September 30, 2012:	Less than 12 months		Greater than 12 months	
	Amortized cost	Fair value	Amortized cost	Fair value
Common stock	\$197	360	—	—
Government and agency securities	26,868	26,868	—	—
Total available-for-sale securities	\$27,065	27,228	—	—

(3) Stockholders' Equity – See note (1) regarding our stock split.

Our authorized and issued shares (share amounts stated in whole numbers) consist of the following:

	Par Value	September 30, 2012	December 31, 2011	September 30, 2011
Preferred Stock	\$.01 /share			
Shares authorized		5,000,000	5,000,000	5,000,000
Shares issued		—	—	—
Common Stock	\$.01 /share			
Shares authorized		400,000,000	400,000,000	400,000,000
Shares issued		296,307,832	295,258,674	295,203,874

## Dividends

On October 10, 2012, our board of directors declared a dividend of \$0.21 per share of common stock. This dividend is to be paid in cash on November 26, 2012 to shareholders of record at the close of business on October 29, 2012.

Historically, we have paid semi-annual dividends, which were typically paid in the first and third quarters. In 2010 and 2008, we paid a supplemental dividend in the fourth quarter. In 2011, our board of directors declared a semi-annual dividend in January, and then switched to a quarterly dividend in April, July, and October. Our board of directors expect to continue paying quarterly dividends, provided the future determination as to payment of dividends will depend on the financial needs of the Company and such other factors as deemed relevant by the board of directors.

The following table presents the dividends either paid previously or declared by our board of directors for future payment:

	2012	2011
First quarter	\$0.17	0.25
Second quarter	\$0.17	0.13
Third quarter	\$0.19	0.13
Fourth quarter	\$0.21	0.14
Total	\$0.74	0.65

(Continued)

7

Table of ContentsFASTENAL COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share and per share information and where otherwise noted)

September 30, 2012 and 2011

(Unaudited)

## Stock Options

The following tables summarize the details of grants made under our stock option plan of options that have been granted and are outstanding, and the assumptions used to value these options. All options granted were effective at the close of business on the date of grant.

Date of grant	Options granted	Option exercise price (strike)	Closing stock price on date of grant	September 30, 2012	
				Options outstanding	Options vested
April 17, 2012	1,235,000	\$54.00	\$49.01	1,192,500	—
April 19, 2011	410,000	\$35.00	\$31.78	380,000	—
April 20, 2010	530,000	\$30.00	\$27.13	380,000	—
April 21, 2009	790,000	\$27.00	\$17.61	590,000	—
April 15, 2008	550,000	\$27.00	\$24.35	305,167	135,167
April 17, 2007	4,380,000	\$22.50	\$20.15	2,328,425	1,276,175
Total	7,895,000			5,176,092	1,411,342

  

Date of grant	Risk-free interest rate	Expected life of option in years	Expected dividend yield	Expected stock volatility	Estimated fair value of stock option	
April 17, 2012	0.9	% 5.00	1.4	% 39.25	%	\$13.69
April 19, 2011	2.1	% 5.00	1.6	% 39.33	%	\$11.20
April 20, 2010	2.6	% 5.00	1.5	% 39.10	%	\$8.14
April 21, 2009	1.9	% 5.00	1.0	% 38.80	%	\$3.64
April 15, 2008	2.7	% 5.00	1.0	% 30.93	%	\$7.75
April 17, 2007	4.6	% 4.85	1.0	% 31.59	%	\$5.63

All of the options in the tables above vest and become exercisable over a period of up to eight years. Each option will terminate, to the extent not previously exercised, 13 months after the end of the relevant vesting period.

The fair value of each share-based option is estimated on the date of grant using a Black-Scholes valuation method that uses the assumptions listed above. The expected life is the average length of time over which we expect the employee groups will exercise their options, which is based on historical experience with similar grants. Expected volatilities are based on the movement of our stock over the most recent historical period equivalent to the expected life of the option. The risk-free interest rate is based on the U.S. Treasury rate over the expected life at the time of grant. The dividend yield is estimated over the expected life based on our current dividend payout, historical dividends paid, and expected future cash dividends.

Compensation expense equal to the grant date fair value is recognized for all of these awards over the vesting period. The stock-based compensation expense for the nine month periods ended September 30, 2012 and 2011 was \$3,450 and \$2,925, respectively. Unrecognized compensation expense related to outstanding stock options as of September 30, 2012 was \$21,447 and is expected to be recognized over a weighted average period of 4.88 years. Any future changes in estimated forfeitures will impact this amount.

(Continued)

8

---

Table of ContentsFASTENAL COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share and per share information and where otherwise noted)

September 30, 2012 and 2011

(Unaudited)

## Earnings Per Share

The following tables present a reconciliation of the denominators used in the computation of basic and diluted earnings per share and a summary of the options to purchase shares of common stock which were excluded from the diluted earnings calculation because they were anti-dilutive:

Reconciliation	Nine-month period		Three-month period	
	2012	2011	2012	2011
Basic-weighted average shares outstanding	295,964,359	294,994,553	296,237,956	295,144,175
Weighted shares assumed upon exercise of stock options	1,119,341	768,209	940,790	750,788
Diluted-weighted average shares outstanding	297,083,700	295,762,762	297,178,746	295,894,963

Summary of anti-dilutive options excluded	Nine-month period		Three-month period	
	2012	2011	2012	2011
Options to purchase shares of common stock	735,675	668,791	1,578,804	818,261
Weighted-average exercise price of options	\$54.00	\$31.85	\$49.43	\$32.51

Any dilutive impact summarized above would relate to periods when the average market price of our stock exceeded the exercise price of the potentially dilutive option securities then outstanding.

## (4) Income Taxes

Fastenal, or one of its subsidiaries, files income tax returns in the United States federal jurisdiction, numerous states, and various local and foreign jurisdictions. With limited exceptions, we are no longer subject to income tax examinations by taxing authorities for taxable years before 2009 in the case of United States federal and non-United States examinations and 2008 in the case of state and local examinations.

As of September 30, 2012 and 2011, the Company had \$4,254 and \$4,399, respectively, of liabilities recorded related to unrecognized tax benefits. Included in this liability for unrecognized tax benefits is an immaterial amount for interest and penalties, both of which we classify as a component of income tax expense. The Company does not anticipate its total unrecognized tax benefits will change significantly during the next 12 months.

## (5) Operating Leases

We lease certain pick-up trucks under operating leases. These leases have a non-cancellable lease term of one year, with renewal options for up to 72 months. The pick-up truck leases include an early buy out clause we generally exercise, thereby giving the leases an effective term of 28-36 months. Certain operating leases for vehicles contain residual value guarantee provisions which would become due at the expiration of the operating lease agreement if the fair value of the leased vehicles is less than the guaranteed residual value. The aggregate residual value guarantee related to these leases is approximately \$48,630. We believe the likelihood of funding the guarantee obligation under any provision of the operating lease agreements is remote, except for a \$256 loss on disposal reserve provided at September 30, 2012. Our fleet also contains vehicles we estimate will settle at a gain. Gains on these vehicles will be recognized when we sell or dispose of the vehicle or at the end of the lease term.

(Continued)

9





Table of Contents

FASTENAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except share and per share information and where otherwise noted)

September 30, 2012 and 2011

(Unaudited)

(6) Contingencies

In early February 2010, we received a letter from a California fastener supplier dated January 26, 2010. This letter threatened to sue us for an alleged violation of an exclusive distribution arrangement this supplier believes exists between our organizations. In addition to the letter, this supplier provided a press release and a video regarding the claim which they threatened to make public unless we agreed to mediation of the claim. Shortly after receipt of this letter, we performed a preliminary internal review to understand (1) who this supplier was and (2) the nature of our relationship with this supplier. Based on that review, we determined (1) this supplier manufactures a niche type of fastener and (2) the total volume of purchases by us, from all suppliers, over the purported term of the alleged exclusivity arrangement of this niche type of fastener did not exceed \$1 million. Following completion of our preliminary internal review, we requested additional information and documentation from the supplier. The supplier's response failed to provide the requested information and documentation. By letter dated February 26, 2010, we quantified for the supplier our total volume of purchases as discussed above and informed the supplier that we believed their claim was grossly exaggerated and completely unsupported. We have not received any direct response to our February 26, 2010 letter. On May 3, 2010, this supplier filed suit in Arkansas federal court alleging damages. In response, we filed a motion to dismiss. This motion to dismiss was denied on August 16, 2010. We subsequently filed two motions for summary judgment. The first summary judgment motion was partially denied.

On August 24, 2011, the court issued an order granting Fastenal's second motion for summary judgment in its entirety, the supplier appealed this order on September 8, 2011. On December 16, 2011, the court issued an order granting, in part, Fastenal's request to recover on its Bill of Costs and Petition for Attorney's Fees from this supplier, the supplier appealed this order on January 9, 2012. On August 21, 2012, the appeals court issued a ruling affirming the August 24, 2011 and December 16, 2011 orders. The appeals court filed a Mandate order on September 13, 2012 to effectively conclude these proceedings. While we are not required to disclose this matter under the rules of the Securities and Exchange Commission ('SEC'), we initially disclosed the existence of this threat in February 2010 (in our 2009 annual report on Form 10-K) as we believed our disclosure was prudent due to the alleged amount (\$180 million) of the claim and the threat to make these allegations public. The disclosure of these legal proceedings will be omitted from future filings.

(7) Subsequent Events

On October 10, 2012, our board of directors declared a dividend of \$0.21 per share. This dividend is discussed in footnote (3) 'Stockholders' Equity'.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of certain significant factors which have affected our financial position and operating results during the periods included in the accompanying consolidated financial statements. (Dollar amounts are stated in thousands except for per share amounts and where otherwise noted.)

**BUSINESS AND OPERATIONAL OVERVIEW:**

Fastenal is a North American leader in the wholesale distribution of industrial and construction supplies. We distribute these supplies through a network of approximately 2,600 company owned stores. Most of our customers are in the manufacturing and non-residential construction markets. The manufacturing market includes both original equipment manufacturers (OEM) and maintenance and repair operations (MRO). The non-residential construction market includes general, electrical, plumbing, sheet metal, and road contractors. Other users of our product include farmers, ranchers, truckers, railroads, mining companies, federal, state, and local governmental entities, schools, and certain retail trades. Geographically, our stores and customers are primarily located in North America.

In the past decade, we have experienced periods of inflation and deflation related to steel prices (this is meaningful to our business because approximately 50% of our sales consist of some type of fastener – nuts, bolts, screws, etc. – most of which are made of steel). In the period from 2003 to the fall of 2008, we experienced inflation in steel prices, this was most pronounced in 2008. In the fourth quarter of 2008, and throughout much of 2009, we experienced deflation in steel prices. When the swings are dramatic, this can hurt our gross margins because we are selling expensive inventory on the shelf at declining prices. This hurt our gross margins in 2009. The drop in energy costs (this is meaningful to our business because we are a store based distributor with a large trucking fleet) over the same period provided some relief, but it was small in comparison to the impact of the steel deflation. The deflation of 2009 ended and these conditions normalized and allowed our gross margins to recover into a more normal range beginning in 2010. (See later discussion on gross margins.)

Similar to previous quarters, we have included comments regarding several aspects of our business:

- (1) Monthly sales changes, sequential trends, and end market performance – a recap of our recent sales trends and some insight into the activities with different end markets.
- (2) Growth drivers of our business – a recap of how we grow our business.
- (3) Profit drivers of our business – a recap of how we increase our profits.
- (4) Statement of earnings information – a recap of the components of our income statement.
- (5) Operational working capital, balance sheet, and cash flow – a recap of the operational working capital utilized in our business, and the related cash flow.

While reading these items, it is helpful to appreciate several aspects of our marketplace: (1) it's big, the North American marketplace for industrial supplies is estimated to be in excess of \$160 billion per year (and we have expanded beyond North America), (2) no company has a significant portion of this market, (3) many of the products we sell are individually inexpensive, (4) when our customer needs something quickly or unexpectedly our local store is a quick source, and (5) the cost to manage and procure these products can be significant, and (6) the cost to move these products, many of which are bulky, can also be significant.

Our motto is Growth through Customer Service. This is important given the points noted above. We believe in efficient markets – to us, this means we can grow our market share if we provide the greatest value to the customer. We believe our ability to grow is amplified if we can service our customer at the closest economic point of contact.

The concept of growth is simple, find more customers every day and increase your activity with them. However, execution is hard work. First, we recruit service minded individuals to support our customers and their business. Second, we operate in a decentralized fashion to help identify the greatest value for our customers. Third, we build a great machine behind the store to operate efficiently and to help identify new business solutions. Fourth, we do these things every day. Finally, we strive to generate strong profits; these profits produce the cash flow necessary to fund the growth and to support the needs of our customers.



Table of Contents

## SALES GROWTH:

Net sales and growth rates in net sales were as follows:

	Nine-month period		Three-month period		
	2012	2011	2012	2011	
Net sales	\$2,376,342	2,069,055	\$802,577	726,742	
Percentage change	14.9	% 22.0	% 10.4	% 20.4	%

The increase in net sales in the first nine months of 2012 and 2011 came primarily from higher unit sales. Our growth in net sales was impacted by inflationary price changes in our products, but the impact was limited. Our growth in net sales was not meaningfully impacted by the introduction of new products or services, with one exception, our FAST Solutions<sup>SM</sup> (industrial vending) initiative did stimulate faster growth (discussed later in this document). The higher unit sales resulted primarily from increases in sales at older store locations (discussed below and again later in this document) and to a lesser degree the opening of new store locations in the last several years. The growth in net sales at the older store locations was due to the growth drivers of our business (discussed later in this document), and in the case of 2011, the moderating impacts of the recessionary environment. The change in currencies in foreign countries (primarily Canada) relative to the United States dollar lowered our daily sales growth rate by 0.3 % in the first nine months of 2012 and increased our daily sales growth rate by 0.9% in the first nine months of 2011. The change in currencies in foreign countries (primarily Canada) relative to the United States dollar lowered our daily sales growth rate by 0.2% in the third quarter of 2012 and increased our daily sales growth by 0.9% in the third quarter of 2011. Our sales growth of 10.4% in the third quarter of 2012 was impacted by the loss of one business day versus the prior year (63 days versus 64). Our sales growth adjusted to a daily basis was 12.2% in the third quarter of 2012; the calendar change also impacted the sales by store age table below.

The stores opened greater than two years represent a consistent 'same store' view of our business (store sites opened as follows: 2012 group – opened 2010 and earlier, and 2011 group – opened 2009 and earlier). However, the impact of the economy is best reflected in the growth performance of our stores opened greater than five years (store sites opened as follows: 2012 group – opened 2007 and earlier, and 2011 group – opened 2006 and earlier) and opened greater than ten years (store sites opened as follows: 2012 group – opened 2002 and earlier, and 2011 group – opened 2001 and earlier). These two groups of stores are more cyclical due to the increased market share they enjoy in their local markets. The daily sales change for each of these groups was as follows:

Store Age	Nine-month period		Three-month period		
	2012	2011	2012	2011	
Opened greater than 2 years	12.6	% 18.0	% 9.0	% 16.8	%
Opened greater than 5 years	11.6	% 17.2	% 8.1	% 15.6	%
Opened greater than 10 years	9.9	% 14.9	% 6.6	% 13.2	%

Note: The age groups above are measured as of the last day of each respective calendar year.

## SALES BY PRODUCT LINE:

The mix of sales from the original fastener product line and from the other product lines was as follows:

	Nine-month period		Three-month period		
	2012	2011	2012	2011	
Fastener product line	44.4	% 47.3	% 43.5	% 46.5	%
Other product lines	55.6	% 52.7	% 56.5	% 53.5	%
	100.0	% 100.0	% 100.0	% 100.0	%



Table of Contents

## MONTHLY SALES CHANGES, SEQUENTIAL TRENDS, AND END MARKET PERFORMANCE

Note – Daily sales are defined as the sales for the period divided by the number of business days (in the United States) in the period.

This section focuses on three distinct views of our business – monthly sales changes, sequential trends, and end market performance. The first discussion regarding monthly sales changes provides a good mechanical view of our business based on the age of our stores. The second discussion provides a framework for understanding the sequential trends (that is, comparing a period to the immediately preceding period) in our business. Finally, we believe the third discussion regarding end market performance provides insight into activities with our various types of customers.

## MONTHLY SALES CHANGES:

All company sales – During the months in 2012, 2011, and 2010, all of our selling locations, when combined, had daily sales growth rates of (compared to the comparable month in the preceding year):

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
2012	21.3	%20.0	%19.3	%17.3	%13.1	%14.0	%12.1	%12.0	%12.9	%		
2011	18.8	%21.5	%22.8	%23.2	%22.6	%22.5	%22.4	%20.0	%18.8	%21.4	%22.2	%21.2
2010	2.4	%4.4	%12.1	%18.6	%21.1	%21.1	%24.4	%22.1	%23.5	%22.4	%17.9	%20.9

The growth in the first three months of 2012 generally continued the relative strength we saw in 2011 and in most of 2010. The April to June 2012 time frame experienced a reduction in our daily sales growth rate as the market we sell into slowed (see further discussion in sequential trends and end market performance). This slow down continued into the July to September 2012 time frame. The change in currencies in foreign countries (primarily Canada) relative to the United States dollar lowered our daily sales growth rate by 0.3% during the first nine months of 2012 (this lowered growth in the first, second, and third quarters was 0.1%, 0.4%, and 0.2% respectively). This was a sharp contrast to 2011 and 2010, when changes in foreign currencies increased our growth in the first nine months by 0.9% and 0.3%, respectively.

Stores opened greater than two years – Our stores opened greater than two years (store sites opened as follows: 2012 group – opened 2010 and earlier, 2011 group – opened 2009 and earlier, and 2010 group – opened 2008 and earlier) represent a consistent 'same-store' view of our business. During the months in 2012, 2011, and 2010, the stores opened greater than two years had daily sales growth rates of (compared to the comparable month in the preceding year):

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
2012	18.8	%17.1	%16.8	%14.5	%10.1	%11.1	%9.1	%8.6	%9.8	%		
2011	16.0	%18.4	%19.4	%19.6	%19.2	%19.1	%18.7	%16.5	%15.2	%18.0	%18.5	%17.5
2010	0.6	%2.3	%9.6	%16.3	%18.5	%18.3	%21.3	%19.2	%19.8	%18.8	%14.1	%16.8

Stores opened greater than five years – The impact of the economy, over time, is best reflected in the growth performance of our stores opened greater than five years (store sites opened as follows: 2012 group – opened 2007 and earlier, 2011 group – opened 2006 and earlier, and 2010 group – opened 2005 and earlier). This group is more cyclical due to the increased market share they enjoy in their local markets. During the months in 2012, 2011, and 2010, the stores opened greater than five years had daily sales growth rates of (compared to the comparable month in the preceding year):

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
2012	17.4	%15.8	%15.7	%13.7	%9.0	%10.2	%8.3	%7.9	%8.5	%		
2011	15.3	%17.9	%19.2	%19.1	%17.9	%18.2	%17.3	%15.2	%14.5	%17.0	%17.4	%16.9
2010	-2.1	%-0.5	%7.4	%14.9	%17.3	%16.2	%19.8	%18.2	%18.9	%17.9	%13.2	%16.0

Table of Contents

## SEQUENTIAL TRENDS:

We find it helpful to think about the monthly sequential changes in our business using the analogy of climbing a stairway – This stairway has several predictable landings where there is a pause in the sequential gain (i.e. April, July, and October to December), but generally speaking, climbs from January to October. The October landing then establishes the benchmark for the start of the next year.

History has identified these landings in our business cycle. They generally relate to months with impaired business days (certain holidays). The first landing centers on Easter, which alternates between March and April (Easter occurred in April in 2012, 2011, and 2010), the second landing centers on July 4th, and the third landing centers on the approach of winter with its seasonal impact on primarily our construction business and with the Christmas / New Year holidays. The holidays we noted impact the trends because they either move from month-to-month or because they move around during the week.

The table below shows the pattern to our sequential change in our daily sales. The line labeled 'Past' is an historical average of our sequential daily sales change for the period 1998 to 2003. We chose this time frame because it had similar characteristics, a weaker industrial economy in North America, and could serve as a benchmark for a possible trend line. The '2012', '2011', and '2010' lines represent our actual sequential daily sales changes. The '12Delta', '11Delta', and '10Delta' lines indicate the difference between the 'Past' and the actual results in the respective year.

	Jan.(1)	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Cumulative change from Jan. to Sept.	
Past	0.9	%3.3	%2.9	%-0.3	%3.4	%2.8	%-2.3	%2.6	%2.6	%-0.7	%15.9	%
2012	-0.3	%0.5	%6.4	%-0.8	%0.5	%2.5	%-2.7	%1.3	%4.3	%	12.5	%
12Delta	-1.2	%-2.8	%3.5	%-0.5	%-2.9	%-0.3	%-0.4	%-1.3	%1.7	%	-3.4	%
2011	-0.2	%1.6	%7.0	%0.9	%4.3	%1.7	%-1.0	%1.4	%3.4	%0.7	%20.8	%
11Delta	-1.1	%-1.7	%4.1	%1.2	%0.9	%-1.1	%1.3	%-1.2	%0.8	%1.4	%4.9	%
2010	2.9	%-0.7	%5.9	%0.6	%4.8	%1.7	%-1.0	%3.5	%4.5	%-1.5	%20.8	%
10Delta	2.0	%-4.0	%3.0	%0.9	%1.4	%-1.1	%1.3	%0.9	%1.9	%-0.8	%4.9	%

(1) The January figures represent the percentage change from the previous October, whereas the remaining figures represent the percentage change from the previous month.

A graph of the sequential daily sales change pattern discussed above, starting with a base of '100' in the previous October and ending with the next October, would be as follows:

Table of Contents

Several observations stand out while viewing the 2012 sequential pattern: (1) The direction of the historical sequential pattern (increased daily sales on a sequential basis in February, March, May, June, August, and September and decreased daily sales on a sequential basis in April and July) has played out each month; however, the cumulative growth in the daily sales from January to September has fallen short of the benchmark figure and of the actual results in 2011 and 2010. (2) The magnitude of the February and May '12Delta' of approximately -2.8% was similar. This fact, as well as the choppiness of the year in general, has caused us to approach the year with a conservative tone. (3) The weakness in the first eight months of 2012 was amplified by changes in foreign currencies (primarily Canada) relative to the U.S. dollar.

**END MARKET PERFORMANCE:**

Fluctuations in end market business – The sequential trends noted above were directly linked to fluctuations in our end markets. To place this in perspective – approximately 50% of our business has historically been with customers engaged in some type of manufacturing. The daily sales to these customers grew in the first, second, third, and fourth quarters (when compared to the same quarter in the previous year), and for the year, as follows:

	Q1		Q2		Q3		Q4		Annual
2012	20.3	%	15.8	%	14.0	%			
2011	15.5	%	18.5	%	18.3	%	21.0	%	20.0
2010	15.7	%	29.8	%	30.6	%	17.7	%	22.4

Our manufacturing business consists of two subsets: the industrial production business (this is business where we supply products that become part of the finished goods produced by our customers) and the maintenance portion (this is business where we supply products that maintain the facility or the equipment of our customers engaged in manufacturing). The industrial business is more fastener centered, while the maintenance portion is represented by all product categories.

In the second and third quarters of 2012, the decrease in the rate of growth was more pronounced in our industrial production business. This is in sharp contrast to the first quarter of 2012 where the growth was more pronounced in the industrial production business, a trend that had also existed in 2011 and 2010. The first quarter and prior quarters were a direct counter to the 2009 contraction, which was more severe in our industrial production business and less severe in the maintenance portion of our manufacturing business.

The best way to understand the change in our industrial production business is to examine the results in our fastener product line. In the first three months of 2012, the daily sales growth in our fastener product line was approximately 15.4%. This dropped to 10.5%, 6.1%, and 8.6% in April, May, and June, respectively, and averaged 6.0% in the third quarter. By contrast, the best way to understand the change in the maintenance portion of the manufacturing business is to examine the results in our non-fastener product lines. In the first three months of 2012, the daily sales growth in our non-fastener business was approximately 25.1%. This dropped to 24.4%, 19.0%, and 19.6% in April, May, and June, respectively, and averaged 18.0% in the third quarter.

The patterns related to the industrial production business, as noted above, are influenced by the movements noted in the Purchasing Manufacturers Index ('PMI') published by the Institute for Supply Management (<http://www.ism.ws/>), which is a composite index of economic activity in the manufacturing sector. The PMI in 2012, 2011, and 2010 was as follows:

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
2012	54.1	52.4	53.4	54.8	53.5	49.7	49.8	49.6	51.5			
2011	59.9	59.8	59.7	59.7	54.2	55.8	51.4	52.5	52.5	51.8	52.2	53.1
2010	56.7	55.8	59.3	59.0	58.8	56.0	55.7	57.4	56.4	57.0	58.0	57.3

Our non-residential construction customers have historically represented 20% to 25% of our business. The daily sales to these customers grew or contracted in the first, second, third, and fourth quarters (when compared to the same quarter in the previous year), and for the year, as follows:

	Q1		Q2		Q3		Q4		Annual
2012	17.1	%	12.7	%	8.2	%			
2011	17.7	%	15.8	%	15.8	%	17.4	%	17.1
2010	-14.7	%	0.5	%	6.3	%	10.3	%	-0.3





Table of Contents

A graph of the sequential daily sales trends to these two end markets in 2012, 2011, and 2010, starting with a base of '100' in the previous October and ending with the next October, would be as follows:

Manufacturing

Non-Residential Construction

16

---

Table of Contents**GROWTH DRIVERS OF OUR BUSINESS**

We grow by continuously adding customers and by increasing the activity with each customer. We believe this growth is enhanced by our close proximity to our customers, which allows us to provide a range of services and product availability that our competitors can't easily match. Historically, we expanded our reach by opening stores at a very fast pace. These openings were initially in the United States, but expanded beyond the United States beginning in the mid 1990's.

In our first ten years of being public (1987 to 1997), we opened stores at a rate approaching 30% per year. In the next ten years, we opened stores at an annual rate of approximately 10% to 15% and, over the last five years, at a rate of approximately 3% to 8% (we currently expect approximately 85 stores in 2012, or approximately 3.3%). As we gained proximity to more customers, we continued to diversify our growth drivers – this was done to provide existing store personnel with more tools to grow their business organically – the results of this are reflected in our earlier discussion on sales growth at stores opened greater than five years. In the early 1990's, we began to expand our product lines, and we added new product knowledge to our bench. This was our first big effort to diversify our growth drivers. The next step began in the mid to late 1990's when we began to add sales personnel with certain specialties or focus. This began with our National Accounts group in 1995, and, over time, has expanded to include individuals dedicated to: (1) sales related to our internal manufacturing division, (2) government sales, (3) internet sales, (4) specific products (most recently metal working), and (5) FAST Solutions<sup>SM</sup> (industrial vending). Another step occurred at our sales locations (this includes Fastenal stores as well as strategic account stores and in-plant locations) and at our distribution centers, and began with a targeted merchandising and inventory placement strategy that included our 'Customer Service Project' approximately ten years ago and our 'Master Stocking Hub' initiative approximately five years ago. This strategy allowed us to better target where to stock certain products (local store, regional distribution center, master stocking hub, or supplier) and allowed us to improve our fulfillment and our ability to serve a broader range of customers.

Our FAST Solutions<sup>SM</sup> (industrial vending) operation is a rapidly expanding component of our business. We believe industrial vending is the next logical chapter in the Fastenal story, we also believe it has the potential to be transformative to industrial distribution, and that we have a 'first mover' advantage. We are investing aggressively to maximize this advantage. At our investor day in May 2011, we discussed our progress with industrial vending. In addition to our discussion regarding progress, we discussed our goals with the rollout of the industrial vending machines. One of the goals we identified related to our rate of 'machine signings' (the first category below) – our goal was simple, sign 2,500+ machines per quarter (or an annualized run rate of 10,000 machines). In 2012, we hit our annual goal of 10,000 machines during July, and the momentum has continued as we finished the third quarter. We intend to continue our aggressive push with industrial vending in 2013 and, to this end, expect to open approximately 50 - 100 stores in 2013, or an annual rate of new store openings of 2% to 4%. In addition, during 2012 we developed plans to (1) reinvigorate our fastener growth and to (2) improve the performance (growth) at under performing locations.

The following table includes some statistics regarding our industrial vending business:

		Q1	Q2	Q3	Q4		
Number of vending machines in contracts signed during the period <sup>1</sup>	2012	4,568	4,669	5,334			
	2011	1,405	2,107	2,246	2,084		
	2010	257	420	440	792		
Cumulative machines installed <sup>2</sup>	2012	9,798	13,036	17,013			
	2011	2,659	3,867	5,642	7,453		
	2010	892	1,184	1,515	1,925		
Percent of total net sales to customers with vending machines <sup>3</sup>	2012	17.8	% 20.8	% 23.2	%		
	2011	8.9	% 10.5	% 13.1	% 15.7	%	
	2010	3.4	% 4.6	% 6.1	% 7.5	%	
Daily sales growth to customers with vending machines <sup>4</sup>	2012	33.9	% 34.3	% 32.9	%		
	2011	50.6	% 43.9	% 42.5	% 40.7	%	
	2010	37.4	% 54.0	% 56.4	% 60.2	%	

Edgar Filing: FASTENAL CO - Form 10-Q

- <sup>1</sup> This represents the gross number of machines signed during the quarter, not the number of contracts.
- <sup>2</sup> This represents the number of machines installed and dispensing product on the last day of the quarter.
- <sup>3</sup> The percentage of total sales (vended and traditional) to customers currently using a vending solution.
- <sup>4</sup> The growth in total sales (vended and traditional) to customers currently using a vending solution compared to the

17

---

Table of Contents

comparable period in the preceding year.

We are pleased with the increases in the number of vending machine contracts signed, and with our ability to install machines. We increased our installed machine base by 3,977 machines (17,013 versus 13,036) in the third quarter of 2012, by 1,775 machines (5,642 versus 3,867) in the third quarter of 2011, and by 331 machines (1,515 versus 1,184) in the third quarter of 2010.

**PROFIT DRIVERS OF OUR BUSINESS**

We grow our profits by continuously working to grow sales and to improve our relative profitability. We also grow our profits by allowing our inherent profitability to shine through – we refer to this as the 'pathway to profit'. The distinction is important.

We achieve improvements in our relative profitability by increasing our gross margin, by structurally lowering our operating expenses, or both. We advance on the 'pathway to profit' by increasing the average store size (measured in terms of monthly sales), and by allowing the changing store mix to improve our profits. This is best explained by comparing the varying profitability of our 'traditional' stores in the table below. The average store size for the group, and the average age, number of stores, and pre-tax earnings data by store size for the third quarter of 2012, 2011, and 2010, respectively, were as follows:

Sales per Month	Average Age (Years)	Number of Stores	Percentage of Stores	Pre-Tax Earnings Percentage	
Three months ended September 30, 2012				Average store sales =	
				\$88,337	
\$0 to \$30,000	4.2	252	9.5	% -14.2	%
\$30,001 to \$60,000	7.3	795	30.0	% 12.7	%
\$60,001 to \$100,000	10.0	767	28.9	% 22.2	%
\$100,001 to \$150,000	12.0	420	15.8	% 25.7	%
Over \$150,000	15.1	305	11.5	% 29.4	%
Strategic Account/Overseas Store		111	4.2	%	
Company Total		2,650	100.0	% 21.9	%
Three months ended September 30, 2011				Average store sales =	
				\$82,724	
\$0 to \$30,000	3.5	319	12.4	% -12.6	%
\$30,001 to \$60,000	7.0	816	31.8	% 13.3	%
\$60,001 to \$100,000	9.4	712	27.7	% 22.4	%
\$100,001 to \$150,000	11.7	375	14.6	% 26.5	%
Over \$150,000	14.9	257	10.0	% 28.5	%
Strategic Account/Overseas Store		87	3.4	%	
Company Total		2,566	100.0	% 21.4	%
Three months ended September 30, 2010				Average store sales =	
				\$71,603	
\$0 to \$30,000	3.8	414	16.9	% -11.0	%
\$30,001 to \$60,000	6.8	893	36.4	% 13.2	%
\$60,001 to \$100,000	9.4	590	24.1	% 22.7	%
\$100,001 to \$150,000	11.8	322	13.1	% 26.0	%
Over \$150,000	15.6	163	6.6	% 27.7	%
Strategic Account/Overseas Store		71	2.9	%	
Company Total		2,453	100.0	% 20.0	%

Note – Amounts may not foot due to rounding difference.

When we originally announced the 'pathway to profit' strategy in 2007, our goal was to increase our pre-tax earnings, as a percentage of sales, from 18% to 23%. This goal was to be accomplished by slowly moving the mix from the first three categories (\$0 to \$30,000, \$30,001 to \$60,000, and \$60,001 to \$100,000, these groups represented 76.5% of our store base in the first three months of 2007, the last quarter before we announced the 'pathway to profit') to the last three categories (\$60,001 to \$100,000, \$100,001 to \$150,000, and over \$150,000, these groups represented 56.3% of our store base in the third quarter of 2012) and by increasing the average store sales to approximately \$125,000 per month. The weak economic environment in

Table of Contents

2009 caused our average store size to decrease, and consequently lowered our level of profitability; however, subsequent to this period we improved our gross margin and structurally lowered our operating expenses. This improvement allowed us to amplify the 'pathway to profit' and effectively lowered the average store size required to hit our 23% goal. Today we believe we can accomplish our 'pathway to profit' goal with an average store size of approximately \$100,000 to \$110,000 per month.

Note – Dollar amounts in this section are presented in whole dollars, not thousands.

Store Count and Full-Time Equivalent (FTE) Headcount – The table that follows highlights certain impacts on our business of the 'pathway to profit' since its introduction in 2007. Under the 'pathway to profit' we increased both our store count and our store FTE headcount during 2007 and 2008. However, the rate of increase in store locations slowed and our FTE headcount for all types of personnel was reduced when the economy weakened late in 2008. In the table that follows, we refer to our 'store' net sales, locations, and personnel. When we discuss 'store' net sales, locations, and personnel, we are referring to (1) 'Fastenal' stores and (2) strategic account stores. 'Fastenal' stores are either a 'traditional' store, the typical format in the United States or Canada, or an 'overseas' store, which is the typical format outside the United States and Canada. This is discussed in greater detail in our 2011 annual report on Form 10-K. Strategic account stores are stores that are focused on selling to a group of large customers in a limited geographic market. The sales, outside of our 'store' group, relate to either (1) our in-plant locations, (2) the portion of our internally manufactured product that is sold directly to a customer and not through a store (including our Holo-Krome business acquired in December 2009), or (3) our direct import business.

The breakdown of our sales, the average monthly sales per store, the number of stores at quarter end, the average headcount at our stores during a quarter, the average FTE headcount during a quarter, and the percentage change were as follows for the first quarter of 2007 (the last completed quarter before we began the 'pathway to profit'), for the third quarter of 2008 (our peak quarter before the economy weakened), and for each of the last five quarters:

	Q1 2007	Q3 2008	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	
Total net sales reported	\$489,157	\$625,037	\$726,742	\$697,804	\$768,875	\$804,890	\$802,577	
Less: Non-store sales (approximate)	40,891	57,267	88,500	86,737	92,459	98,735	100,124	
Store net sales (approximate)	\$448,266	\$567,770	\$638,242	\$611,067	\$676,416	\$706,155	\$702,453	
% change since Q1 2007		26.7	% 42.4	% 36.3	% 50.9	% 57.5	% 56.7	%
% change (twelve months)		17.5	% 21.1	% 21.0	% 20.2	% 14.6	% 10.1	%
Percentage of sales through a store	92	% 91	% 88	% 88	% 88	% 88	% 88	%
Average monthly sales per store (using ending store count)	\$72	\$82	\$83	\$79	\$86	\$89	\$88	
% change since Q1 2007		13.9	% 15.3	% 9.7	% 19.4	% 23.6	% 22.2	%
% change (twelve months)		9.3	% 15.3	% 16.2	% 16.2	% 11.3	% 6.0	%

Edgar Filing: FASTENAL CO - Form 10-Q

Table of Contents

	Q1 2007	Q3 2008	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	
Store locations - quarter end count	2,073	2,300	2,566	2,585	2,611	2,635	2,650	
% change since Q1 2007		11.0	% 23.8	% 24.7	% 26.0	% 27.1	% 27.8	%
% change (twelve months)		7.2	% 4.6	% 3.8	% 3.5	% 3.0	% 3.3	%
Store personnel - absolute headcount	6,849	9,123	10,057	10,328	10,486	10,637	10,604	
% change since Q1 2007		33.2	% 46.8	% 50.8	% 53.1	% 55.3	% 54.8	%
% change (twelve months)		17.9	% 16.4	% 14.1	% 12.2	% 9.3	% 5.4	%
Store personnel - FTE	6,383	8,280	8,629	8,684	8,900	9,126	9,244	
Non-store selling personnel - FTE	616	599	920	953	998	1,054	1,066	
Sub-total of all sales personnel - FTE	6,999	8,879	9,549	9,637	9,898	10,180	10,310	
Distribution personnel-FTE	1,646	1,904	1,830	1,820	1,815	1,881	1,887	
Manufacturing personnel - FTE <sup>1</sup>	316	340	513	516	527	545	544	
Administrative personnel-FTE	767	805	811	796	796	794	808	
Sub-total of non-sales personnel - FTE	2,729	3,049	3,154	3,132	3,138	3,220	3,239	
Total - average FTE headcount	9,728	11,928	12,703	12,769	13,036	13,400	13,549	
% change since Q1 2007								
Store personnel - FTE		29.7	% 35.2	% 36.0	% 39.4	% 43.0	% 44.8	%
Non-store selling personnel - FTE		-2.8	% 49.4	% 54.7	% 62.0	% 71.1	% 73.1	%
Sub-total of all sales personnel - FTE		26.9	% 36.4	% 37.7	% 41.4	% 45.4	% 47.3	%
Distribution personnel-FTE		15.7	% 11.2	% 10.6	% 10.3	% 14.3	% 14.6	%
Manufacturing personnel-FTE <sup>1</sup>		7.6	% 62.3	% 63.3	% 66.8	% 72.5	% 72.2	%
Administrative personnel-FTE		5.0	% 5.7	% 3.8	% 3.8	% 3.5	% 5.3	%
Sub-total of non-sales personnel - FTE		11.7	% 15.6	% 14.8	% 15.0	% 18.0	% 18.7	%
Total - average FTE headcount		22.6	% 30.6	% 31.3	% 34.0	% 37.7	% 39.3	%
% change (twelve months)								
Store personnel - FTE		15.2	% 15.8	% 14.1	% 13.7	% 10.6	% 7.1	%
Non-store selling personnel - FTE		-2.4	% 44.0	% 33.8	% 28.1	% 24.0	% 15.9	%
Sub-total of all sales personnel - FTE		13.8	% 18.0	% 15.8	% 15.0	% 11.8	% 8.0	%



Edgar Filing: FASTENAL CO - Form 10-Q

Distribution personnel-FTE	6.0	% 16.1	% 14.1	% 12.9	% 7.1	% 3.1	%
Manufacturing personnel - FTE <sup>1</sup>	1.8	% 19.0	% 16.2	% 14.3	% 10.8	% 6.0	%
Administrative personnel - FTE	7.9	% 11.7	% 7.0	% 4.7	% 1.4	% -0.4	%
Sub-total of non-sales personnel - FTE	6.0	% 15.4	% 12.5	% 10.9	% 6.2	% 2.7	%
Total - average FTE headcount	11.7	% 17.4	% 15.0	% 14.0	% 10.4	% 6.7	%

<sup>1</sup> The distribution and manufacturing headcount was impacted by the addition of 92 employees with the acquisition of Holo-Krome in December 2009.

Table of Contents

STATEMENT OF EARNINGS INFORMATION (percentage of net sales) for the periods ended September 30:

	Nine-month period		Three-month period		
	2012	2011	2012	2011	
Net sales	100.0	% 100.0	% 100.0	% 100.0	%
Gross profit	51.5	% 52.1	% 51.6	% 51.9	%
Operating and administrative expenses	29.8	% 31.1	% 29.8	% 30.6	%
(Gain) loss on sale of property and equipment	0.0	% 0.0	% 0.0	% 0.0	%
Operating income	21.7	% 21.0	% 21.9	% 21.4	%
Interest income	0.0	% 0.0	% 0.0	% 0.0	%
Earnings before income taxes	21.7	% 21.0	% 21.9	% 21.4	%

Note – Amounts may not foot due to rounding difference.

Gross profit – percentage for the first nine months of 2012 decreased from the same period in 2011. Sequentially, the gross profit percentage was unchanged from the second quarter of 2012.

The gross profit percentage in the first, second, third, and fourth quarters was as follows:

	Q1	Q2	Q3	Q4	
2012	51.3	% 51.6	% 51.6	%	
2011	52.0	% 52.2	% 51.9	% 51.2	%
2010	51.1	% 52.1	% 51.8	% 52.0	%

The fluctuations in our gross profit percentages are typically driven by changes in: (1) transactional gross profit, (2) organizational gross profit, and (3) vendor incentive gross profit. The transactional gross profit represents the gross profit realized from the day-to-day fluctuations in customer pricing relative to product and freight costs. The organizational gross profit represents the component of gross profit we attribute to buying scale and efficiency gains. The third component relates to vendor volume allowances. In the short-term, periods of inflation or deflation can influence the first two categories, while sudden changes in business volume can influence the third.

We believe a normal gross profit percentage range for our business is 51% to 53%. This is based on our current mix of products, geographies, end markets, and end market uses (such as industrial production business versus maintenance business). Our business operated below our expected gross profit range at the end of 2009, and expanded into the low end of this range during 2010. In the second quarter of 2010, we moved into the middle of the range as the three components of gross profit improved, the contribution being split fairly evenly between the three components. We remained in the middle of the range until the fourth quarter of 2011. In the fourth quarter of 2011, our gross margin felt pressure and dropped to the lower end of the range. This drop was primarily due to changes in our transactional margin (primarily due to changes in product and customer mix), lower vendor incentive gross profit, and lower freight utilization. The latter two items created half of the gross margin drop and are more of a seasonal issue. In the first quarter of 2012, our gross margin improved nominally over the previous quarter. This was primarily caused by the seasonal improvement of vendor volume allowances as rising fuel prices offset our improvements in freight utilization. In the second and third quarters of 2012, our gross margin improved sequentially when compared to the first quarter. Most of this improvement related to improvements in our transactional gross margin. The improvement was partially offset by the weakening of our selling prices in certain foreign markets due to changes in the exchange rate.

Operating and administrative expenses - improved relative to sales in the first nine months and the third quarter of 2012 versus the same periods in 2011.

Historically, our two largest components to operating and administrative expenses have consisted of employee related expenses (approximately 65% to 70%) and occupancy related expenses (approximately 15% to 20%). The remaining expenses cover a variety of items with selling transportation typically being the largest.

Table of Contents

The three largest components of operating and administrative expenses grew as follows for the periods ended September 30 (compared to the comparable periods in the preceding year):

	Nine-month period			Three-month period		
	2012	2011		2012	2011	
Employee related expenses	10.7	% 21.3	%	6.7	% 16.7	%
Occupancy related expenses	3.6	% 7.7	%	4.4	% 8.2	%
Selling transportation costs	11.3	% 23.7	%	6.8	% 32.4	%

Employee related expenses include: (1) payroll (which includes cash compensation, stock option expense, and profit sharing), (2) health care, (3) personnel development, and (4) social taxes. The increase in the first nine months of 2012 was driven by the following factors: (1) employee headcount, measured on a full-time equivalent basis, grew 6.7%, (2) sales commissions grew, (3) bonus amounts related to our growth drivers grew (this includes items such as industrial vending bonuses and manager minimum pay adjustments), and (4) our profit sharing contribution grew. The increase in the first nine months of 2011 was driven by the following factors: (1) employee headcount, measured on a full-time equivalent basis, grew 17.4%, (2) sales commissions grew (this increase was amplified by stronger sales growth, relative to 2010, which had a meaningful impact on the commission earned and higher gross profit margins), (3) total bonuses earned increased due to our profit growth, (4) hours worked per employee grew, and (5) our profit sharing contribution grew.

Occupancy related expenses include: (1) building rent and depreciation, (2) building utility costs, (3) equipment related to our stores and distribution locations, and (4) FAST Solutions<sup>SM</sup> (industrial vending) equipment (we consider the vending equipment to be a logical extension of our store operation and classify the expense as occupancy). The increase in the first nine months of 2012 was driven by (1) a dramatic increase in the amount of FAST Solutions<sup>SM</sup> (industrial vending) equipment as discussed earlier in this document, (2) an increase in the number of locations, and (3) increased investment in our distribution infrastructure over the last several years. This increase was partially offset by an absolute drop in the utilities expense due to a drop in natural gas prices during the heating season, a mild winter, and our efforts to lower our energy consumption. The increase in the first nine months of 2011 was driven by the same factors noted above with one exception; in 2011 approximately 50% of the increase was due to rising utility costs.

Our selling transportation costs consist primarily of our store fleet as most of the distribution fleet costs are included in the cost of sales. Selling transportation costs included in operating and administrative expenses increased in the first nine months of 2012; however, that component of the selling transportation costs increased at a rate less than sales growth. The increase in the first nine months of 2012 and 2011 was primarily related to the increase in per gallon fuel costs discussed below and the expansion of our fleet related to additions to our non-store sales personnel, particularly FAST Solutions<sup>SM</sup> (industrial vending) vehicles. The increase in the third quarter of 2012 dropped because the per gallon fuel costs remained consistent with the prior year and the number of our industrial vending vehicles had normalized to the prior year; therefore, the increases related primarily to sales activity. Conversely, the increase in the third quarter of 2011 was driven by the dramatic increase in per gallon fuel costs and the ramp up in the number of industrial vending vehicles.

Table of Contents

The last several years have seen meaningful swings in the cost of diesel fuel and gasoline – During the first, second, and third quarters of 2012, our total vehicle fuel costs were approximately \$10.6, \$10.8, and \$10.8 million, respectively. During the first, second, third, and fourth quarters of 2011, our total vehicle fuel costs were approximately \$8.6, \$10.5, \$9.8, and \$9.8 million, respectively. The changes resulted from variations in fuel costs, variations in the service levels provided to our stores from our distribution centers, changes in the number of vehicles at our store locations, and changes in the number of other sales centered vehicles as a result of store openings and the expansion of our non-store sales force. These fuel costs include the fuel utilized in our distribution vehicles (semi-tractors, straight trucks, and sprinter trucks) which is recorded in cost of sales and the fuel utilized in our store delivery and other sales centered vehicles which is included in operating and administrative expenses (the split in the last several years has been approximately 50:50 between distribution and store and other sales centered use). The average per gallon fuel costs (in actual dollars) and the percentage change (on a year-over-year basis) for the last three years was as follows:

Per gallon average price	Q1	Q2	Q3	Q4	Annual Average <sup>1</sup>	
2012 price						
Diesel fuel	\$3.92	3.98	3.88			
Gasoline	\$3.53	3.73	3.61			
2011 price						
Diesel fuel	\$3.60	4.04	3.90	3.87	3.85	
Gasoline	\$3.22	3.78	3.62	3.37	3.50	
2010 price						
Diesel fuel	\$2.89	3.06	2.96	3.14	3.01	
Gasoline	\$2.68	2.80	2.71	2.84	2.76	
Per gallon price change	Q1	Q2	Q3	Q4	Annual <sup>1</sup>	
2012 change						
Diesel fuel	8.9	%-1.5	%-0.5	%		
Gasoline	9.6	%-1.3	%-0.3	%		
2011 change						
Diesel fuel	24.6	%32.0	%31.8	%23.2	%27.9	%
Gasoline	20.1	%35.0	%33.6	%18.7	%26.8	%

<sup>1</sup> Average of the four quarterly figures contained in the table.

Income taxes – Incomes taxes, as a percentage of earnings before income taxes, were approximately 37.6% and 37.7% for the first nine months of 2012 and 2011, respectively. As our international business and profits grow over time, the lower income tax rates in those jurisdictions, relative to the United States, have begun to lower our effective tax rate.

Table of Contents**OPERATIONAL WORKING CAPITAL:**

The year-over-year comparison and the related dollar and percentage changes related to accounts receivable and inventories were as follows:

	Balance at September 30:			Twelve Month Dollar Change		Twelve Month Percentage Change			
	2012	2011	2010	2012	2011	2012	2011		
Accounts receivable, net	\$411,033	361,075	301,721	49,958	59,354	13.8	% 19.7	%	
Inventories	\$675,828	618,149	546,063	57,679	72,086	9.3	% 13.2	%	
Operational working capital <sup>1</sup>	\$1,086,861	979,224	847,784	107,637	131,440	11.0	% 15.5	%	
Sales in last two months	\$540,782	504,398	413,053	36,384	91,345	7.2	% 22.1	%	

The growth in accounts receivable noted above was driven by our sales growth in the final two months of the period. The strong growth in recent years with our international business and with large customer accounts has created some difficulty with managing the growth of accounts receivable relative to the growth in sales. This was exaggerated by the short month in September 2012 versus 2011 (19 business days versus 21 days). Our sales growth, for the two-month period, as indicated above is 7.2%; however, our daily sales growth in this period was 12.5%.

Our growth in inventory balances over time does not have as direct a relationship to our monthly sales patterns as does our growth in accounts receivable. This is impacted by other aspects of our business. For example, the dramatic economic slowdown in late 2008 and early 2009 caused our inventory to spike. This occurred because the lead time for inventory procurement is typically longer than the visibility we have into future monthly sales patterns. Over the last decade, we increased our relative inventory levels due to the following: (1) new store openings, (2) expanded stocking breadth at individual stores, (3) expanded stocking breadth at our distributions centers (for example, our master stocking hub in Indianapolis expanded its product breadth over six fold from 2005 to 2011), (4) expanded direct sourcing, (5) expanded exclusive brands (private label), and (6) expanded industrial vending solutions. Items (4), (5), and (6), plus the impact of strong growth with national accounts and international expansion, created most of our inventory growth in the first nine months of both 2012 and 2011.

<sup>1</sup> For purposes of this discussion, we are defining operational working capital as accounts receivable, net and inventory.

**BALANCE SHEET AND CASH FLOW:**

Our balance sheet continues to be very strong and our operations have good cash generating characteristics. During the third quarter of 2012, we generated \$98,665 (or 90.3% of net earnings) of operating cash flow; year-to-date, we generated \$289,096 (or 89.8% of net earnings) of operating cash flow. Our first quarter typically has stronger cash flow characteristics due to the timing of tax payments; this benefit reverses itself in the second, third, and fourth quarters as income tax payments go out in April, June, September, and December. The remaining amounts of cash flow from operating activities are largely linked to the pure dynamics of a distribution business and its strong correlation to working capital as discussed above.

The strong free cash flow (operating cash flow less net capital expenditures) during 2011 and 2012 allowed us to increase our dividend in 2012. We paid our regular semi-annual dividend in the first quarter of 2011; subsequent to this, we declared and paid our 'first' second quarter dividend. With this payment, our board of directors indicated their desire to begin paying quarterly dividends. Our dividends (per share basis) were as follows in 2012 and 2011:

	2012	2011
First quarter	\$0.17	0.25
Second quarter	\$0.17	0.13
Third quarter	\$0.19	0.13
Fourth quarter*	\$0.21	0.14
Total	\$0.74	0.65

\*The fourth quarter dividend was declared on October 10, 2012, and is payable on November 26, 2012 to shareholders of record at the close of business on October 29, 2012.



Table of Contents

## STOCK REPURCHASE:

We did not purchase any stock in the first nine months of 2012. We currently have authority to purchase up to 1,800,000 shares.

## CRITICAL ACCOUNTING POLICIES:

A discussion of the critical accounting policies related to accounting estimates is contained in our 2011 annual report on Form 10-K.

## LIQUIDITY AND CAPITAL RESOURCES:

Cash flow activity in dollars and as a percentage of net earnings was as follows:

	Nine-month period			
	2012	2011		
Net cash provided by operating activities	\$289,096	194,181		
Net cash used in investing activities	\$87,406	84,276		
Net cash used in financing activities	\$124,068	141,907		
Net cash provided by operating activities	89.8	% 71.8	%	
Net cash used in investing activities	27.2	% 31.2	%	
Net cash used in financing activities	38.6	% 52.5	%	

Net cash provided by operating activities increased from the prior year. This increase was driven by the expansion of both our absolute and relative profitability from 2011 to 2012. The increase was also driven by a slower growth in the cash required to fund our working capital growth. These include: accounts receivable changes, inventory and related accounts payable changes.

Net cash used in investing activities changed primarily due to changes in capital expenditures and short-term investments. Property and equipment expenditures in the first nine months of 2012 and 2011 consisted of: (1) the purchase of software and hardware for Fastenal's information processing systems, (2) the addition of certain pickup trucks, (3) the purchase of signage, shelving, and other fixed assets related to store openings, (4) the addition of manufacturing and warehouse equipment, (5) the expansion or improvement of certain owned or leased store properties, (6) the expansion of Fastenal's distribution/trucking fleet, (7) the capital improvements to our new manufacturing property in Connecticut to support our new Holo-Krome business into the future (primarily a 2011 item), (8) the expansion of our Indianapolis, Indiana master distribution center (primarily a 2011 item), (9) the expansion of our Winona, Minnesota distribution center (primarily a 2012 item), and (10) purchases related to FAST Solutions<sup>SM</sup> (industrial vending). Of these factors, the growth related to industrial vending created the greatest impact to our capital expenditures in 2012 and 2011. Disposals of property and equipment in both periods consisted of the planned disposition of certain pickup trucks, semi-tractors, and trailers in the normal course of business and the disposition of real estate relating to several store locations.

Cash requirements for property and equipment expenditures were satisfied from net earnings, cash on hand, and the proceeds of disposals. We anticipate funding our current expansion plans with cash generated from operations, from available cash and cash equivalents, and, to a lesser degree, from our borrowing capacity.

Net cash used in financing activities consisted of the payment of dividends, with some offset in 2012 related to the exercise of stock options.

A discussion of the nature and amount of future cash commitments is contained in our 2011 annual report on Form 10-K.

Certain Risks and Uncertainties – This report contains statements that are not historical in nature and that are intended to be, and are hereby identified as, “forward-looking statements” under the Private Securities Litigation Reform Act of 1995, including statements regarding (1) the goals of our long-term growth strategy, ‘pathway to profit’, including the growth in average store sales and profitability expected to result from that strategy (including our belief that we can achieve targeted profitability due to an improvement in our gross margins and a lowering of our operating expenses even if our average store sales do not grow as originally expected), (2) the expected rate of new store openings, (3) our belief in the transformative nature of FAST Solutions<sup>SM</sup> (industrial vending) and our advantage as a first mover in this

area, and our expectations regarding expansion of that business, including our goals regarding our rate of 'machine signings', (4) our expected gross profit range, (5) our expected future dividend practices, (6) the funding of our expansion plans, (7) our expectation that total unrecognized tax benefits will not change significantly during the next twelve months, (8) the expected unrecognized compensation expense related to stock options, and (9) our ability to mitigate the effect of rising fuel prices by passing freight costs on to our customers. The following factors are among those that could cause the Company's actual results to differ materially from those predicted in such forward-looking statements: (1) a downturn or continued weakness in the economy or in the manufacturing or



Table of Contents

commercial construction industries, changes in the expected rate of new store openings, difficulties in successfully attracting and retaining additional qualified sales personnel, an inability to realize or sustain improvements in our gross margins and savings from lowering our operating expenses, and difficulties in changing our sales process could adversely impact our ability to achieve the goals of our 'pathway to profit' initiative, (2) a downturn or continued weakness in the economy or in the manufacturing or commercial construction industries, a change from that projected in the number of North American markets able to support stores, or an inability to recruit and retain qualified employees could cause the rate of new store openings to change from that expected, (3) a weaker level of industry acceptance or adoption of the vending technology from what we are currently experiencing could cause us to alter our plans to introduce new vending machines, cause us to fail to meet our goals regarding our rate of 'machine signings', or cause industrial vending to be less transformative than expected, (4) our competitors could choose, over time, to open additional locations and to develop their own vending platform which could allow our competitors to replicate our local store front combined with industrial vending business model mitigating our first mover advantage, (5) changes in our current mix of products, geographies, end markets and end market uses could impact our expected gross profit range, (6) changes in our financial condition or results of operations could cause us to modify our expected future dividend practices, (7) a change in our ability to generate free cash flow resulting from a slowdown in our sales or our inability to manage expenses could negatively impact the funding of our expansion plans, (8) changes in tax law or changes in the interpretation of tax law at the federal, state or local level could impact our expectation about total unrecognized tax benefits during the next twelve months, (9) an unexpected change in forfeiture rates due to demotion or turnover could impact the unrecognized compensation expense related to stock options, and (10) our ability to pass freight costs on to our customers could be adversely impacted by, in the short term, changes in fuel prices and by competitive selling pressures. A discussion of other risks and uncertainties which could cause our operating results to vary from anticipated results or which could materially adversely effect our business, financial condition, or operating results is included in our 2011 annual report on Form 10-K under the sections captioned Certain Risks and Uncertainties and Item 1A – Risk Factors. We assume no obligation to update any forward-looking statements or any discussions of risks and uncertainties.

Table of Contents

Item 3 – Quantitative and Qualitative Disclosures About Market Risk

We are exposed to certain market risks from changes in interest rates, foreign currency exchange rates, commodity steel pricing, and commodity fuel prices. Changes in these factors cause fluctuations in our earnings and cash flows. We evaluate and manage exposure to these market risks as follows:

**Interest Rates** – We have a line of credit totaling \$8 million which expires on September 20, 2013. The line bears interest at 0.9% over the LIBOR rate. During the quarter ended September 30, 2012, there was \$0 outstanding on the line. We pay no fee for the unused portion of the line of credit.

**Foreign Currency Exchange Rates** – Foreign currency fluctuations can affect our net investments and earnings denominated in foreign currencies. Our primary exchange rate exposure is with the Canadian dollar against the United States dollar. Our estimated net earnings exposure for foreign currency exchange rates was not material at September 30, 2012.

**Commodity Steel Pricing** – We buy and sell various types of steel products; these products consist primarily of different types of threaded fasteners. During the last decade, there has been nominal movement in overall steel pricing, with some deflation occurring in the wake of the economic crisis of the Far East markets that occurred in the late 1990's. This trend reversed to inflation in the period from late 2003 to the early part of 2005 and again from mid 2007 to the fall of 2008. In the first half of 2009, we noted meaningful deflation. Since 2009, we have noted minimal price changes except for stainless steel which tends to fluctuate over time. Stainless steel products represent approximately 5% of our sales. We are exposed to the impacts of commodity steel pricing and our related ability to pass through the impacts to our end customers.

**Commodity Fuel Prices** – We have market risk for changes in gasoline and diesel fuel costs, related to our trucking fleet as well as natural gas costs related to our numerous locations and to our heat treating operations. Historically the risk related to our trucking fleet has been mitigated over time by our ability to pass freight costs to our customers and the efficiency of our trucking distribution network. We also have market risk for energy costs outside of transportation. This is primarily related to energy utilized in the production of products we sell (see also commodity steel pricing discussion above) and the energy needed to heat or cool our extensive store network. The drop in prices related to natural gas provided some benefit to our occupancy costs in the first nine months of 2012.

Item 4 – Controls and Procedures

**Evaluation of Disclosure Controls and Procedures** – As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer of Fastenal, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the 'Exchange Act')). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to our management, including the principal executive officer and principal financial officer, to allow for timely decisions regarding disclosure. There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II—OTHER INFORMATION

Item 1 – Legal Proceedings

In early February 2010, we received a letter from a California fastener supplier dated January 26, 2010. This letter threatened to sue us for an alleged violation of an exclusive distribution arrangement this supplier believes exists between our organizations. In addition to the letter, this supplier provided a press release and a video regarding the claim which they threatened to make public unless we agreed to mediation of the claim. Shortly after receipt of this letter, we performed a preliminary internal review to understand (1) who this supplier was and (2) the nature of our relationship with this supplier. Based on that review, we determined (1) this supplier manufactures a niche type of fastener and (2) the total volume of purchases by us, from all suppliers, over the purported term of the alleged exclusivity arrangement of this niche type of fastener did not exceed \$1 million. Following completion of our preliminary internal review, we requested additional information and documentation from the supplier. The supplier's response failed to provide the requested information and documentation. By letter dated February 26, 2010, we quantified for the supplier our total volume of purchases as discussed above and informed the supplier that we believed their claim was grossly exaggerated and completely unsupported. We have not received any direct response to our February 26, 2010 letter. On May 3, 2010, this supplier filed suit in Arkansas federal court alleging damages. In response, we filed a motion to dismiss. This motion to dismiss was denied on August 16, 2010. We subsequently filed two motions for summary judgment. The first summary judgment motion was partially denied. On August 24, 2011, the court issued an order granting Fastenal's second motion for summary judgment in its entirety, the supplier appealed this order on September 8, 2011. On December 16, 2011, the court issued an order granting, in part, Fastenal's request to recover on its Bill of Costs and Petition for Attorney's Fees from this supplier, the supplier appealed this order on January 9, 2012. On August 21, 2012, the appeals court issued a ruling affirming the August 24, 2011 and December 16, 2011 orders. The appeals court filed a Mandate order on September 13, 2012 to effectively conclude these proceedings. While we are not required to disclose this matter under the rules of the Securities and Exchange Commission ('SEC'), we initially disclosed the existence of this threat in February 2010 (in our 2009 annual report on Form 10-K) as we believed our disclosure was prudent due to the alleged amount (\$180 million) of the claim and the threat to make these allegations public. The disclosure of these legal proceedings will be omitted from future filings.

Item 1A – Risk Factors

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. The significant factors known to us that could materially adversely affect our business, financial condition, or operating results are described in Item 2 of Part I above and in our most recently filed annual report on Form 10-K under Certain Risks and Uncertainties and Item 1A – Risk Factors. There has been no material change in those risk factors.

Item 6 – Exhibits

- 3.1 Restated Articles of Incorporation of Fastenal Company, as amended effective as of April 17, 2012 (incorporated by reference to Exhibit 3.1 to Fastenal Company's Form 10-Q for the quarter ended March 31, 2012)
- 3.2 Restated By-Laws of Fastenal Company (incorporated by reference to Exhibit 3.2 to Fastenal Company's Form 8-K dated as of October 15, 2010)
- 31 Certifications under Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification under Section 906 of the Sarbanes-Oxley Act of 2002

Edgar Filing: FASTENAL CO - Form 10-Q

101 The following financial statements from Fastenal Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, filed on October 18, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Statements of Earnings, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Balance Sheets, (iv) Consolidated Statements of Cash Flows, and (v) the Notes to Consolidated Financial Statements.

28

---

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FASTENAL COMPANY

/s/ Willard D. Oberton  
(Willard D. Oberton, Chief Executive Officer)  
(Duly Authorized Officer)

Date October 18, 2012

/s/ Daniel L. Florness  
(Daniel L. Florness, Chief Financial Officer)  
(Principal Financial Officer)

Table of Contents

INDEX TO EXHIBITS

3.1	Restated Articles of Incorporation of Fastenal Company, as amended effective as of April 17, 2012	(Incorporated by reference to Exhibit 3.1 to Fastenal Company's Form 10-Q for the quarter ended March 31, 2012)
3.2	Restated By-Laws of Fastenal Company	(Incorporated by reference to Exhibit 3.2 to Fastenal Company's Form 8-K dated as of October 15, 2010)
31	Certifications under Section 302 of the Sarbanes-Oxley Act of 2002	Electronically Filed
32	Certification under Section 906 of the Sarbanes-Oxley Act of 2002	Electronically Filed
101.INS	XBRL Instance Document	Electronically Filed
101.SCH	XBRL Taxonomy Extension Schema Document	Electronically Filed
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Electronically Filed
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Electronically Filed
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Electronically Filed
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Electronically Filed

30