

FASTENAL CO  
Form 10-Q  
October 21, 2010  
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, 2010,

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)

Edgar Filing: FASTENAL CO - Form 10-Q

**Minnesota**  
(State or other jurisdiction of  
incorporation or organization)  
**2001 Theurer Boulevard**  
**Winona, Minnesota**  
(Address of principal executive offices)  
**(507) 454-5374**  
(Registrant's telephone number, including area code)

**41-0948415**  
(I.R.S. Employer  
Identification No.)  
**55987-1500**  
(Zip 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

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 19, 2010
Common Stock, \$.01 par value	147,430,712

**Table of Contents**

**FASTENAL COMPANY**

**INDEX**

	<b>Page No.</b>
Part I Financial Information:	
<u>Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009</u>	1
<u>Consolidated Statements of Earnings for the nine months and three months ended September 30, 2010 and 2009</u>	2
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009</u>	3
<u>Notes to Consolidated Financial Statements</u>	4 8
<u>Management's discussion and analysis of financial condition and results of operations</u>	9 23
<u>Quantitative and qualitative disclosures about market risk</u>	24
<u>Controls and procedures</u>	24
Part II Other Information:	
<u>Legal Proceedings</u>	25
<u>Risk Factors</u>	25
<u>Exhibits</u>	26

**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, 2010	December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 172,565	164,852
Marketable securities	24,641	24,400
Trade accounts receivable, net of allowance for doubtful accounts of \$4,354 and \$4,086, respectively	301,721	214,169
Inventories	546,063	508,405
Deferred income tax assets	14,710	12,919
Prepaid income taxes	0	11,657
Other current assets	57,103	45,962
Total current assets	1,116,803	982,364
Marketable securities	5,166	6,238
Property and equipment, less accumulated depreciation	343,848	335,004
Other assets, net	3,520	3,752
Total assets	\$ 1,469,337	1,327,358
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 73,605	53,490
Accrued expenses	95,225	66,019
Income taxes payable	8,313	0
Total current liabilities	177,143	119,509
Deferred income tax liabilities	16,819	17,006
Stockholders equity:		
Preferred stock, 5,000,000 shares authorized	0	0
Common stock, 200,000,000 shares authorized, 147,430,712 shares issued and outstanding	1,474	1,474
Additional paid-in capital	3,348	333
Retained earnings	1,254,943	1,175,641
Accumulated other comprehensive income	15,610	13,395
Total stockholders equity	1,275,375	1,190,843

Edgar Filing: FASTENAL CO - Form 10-Q

Total liabilities and stockholders' equity	\$ 1,469,337	1,327,358
--	--------------	-----------

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

-1-

**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,	
	2010	2009	2010	2009
Net sales	\$ 1,695,705	1,453,580	603,750	489,339
Cost of sales	819,486	707,860	291,102	244,772
Gross profit	876,219	745,720	312,648	244,567
Operating and administrative expenses	553,333	520,171	192,140	168,119
Loss (gain) on sale of property and equipment	103	790	(2)	38
Operating income	322,783	224,759	120,510	76,410
Interest income	713	1,312	192	592
Earnings before income taxes	323,496	226,071	120,702	77,002
Income tax expense	123,301	86,250	45,708	29,413
Net earnings	\$ 200,195	139,821	74,994	47,589
Basic net earnings per share	\$ 1.36	0.94	0.51	0.32
Diluted net earnings per share	\$ 1.36	0.94	0.51	0.32
Basic weighted average shares outstanding	147,431	148,531	147,431	148,531
Diluted weighted average shares outstanding	147,431	148,531	147,431	148,531

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,	
	2010	2009
Cash flows from operating activities:		
Net earnings	\$ 200,195	139,821
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of property and equipment	30,432	30,147
Loss on sale of property and equipment	103	790
Bad debt expense	6,004	7,300
Deferred income taxes	(1,978)	(3,104)
Stock based compensation	3,015	2,850
Amortization of non-compete agreement	50	50
Changes in operating assets and liabilities:		
Trade accounts receivable	(93,556)	(1,683)
Inventories	(37,658)	66,141
Other current assets	(11,141)	16,938
Accounts payable	20,115	(3,925)
Accrued expenses	29,206	(11,328)
Income taxes	19,970	4,676
Other	1,536	4,511
Net cash provided by operating activities	166,293	253,184
Cash flows from investing activities:		
Purchase of property and equipment	(42,643)	(40,128)
Proceeds from sale of property and equipment	3,264	4,264
Net decrease (increase) in marketable securities	831	(5,149)
Net decrease (increase) in other assets	182	(18)
Net cash used in investing activities	(38,366)	(41,031)
Cash flows from financing activities:		
Purchase of common stock	0	0
Payment of dividends	(120,893)	(106,943)
Net cash used in financing activities	(120,893)	(106,943)
Effect of exchange rate changes on cash	679	2,642
Net increase in cash and cash equivalents	7,713	107,852
Cash and cash equivalents at beginning of period	164,852	85,892

Edgar Filing: FASTENAL CO - Form 10-Q

Cash and cash equivalents at end of period	\$ 172,565	193,744
--	------------	---------

Supplemental disclosure of cash flow information:

Cash paid during each period for income taxes	\$ 105,309	81,574
---	------------	--------

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

---

**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, 2010 and 2009

(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, 2009. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

(2) Stockholders' Equity

*Stock Options*

On April 20, 2010, our Board of Directors approved the grant under our employee stock option plan, effective at the close of business that day, of options to purchase approximately 265 thousand shares of our common stock at a strike price of \$60.00 per share. The closing stock price on the date of grant was \$54.26 per share.

During April 2009, April 2008, and April 2007, our Board of Directors approved the grant under our employee stock option plan, effective at the close of business that day, of options to purchase approximately 395 thousand shares, 275 thousand shares, and 2.2 million shares, respectively, of our common stock.

All of the options noted 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. As of September 30, 2010, options granted in April 2007 had vested with respect to approximately 210 thousand shares. No other options were vested as of September 30, 2010.

Compensation expense equal to the grant date fair value will be recognized for all of these awards over the vesting period. The stock-based compensation expense for the nine month periods ended September 30, 2010 and 2009 was \$3,015 and \$2,850, respectively. Unrecognized compensation expense related to outstanding stock options as of September 30, 2010 was \$17,386 and is expected to be recognized over a weighted average period of 5.79 years. Any future changes in estimated forfeitures will impact this amount.

(Continued)

**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, 2010 and 2009

(Unaudited)

The fair value of each share-based option outstanding as of September 30, 2010, is estimated on the date of grant using a Black-Scholes valuation method that uses the assumptions noted in the following table. The expected life is the most significant assumption as it determines the period for which the risk-free interest rate, volatility, and dividend yield must be applied. The expected life is the average length of time over which the employee groups will exercise their options, which is based on historical experience with similar grants. Expected volatilities are based on the movement of the Company's stock over the most recent historical period equivalent to the expected life of the options. 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, our historical dividends paid, and our expected future cash dividends. The following table illustrates the share price information and assumptions used to determine fair value:

	<b>Options Granted</b>			
	<b>April 2010</b>	<b>April 2009</b>	<b>April 2008</b>	<b>April 2007</b>
Strike price	\$ 60.00	54.00	54.00	45.00
Closing market price on date of grant	\$ 54.26	35.22	48.70	40.30
Weighted-average expected life of option in years	5.0	5.0	5.0	4.9
Weighted-average volatility	39.1%	38.8%	30.7%	31.6%
Risk free interest rate	2.6%	1.9%	2.7%	4.6%
Expected dividend yield	1.5%	1.0%	1.0%	1.0%
Weighted-average grant date fair value of stock option	\$ 16.27	7.27	15.50	11.36

*Earnings per share*

The following tables present: [Table 1](#) - a reconciliation of the denominators used in the computation of basic and diluted earnings per share related to our employee stock option plan and [Table 2](#) - a summary of the options to purchase shares of common stock which were excluded from the diluted earnings calculation because they were anti-dilutive:

	<b>Nine-month period</b>		<b>Three-month period</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Table 1 - Reconciliation</b>				
Basic - weighted shares outstanding	147,431	148,531	147,431	148,531
Weighted shares assumed upon exercise of stock options	0	0	0	0
Diluted - weighted shares outstanding	147,431	148,531	147,431	148,531
<b>Table 2 - Summary of options excluded</b>				
Options to purchase shares of common stock	2,660	2,649	2,733	2,632
Weighted-average exercise prices of options	\$ 47.80	47.15	\$ 48.24	47.14

Edgar Filing: FASTENAL CO - Form 10-Q

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.

*(Continued)*

**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, 2010 and 2009

(Unaudited)

## (3) Comprehensive Income

Comprehensive income and the components of other comprehensive income were as follows:

	Nine-month period		Three-month period	
	2010	2009	2010	2009
Net earnings	\$ 200,195	139,821	\$ 74,994	47,589
Translation adjustment	2,156	7,148	2,423	4,713
Change in marketable securities	59	4	(6)	1
Total comprehensive income	\$ 202,410	146,973	77,411	52,303

## (4) Unrealized Investment Gains and Losses

The following tables show the fair value of our investments and the gross unrealized gains and losses of those investments as of the dates indicated. This information is aggregated by the investment category and maturity of the investment.

	Current		September 30, 2010 Non-current		Total	
	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)
Common stock	\$ 160	(23)	0	0	160	(23)
State and municipal bonds	0	0	5,166	1	5,166	1
Government and agency securities	24,481	81	0	0	24,481	81
Total	\$ 24,641	58	5,166	1	29,807	59

	Current		September 30, 2009 Non-current		Total	
	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)
State and municipal bonds	\$ 1,295	4	5,551	0	6,846	4
Certificates of deposit or money market	0	0	0	0	0	0
Total	\$ 1,295	4	5,551	0	6,846	4



**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, 2010 and 2009

(Unaudited)

As was disclosed in our 2009 Annual Report on Form 10-K, we classify these securities as available-for-sale. Available-for-sale securities are recorded at fair value based on current market value. Our financial assets that are measured at fair value on a recurring basis consist of debt securities. Government and agency securities have a maturity of 12 months and are valued using Level 1 inputs (Level 1 inputs are quoted prices in active markets for identical assets and liabilities which typically include exchange traded items). State and municipal bonds have maturities ranging from more than one year to 24 years and are valued using Level 2 inputs (Level 2 inputs are observable inputs that include Level 1 prices that have been adjusted, quoted prices for similar assets or liabilities, or quoted prices in less active exchanges). There have been no transfers between Level 1 and Level 2 during the nine month period ended September 30, 2010. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings, but are included in comprehensive income, and are reported as a separate component of stockholders' equity until realized.

(5) Operating Leases with Guarantees

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 could 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 at lease expiration, of the leases that contain residual value guarantees, is approximately \$13,215 at September 30, 2010. We believe the likelihood of funding the guarantee obligation under any provision of the operating lease agreement is remote, except for a \$1,298 loss on disposal reserve provided at September 30, 2010.

(6) 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 2007, in the case of United States Federal and non-United States examinations, and 2004, in the case of state and local examinations.

As of September 30, 2010 and 2009, the Company had \$1,728 and \$7,253, 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 that total unrecognized tax benefits will change significantly during the next 12 months.

*(Continued)*

---

**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, 2010 and 2009

(Unaudited)

(7) Contingencies

In July 2010, we received a letter from the Civil Division of the Department of Justice (the DOJ) advising that they intended to be ready to commence litigation against us regarding a contract we entered into with the United States General Services Administration (the GSA) in 2000. We discontinued the GSA contract in 2005. The letter is related to an audit conducted by the GSA Office of Inspector General (the OIG) in 2005-06 that suggested we had not complied with certain pricing and product requirement provisions, and had potentially overcharged government customers under the contract. We have communicated our disagreement with the audit report, and have participated in several meetings and discussions with the OIG and DOJ on these disputed issues during the past several years. A subpoena dated March 25, 2010 was sent to us from the DOJ seeking information about the Company's position concerning our compliance under the contract, and we provided responsive information to the DOJ in May 2010. Discussions between the DOJ and Fastenal relating to our compliance with the pricing and product requirement provisions under the contract are ongoing. As of June 30, 2010, the DOJ had offered to resolve this matter for a payment by us of \$9.5 million and we had offered \$750 thousand, which amount we had accrued. During the third quarter of 2010 we continued our discussions with the DOJ. The DOJ has currently offered to resolve this matter for \$8.5 million and we have offered \$2.75 million, which amount we have accrued as of September 30, 2010. The timing and outcome of these discussions are uncertain and could include settlement or civil litigation by the DOJ to recover, among other amounts, treble damages and penalties under the False Claims Act. While this matter is not expected to have a material adverse effect on our financial position, an unfavorable resolution could result in payments by the Company in excess of the amounts reserved. We continue to believe that we have complied with our obligations under the GSA contract in all material respects.

In early February 2010, we received a letter from a California fastener supplier dated January 26, 2010. This letter threatened to sue us for our alleged violation of an exclusive distribution arrangement this supplier believes exists between our organizations. In addition, this supplier provided a press release and a video regarding the claim that 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 that this supplier manufactures a niche type of fastener and that 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 does 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 alleging damages. In response, we filed a motion to dismiss. This motion to dismiss was denied on August 16, 2010. It is too early to determine how this case will progress. Based on current information, we believe that the prospect that we will incur a material liability as a result of this claim is remote. While we are not required to disclose this matter under the rules of the SEC, we initially disclosed the existence of this threat in February 2010 as we believed that disclosure was prudent due to the alleged amount (\$180 million) of the claim and the threat to make these allegations public.

---

**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 that have affected our financial position and operating results during the periods included in the accompanying consolidated financial statements. (Dollar amounts are 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 over 2,400 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, 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.

Like most industrial and construction centric organizations, we have endured a roller coaster ride over the last several years. The third quarter of 2008 included the final months of an inflationary period related to both steel prices (approximately 50% of our sales consist of some type of fastener - nuts, bolts, screws, etc. - most of which are made of steel) and energy prices (a meaningful item for us given the amount of energy that is necessary in the production of our products and in the transportation of our products across North America in one of our over 5,000 vehicles on the road).

In the fourth quarter of 2008, and throughout much of 2009, this inflation turned to deflation. 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 over the same period provided some relief, but it was small in comparison to the impact of deflation. The deflation of 2009 ended and these conditions normalized and allowed our gross margins to recover in 2010. (See later discussion on gross margins.)

The discussion that follows includes information regarding our sales growth and our sales by product line during the third quarter of 2010. This information provides a nice summary view to understand the dynamics of the quarter. However, we feel the real story is told in the monthly sales changes, sequential trends, and end market information that follow - they explain the real impact of the market dynamics affecting us over this period of uncertainty.

As always, the pathway to profit is the cornerstone of our business evolution, and it influences everything we do. Remember, our business centers on our 2,400 plus stores - their individual success leads to the success of the entire organization over time. As you read the balance of this discussion, you will see our stores were able to make great strides in their endeavor to dig out of the economic hole known as 2009. We will continue to work to complete this task and maintain our goal of *Growth through Customer Service*.

**Table of Contents****SALES GROWTH:**

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

	Nine-month period		Three-month period	
	2010	2009	2010	2009
Net sales	\$ 1,695,705	1,453,580	\$ 603,750	489,339
Percentage change	16.7%	-19.0%	23.4%	-21.7%

The increase in net sales in the first nine months of 2010 came primarily from higher unit sales. Our growth in net sales was not meaningfully impacted by deflationary or inflationary price changes in our products or by the introduction of new products or services. 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 moderating impacts of the current recessionary environment, an environment which dramatically worsened late in 2008. The increase in net sales also resulted from the strengthening of the Canadian currency relative to the United States dollar and from our Holo-Krome business, which we acquired in December 2009. These two items added approximately 1.3 and 0.8 percentage points to our growth in the nine month period and in the three month period ended September 30, 2010, respectively.

The impact of the economy is best reflected in the growth performance of our stores opened greater than ten years ago (store sites opened as follows: 2010 group opened 2000 and earlier, and 2009 group opened 1999 and earlier) and opened greater than five years ago (store sites opened as follows: 2010 group opened 2005 and earlier, and 2009 group opened 2004 and earlier). These two groups of stores are more cyclical due to the increased market share they enjoy in their local markets. The stores opened greater than two years ago represent a consistent same store view of our business (store sites opened as follows: 2010 group opened 2008 and earlier, and 2009 group opened 2007 and earlier). The daily sales change for each of these groups was as follows:

Store Age	Nine-month period		Three-month period	
	2010	2009	2010	2009
Opened greater than 10 years ago	12.4%	-23.0%	19.1%	-25.4%
Opened greater than 5 years ago	12.1%	-22.3%	19.0%	-25.2%
Opened greater than 2 years ago	13.9%	-21.1%	20.2%	-24.2%

Note: The age groups above are measured as of the last day of each respective 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	
	2010	2009	2010	2009
Fastener product line	49.6%	49.9%	49.2%	49.5%
Other product lines	50.4%	50.1%	50.8%	50.5%
	100.0%	100.0%	100.0%	100.0%

**Table of Contents****COMMENTS REGARDING 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 period.

This section focuses on three distinct views of our business monthly sales changes, sequential trends, and end market performance. The discussion of monthly sales changes provides a good mechanical view of our business based on the age of our stores. The discussion of sales trends provides a framework for understanding the sequential trends (that is, comparing a period to the immediately preceding period) in our business since the market declined late in 2008. Finally, we believe the discussion regarding end market performance provides insight into activities with our various types of customers.

**MONTHLY SALES CHANGES:**

**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: 2010 group opened 2005 and earlier, 2009 group opened 2004 and earlier, and 2008 group opened 2003 and earlier). This store group is more cyclical due to the increased market share these stores enjoy in their local markets. During each of the first nine months in 2010 and each of the twelve months in 2009 and 2008, 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.
2010	-2.1%	-0.5%	7.4%	14.9%	17.3%	16.2%	19.8%	18.2%	18.9%			
2009	-12.4%	-14.3%	-21.5%	-25.2%	-25.2%	-26.3%	-26.6%	-24.7%	-24.2%	-21.7%	-15.0%	-12.1%
2008	8.9%	8.8%	9.9%	10.5%	10.4%	11.2%	9.7%	11.3%	8.5%	6.8%	0.9%	-5.1%

**Stores opened greater than two years** Our stores opened greater than two years (store sites opened as follows: 2010 group opened 2008 and earlier, 2009 group opened 2007 and earlier, and 2008 group opened 2006 and earlier) represent a consistent same-store view of our business. During each of the first nine months in 2010 and each of the twelve months in 2009 and 2008, 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.
2010	0.6%	2.3%	9.6%	16.3%	18.5%	18.3%	21.3%	19.2%	19.8%			
2009	-11.2%	-13.8%	-20.1%	-24.0%	-23.7%	-25.1%	-25.4%	-24.0%	-23.1%	-20.9%	-13.7%	-10.6%
2008	12.0%	11.1%	12.5%	13.1%	12.0%	12.0%	10.9%	12.8%	10.5%	8.1%	2.3%	-3.9%

**All company sales** During each of the first nine months in 2010 and each of the twelve months in 2009 and 2008, all of our selling locations 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.
2010	2.4%	4.4%	12.1%	18.6%	21.1%	21.1%	24.4%	22.1%	23.5%			
2009	-8.5%	-10.5%	-17.4%	-21.0%	-20.7%	-22.5%	-22.9%	-21.4%	-20.8%	-18.7%	-12.0%	-8.6%
2008	15.6%	15.0%	16.9%	17.1%	16.0%	15.9%	14.8%	16.4%	14.3%	11.9%	6.8%	0.0%

The improvement in the first nine months of 2010 continues the trend we saw in the latter half of 2009. The slow-down in the final three months of 2008 and all of 2009 relate to the general economic weakness in the global marketplace.

Several additional factors positively impacted our sales growth in the first nine months of 2010: (1) the strengthening Canadian dollar (when compared to the United States dollar) added approximately 0.8 percentage points to our daily sales growth and (2) our Holo-Krome business, which we acquired in December 2009, added approximately 0.5 percentage points to our daily sales growth.

**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 both 2009 and 2010), the second landing centers on July 4<sup>th</sup>, 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 the sequential change in our daily sales. The line labeled **Past** is an historical average of the 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 **2009** and **2010** lines represent our actual sequential daily sales changes. The **09Delta** line is the difference between the **Past** and **2009**; similarly, the **10Delta** is the difference between the **Past** and **2010**.

	Jan.(1)	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Past	0.9%	3.3%	2.9%	-0.3%	3.4%	2.8%	-2.3%	2.6%	2.6%	-0.7%	-4.7%	-6.0%
2009	-18.3%	-2.6%	-1.4%	-4.9%	2.7%	1.7%	-3.6%	5.5%	3.3%	-0.7%	-2.0%	-9.0%
09Delta	-19.2%	-5.9%	-4.3%	-4.6%	-0.7%	-1.1%	-1.3%	2.9%	0.7%	0.0%	2.7%	-3.0%
2010	2.9%	-0.7%	5.9%	0.6%	4.8%	1.7%	-1.0%	3.5%	4.5%			
10Delta	2.0%	-4.0%	3.0%	0.9%	1.4%	-1.1%	1.3%	0.9%	1.9%			

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

The 18.3% drop from October 2008 to January 2009 represents the immediate impact of the economy on our business. During this time frame, our daily sales change, on a year-over-year basis, dropped from 11.9% growth in October to a contraction of 8.5% in January. After January, the trend continued downward as the **Delta** (or spread between the benchmark and the 2009 actual) in February, March, and April 2009 averaged a negative 4.9%. The daily sales contraction, on a year-over-year basis, was 21.0% in April. The **Delta** from May 2009 to July 2009 was not as significant, averaging a negative 1.0%. While this period was still painful, it began to show what we believe was the bottom of the drop. Finally, in the period from August 2009 to December 2009, the **Delta** improved, and averaged a positive 0.7%. During 2010, sales have been strong our business exceeded the trend line in January, February took a step back due to inclement weather, and March reestablished the trend of being at or above the trend line (see graph below).

**Table of Contents**

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:

**END MARKETS:**

**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, on an annual basis, approximately 15.7%, 29.8%, and 30.6% in the first, second, and third quarters of 2010, respectively. In the first, second, third, and fourth quarters of 2009, the daily sales of this business contracted 16.0%, 25.2%, 22.8%, and 10.1%, respectively. For the year, our total sales to our manufacturing customers contracted 18.8% from 2008 to 2009. The 2009 contraction was more severe in our industrial production business (this is business where we supply products that become part of the finished goods produced by our customers) and less severe in the maintenance portion of our manufacturing business (this is business where we supply products that maintain the facility or the equipment of our customers engaged in manufacturing).

Our non-residential construction customers have historically represented 20% to 25% of our business. On an annual basis, the daily sales of this business contracted approximately 14.7% in the first quarter of 2010 and then grew 0.5% and 6.3% in the second and third quarters of 2010, respectively. In the first, second, third, and fourth quarters of 2009, the contraction was 6.4%, 19.6%, 25.3%, and 24.8%, respectively. For the year, our total sales to our non-residential construction customers contracted 19.4% from 2008 to 2009.

On a sequential basis, the sales to our manufacturing customers stabilized in May 2009 and then started to demonstrate patterns that resemble historical norms. This reversed the negative trend which began in October 2008. This stabilization and improvement was partially offset by continued deterioration in our non-residential construction business which weakened dramatically in the first eight months of 2009, and then began to also demonstrate patterns that resemble historical norms.

**Table of Contents**

A graph of the sequential sales trends to these two end markets in 2008, 2009, and 2010, starting with a base of 100 in the previous October and ending with the next October, would be as follows:

---

**Table of Contents**

**PATHWAY TO PROFIT AND ITS IMPACT ON OUR BUSINESS:**

**During April 2007 we disclosed our intention to alter the growth drivers of our business** For most of the preceding ten years, we used store openings as the primary growth driver of our business (our historical rate was approximately 14% new stores each year). As announced in April 2007, we began to add outside sales personnel into existing stores at a faster rate than historical patterns. We funded this sales force expansion with the occupancy savings generated by opening stores at the rate of 7% to 10% per year (see our disclosure below regarding the temporary slowing of our store growth in 2009 and 2010). Our goal was four-fold: (1) to continue growing our business at a similar rate with the new outside sales investment model, (2) to grow the sales of our average store to \$125 thousand per month in the five year period from 2007 to 2012, (3) to enhance the profitability of the overall business by capturing the natural expense leverage that has historically occurred in our existing stores as their sales grow, and (4) to improve the performance of our business due to the more efficient use of working capital (primarily inventory) as our average sales volume per store increases. The economic weakness that dramatically worsened in the fall of 2008 and continued into 2009 caused us to alter the pathway to profit beginning in 2009. These changes centered on two aspects (1) temporarily slowing store openings to a range of 2% to 5% per year, and (2) stopping headcount additions except for store openings and for stores that are growing. (See later discussion on future store openings.)

The pathway to profit initiative, described above, has slowly altered our cost structure over the last several years to increase the portion of our operating costs which are variable versus fixed. This dramatically improved our ability to manage through the current economic environment. As discussed in our third quarter 2009 release, we began to stabilize our store headcount in October 2009. From the third quarter of 2009 to the third quarter of 2010 we grew our store average full-time headcount and also grew our store average full-time equivalent (FTE) headcount; the store FTE grew from 7,087 to 7,450, or 5.1%. (See later discussion on store count and FTE numbers by quarter.)

The pathway to profit initiative allows us to focus on the three drivers of our business: (1) store headcount, (2) store (or unit) growth, and (3) average sales volume per store, which ultimately drives our level of profitability. Our original goal was to hit the \$125 thousand per month store average by 2012. We believe the duration of the economic weakness could delay the timing of when we achieve the \$125 thousand per month average by approximately two years. However, the current economic weakness only serves to strengthen our belief in the pathway to profit .

**Future store openings** In July 2010, we indicated our intentions to open 80 to 95 new stores during the second half of 2010, or an annualized rate of 6.8% to 8.0%. During the third quarter of 2010 we opened 45 stores; our goal for openings in the second half of 2010 remains unchanged.

**Table of Contents**

**Store Count and Full-Time Equivalent (FTE) Headcount** In response to the pathway to profit , we increased both our store count (opening 7.5% and 8.1% new stores in calendar 2008 and 2007, respectively) and our store FTE headcount. However, the rate of increase in store locations slowed (we opened 3.0% new stores in calendar 2009) and our FTE headcount for all types of personnel was reduced when the economy weakened late in 2008. The number of stores at quarter (QTR) end, the average FTE headcount per quarter (QTR), and the percentage change were as follows for each of the last five quarters, for the third quarter of 2008 (our peak quarter before the economy weakened), and for the first quarter of 2007 (the last completed quarter before we began the pathway to profit ):

	QTR 3 2010	QTR 2 2010	QTR 1 2010	QTR 4 2009	QTR 3 2009	QTR 3 2008	QTR 1 2007
Store locations-quarter end count	2,453	2,407	2,392	2,369	2,352	2,300	2,073
% change (twelve months)	4.3%	2.4%	2.1%	2.5%	2.3%	7.2%	
% change since March 2007	18.3%	16.1%	15.4%	14.3%	13.5%	11.0%	
Store personnel - absolute headcount	8,643	8,401	8,404	8,519	8,608	9,123	6,849
% change (twelve months)	0.4%	-3.7%	-7.8%	-9.9%	-5.6%	17.9%	
% change since March 2007	26.2%	22.7%	22.7%	24.4%	25.7%	33.2%	
Store personnel - FTE	7,450	7,118	7,004	7,007	7,087	8,280	6,383
Distribution and manufacturing personnel - FTE <sup>1</sup>	2,007	1,884	1,800	1,768	1,763	2,244	1,962
Administrative and sales support personnel - FTE	1,365	1,298	1,300	1,298	1,322	1,404	1,383
Total - average FTE headcount	10,822	10,300	10,104	10,073	10,172	11,928	9,728
<b>% change (twelve months)</b>							
Store personnel - FTE	5.1%	-1.2%	-9.7%	-15.1%	-14.4%	15.2%	
Distribution and manufacturing personnel - FTE <sup>1</sup>	13.8%	1.5%	-8.7%	-20.3%	-21.4%	5.4%	
Administrative and sales support personnel - FTE	3.3%	-4.7%	-6.7%	-8.1%	-5.8%	3.2%	
Total - average FTE headcount	6.4%	-1.2%	-9.1%	-15.2%	-14.7%	11.7%	
<b>% change since March 2007</b>							
Store personnel - FTE	16.7%	11.5%	9.7%	9.8%	11.0%	29.7%	
Distribution and manufacturing personnel - FTE <sup>1</sup>	2.3%	-4.0%	-8.3%	-9.9%	-10.1%	14.4%	
Administrative and sales support personnel - FTE	-1.3%	-6.1%	-6.0%	-6.1%	-4.4%	1.5%	
Total - average FTE headcount	11.2%	5.9%	3.9%	3.5%	4.6%	22.6%	

We have reduced our FTE headcount at our store locations 10.0% since our peak of 8,280 FTE headcount in third quarter of 2008, much of this decrease relates to a reduction in part-time hours worked as our absolute headcount numbers related to store personnel declined by 5.3% during this time period. Since the first quarter of 2007, the last completed quarter before we began the pathway to profit , our store count is up 18.3%, our absolute store headcount is up 26.2%, and our store FTE headcount is up 16.7%. During this timeframe, our non-store FTE headcount increased from 3,345 to 3,372<sup>1</sup>, or 0.8%. We believe these fluctuations allow us to manage our expense in the short-term while maintaining our ability to sell into the marketplace.

<sup>1</sup> Note 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**

**Store Size and Profitability** The store groups listed in the table below, when combined with our strategic account stores, represented approximately 87% and 89% of our sales in the third quarter of 2010 and 2009, respectively. Strategic account stores are stores that are focused on selling to a group of strategic account customers in a limited geographic market. Our remaining sales (approximately 13% to 11%) relate to either: (1) our in-plant locations, (2) our direct Fastenal Cold Heading business (including our Holo-Krome business acquired in December 2009), or (3) our direct import business. Our average store had sales of \$71,600 and \$61,600 per month in the third quarter of 2010 and 2009, respectively. This average amount was \$71,600 per month in the first quarter of 2007 (the last completed quarter before we began the pathway to profit). The average age, number of stores, and pre-tax margin data by store size for the third quarter of 2010 and 2009, respectively, were as follows:

Sales per Month	Average Age (Years)	Number of Stores	Percentage of Stores	Pre-Tax Margin Percentage
<b>Three months ended September 30, 2010</b>				
\$0 to \$30,000	3.8	419	17.1%	-11.0%
\$30,001 to \$60,000	6.7	913	37.2%	13.2%
\$60,001 to \$100,000	9.4	595	24.3%	22.7%
\$100,001 to \$150,000	11.7	325	13.2%	26.0%
Over \$150,000	15.5	166	6.8%	27.5%
Strategic Account Store		35	1.4%	
Total		2,453	100.0%	
<b>Three months ended September 30, 2009</b>				
\$0 to \$30,000	3.9	541	23.0%	-17.7%
\$30,001 to \$60,000	6.4	929	39.5%	9.7%
\$60,001 to \$100,000	9.5	521	22.2%	20.0%
\$100,001 to \$150,000	11.8	231	9.8%	24.2%
Over \$150,000	15.9	105	4.5%	26.6%
Strategic Account Store		25	1.1%	
Total		2,352	100.0%	