FASTENAL CO
Form 10-K
February 06, 2019
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K
(Mark One)
x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2018
or
o 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 incorporation or organization)	(I.R.S. Employer Identification No.)
2001 Theurer Boulevard Winona, Minnesota	55987-0978
(Address of principal executive offices)	(Zip Code)

(507) 454-5374
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	The Nasdaq Stock Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes x No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act Yes o No x
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 x No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large Accelerated Filer	x	Accelerated Filer	o
Non-accelerated Filer	o	Smaller Reporting Company	o
		Emerging Growth Company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of June 30, 2018, the last business day of the registrant's most recently completed second fiscal quarter, was $13,762,835,828, based on the closing sale price of the Common Stock on that date. For purposes of determining this number, all executive officers and directors of the registrant as of June 30, 2018 are considered to be affiliates of the registrant. This number is provided only for the purposes of this report on Form 10-K and does not represent an admission by either the registrant or any such person as to the status of such person.

As of January 18, 2019, the registrant had 285,931,529 shares of Common Stock issued and outstanding.

Table of Contents

FASTENAL COMPANY
ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

Table of Contents

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Proxy Statement for the annual meeting of shareholders to be held Tuesday, April 23, 2019 ('Proxy Statement') are incorporated by reference in Part III. Portions of our 2018 Annual Report to Shareholders are incorporated by reference in Part II.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Form 10-K, or in other reports of the company and other written and oral statements made from time to time by the company, do not relate strictly to historical or current facts. As such, they are considered 'forward-looking statements' that provide current expectations or forecasts of future events. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements can be identified by the use of terminology such as anticipate, believe, should, estimate, expect, intend, may, will, plan, goal, project, hope, trend, target, opportunity, and similar words or expressions, or by references to typical outcomes. Any statement that is not a purely historical fact, including estimates, projections, trends, and the outcome of events that have not yet occurred, is a forward-looking statement. Our forward-looking statements generally relate to our expectations regarding the business environment in which we operate, our projections of future performance, our perceived marketplace opportunities, our strategies, goals, mission and vision, and our expectations related to the impact of tax reform. You should understand that forward-looking statements involve a variety of risks and uncertainties, known and unknown, and may be affected by inaccurate assumptions. Consequently, no forward-looking statement can be guaranteed and actual results may vary materially. Factors that could cause our actual results to differ from those discussed in the forward-looking statements include, but are not limited to, economic downturns, weakness in the manufacturing or commercial construction industries, competitive pressure on selling prices, changes in trade policies or tariffs, changes in our current mix of products, customers, or geographic locations, changes in our average branch size, changes in our purchasing patterns, changes in customer needs, changes in fuel or commodity prices, inclement weather, changes in foreign currency exchange rates, difficulty in adapting our business model to different foreign business environments, failure to accurately predict the market potential of our business strategies, the introduction or expansion of new business strategies, increased competition in industrial vending or Onsite, difficulty in maintaining installation quality as our industrial vending business expands, the leasing to customers of a significant number of additional industrial vending devices, the failure to meet our goals and expectations regarding branch openings, branch closings, or expansion of our industrial vending or Onsite operations, changes in the implementation objectives of our business strategies, difficulty in hiring, relocating, training, or retaining qualified personnel, difficulty in controlling operating expenses, difficulty in collecting receivables or accurately predicting future inventory needs, dramatic changes in sales trends, changes in supplier production lead times, changes in our cash position or our need to make capital expenditures, credit market volatility, changes in tax law or the impact of any such changes on future tax rates, changes in the availability or price of commercial real estate, changes in the nature, price, or availability of distribution, supply chain, or other technology (including software licensed from third parties) and services related to that technology, cyber-security incidents, potential liability and reputational damage that can arise if our products are defective, and other risks and uncertainties detailed in this Form 10-K under the heading 'Item 1A. Risk Factors'. Each forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any such statement to reflect events or circumstances arising after such date.

Table of Contents

PRESENTATION OF DOLLAR AMOUNTS

All dollar amounts in this Form 10-K are presented in millions, except for share and per share amounts or where otherwise noted. Throughout this document, percentage and dollar change calculations, which are based on non-rounded dollar values, may not be able to be recalculated using the dollar values in this document due to the rounding of those dollar values.

STOCK SPLIT

All information contained in this Form 10-K reflects the two-for-one stock split in 2011.

Table of Contents

PART I

ITEM 1. BUSINESS

Note – Information in this section is as of year end unless otherwise noted. The year end is December 31, 2018 unless additional years are included or noted.

Overview

Fastenal Company (together with our subsidiaries, hereinafter referred to as 'Fastenal' or the company or by terms such as we, our, or us) began as a partnership in 1967, and was incorporated under the laws of Minnesota in 1968. We opened our first branch in 1967 in Winona, Minnesota, a city with a population today of approximately 27,000. We began with a marketing strategy of supplying threaded fasteners to customers in small, medium-sized, and, in subsequent years, large cities. Over time, that mandate has expanded to a broader range of industrial and construction supplies spanning more than nine major product lines (described later in this document). The large majority of our transactions are business-to-business, though we also have some walk-in retail business. At the end of 2018, we had 3,121 in-market locations (defined in the table below) in 26 countries supported by 14 distribution centers in North America (11 in the United States, two in Canada, and one in Mexico), and we employed 21,644 people. We believe our success can be attributed to the high quality of our employees and their convenient proximity to our customers, and our ability to offer customers a full range of products and services to reduce their total cost of procurement.

The following table shows our consolidated net sales for each fiscal year as well as the number of public branches, Onsite locations, and total in-market locations at the end of each of the last ten years:

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Net sales	$4,965.1	4,390.5	3,962.0	3,869.2	3,733.5	3,326.1	3,133.6	2,766.9	2,269.5	1,930.3
Public branches	2,227	2,383	2,503	2,622	2,637	2,687	2,652	2,585	2,490	2,369
Onsite locations[1]	894	605	401	264	214					
Total in-market locations[2]	3,121	2,988	2,904	2,886	2,851	2,687	2,652	2,585	2,490	2,369

[1] Onsite location information prior to 2014 is intentionally omitted. While such locations have existed since 1992, we did not specifically track their number until we identified our Onsite program as a growth driver in 2014.

[2] 'In-market locations' is defined as the sum of the total number of public branches and the total number of Onsite locations.

One of Fastenal's guiding principles since inception is that we can improve our service by getting closer to the customer. Through much of our history, this was achieved by opening branches, and today we believe there are few companies that offer our North American branch coverage. In 2018, roughly 54% of our sales and 52% of our branches were in major Metropolitan Statistical Areas ('MSAs'; populations greater than 500,000 people), while 19% of our sales and 16% of our branches were in small MSAs (populations under 500,000 people), and 27% of our sales and 32% of our branches were not in a MSA. In our view, this has proved to be an efficient means of providing customers with a broad range of products and services on a timely basis. These branches have represented, and continue to represent, the foundation of our service approach. However, we are constantly evaluating the efficacy of our branch network, and in recent years, we have developed additional models that get us still closer to the customer, including vending, bin stocks, and Onsite locations.

We currently have several versions of selling locations: (1) a 'traditional (or public) branch' services a wide variety of customers and stocks a wide selection of products we offer, (2) an 'overseas branch' focuses on manufacturing customers and our fastener product line and is the format we typically deploy outside the United States and Canada, (3) a 'strategic account branch' is a unique location that sells to multiple large accounts in a market, (4) a 'strategic account site' is similar to a strategic account branch, but typically operates out of an existing branch rather than from a unique location, and (5) an 'Onsite location' provides dedicated sales and service from within, or in close proximity to, the customer's facility.

Traditional, overseas, and strategic account branches sell to multiple customers, and together comprise our total branch count. Our strategic account sites are considered an extension of the branch from which it operates, and are not included separately in our total branch counts. Onsite locations, which serve a single customer, are similarly not included in our total branch counts. However, outside of the fact that they serve a single customer, we believe the function and operation of an Onsite location is similar to that of a branch. This model also represents a meaningful portion of the company's total revenue, and we expect that share to grow materially over time. As a result, we refer to our network in terms of in-market locations, which includes our total branches and Onsite locations, and we refer to strategic account sites as non-in-market locations.

Branch locations are selected primarily based on their proximity to our distribution network, population statistics, and employment data for manufacturing and non-residential construction companies. We stock all branches with inventory drawn from all of our product lines, and over time, where appropriate, our district and branch personnel may tailor the inventory

Table of Contents

offering to the needs of the local customer base. Since Fastenal's founding and through 2013, branch openings were a primary growth driver for the company, and we experienced net openings each year over that time span. We have long maintained that marketplace demographics could support a North American network of 3,500 traditional branches. However, since establishing this figure, new growth drivers and business models (Onsite, vending, digital solutions) have emerged and diminished the direct role of traditional branch openings in our growth. It is now unlikely that we will operate the total traditional branch locations we previously believed would be the potential of North America. We will continue to open traditional branches as the company sees fit. However, in each year since 2013, the company has experienced a net decline in its total branch count including net declines of 156 branches in 2018, 120 branches in 2017, and 119 branches in 2016.

We first went international when we opened a branch in Canada in 1994. Since then, we have continued to expand our global footprint and at the end of 2018, we operated in 25 countries outside of the United States. Canada and Mexico are the largest of these, representing approximately 11% of total sales collectively, and we also operate in Europe, Asia, Southeast Asia, and Central and South America. This remaining international business is approximately 3% of total sales. Our go-to-market strategy in countries outside of North America, focuses primarily on servicing large, national account customers. From a product perspective, these customers are more heavily oriented toward planned fastener spend. Though in recent years the international business has been growing faster than the U.S. business, we are not as well recognized in many of our foreign locations as we are in the U.S. and, to a lesser extent, Canada. However, our ability to provide a consistent service model, including vending, bin stocks, and Onsites, on a global basis is attractive to our foreign customer base, much of which are the foreign operations of U.S.-based companies. Our international subsidiaries now have over 450 in-market locations, including over 150 Onsite locations, have over 9,600 vending devices installed, and employ over 3,300 people from around the world.

The following table provides a summary of the traditional, overseas, and strategic account branch locations we operated at the end of each year, as well as the openings, closings, and conversions during each year:

	North America					Outside North America					
	United States	Canada	Mexico	Puerto Rico and Dominican Republic	Subtotal	Central & South America (1)	Asia (2)	Southeast Asia (3)	Europe (4)	Africa (5)	Total
Total as of December 31, 2016	2,194	198	52	8	2,452	8	10	7	24	2	2,503
Opened branches	5	3	2	—	10	1	—	—	7	—	18
Closed branches	(118)	(6)	(1)	—	(125)	(2)	(2)	—	(1)	—	(130)
Converted branches(6)	(5)	—	—	—	(5)	(1)	(1)	—	(1)	—	(8)
Total as of December 31, 2017	2,076	195	53	8	2,332	6	7	7	29	2	2,383
Opened branches	2	1	—	—	3	—	—	—	8	—	11
Closed branches	(145)	(10)	—	—	(155)	—	—	—	—	(2)	(157)
Converted branches(6)	(9)	—	(1)	—	(10)	—	—	—	—	—	(10)
Total as of December 31, 2018	1,924	186	52	8	2,170	6	7	7	37	—	2,227

(1) Panama, Brazil, Colombia, and Chile

(2) China

(3) Singapore, Malaysia, and Thailand

(4) The Netherlands, Hungary, United Kingdom, Germany, Czech Republic, Italy, Romania, Sweden, Poland, Austria, Ireland, Spain, and France

(5) South Africa

(6) Converted locations are sites converted from traditional branches to Onsite locations or non-in-market locations, net of sites converted from non-in-market locations or Onsite locations to traditional branches.

Onsite locations may influence the trend in total branch count over time. The Onsite concept is not new, in that we entered into the first such arrangement in 1992. However, we identified it as a growth driver in 2014 and have made substantial investments toward accelerating its traction in the marketplace since 2015. In this model, we service a customer from a location that is physically within the customer's facility (or, in some cases, at a strategically placed off-site location), with inventory that is specific to the customer's needs. In many cases, we are shifting revenue with the customer from an existing branch. The model is best suited to larger companies, though we believe we can provide a higher degree of service at a lower level of revenue than most of our competitors. It has been our experience that gross profit percentages at Onsite locations tend to be lower than at branches, but we gain significant revenue with the customer and our cost to serve is materially lower. We have identified over 15,000 customer locations with potential to implement the Onsite service model. These include customers with which we have

Table of Contents

an existing national account relationship today, as well as potential customers we are aware of due to our local market presence. We expect revenues from Onsite arrangements to increase meaningfully over time. We experienced net increases of 289, 204, and 137 Onsite locations in 2018, 2017, and 2016, respectively. We had 894 Onsite locations as of December 31, 2018, and anticipate signing 375 to 400 new Onsite locations in 2019.
The following table provides a summary of the new Onsite customer locations signed and the total Onsite locations we operated at the end of each year, as well as the Onsite openings and closings during each year:

	New Onsite Customer Locations Signed	Total Active Onsite Locations
Total as of December 31, 2016	176	401
Opened Onsite locations		218
Closed Onsite locations		(14)
Total as of December 31, 2017	270	605
Opened Onsite locations		318
Closed Onsite locations		(29)
Total as of December 31, 2018	336	894

In 1995, we developed a national accounts program aimed at making our products and services more competitive with customers that operate multiple facilities. These customers tend to have more complex supply chains and structures for managing the original equipment manufacturing (OEM) and maintenance, repair, and operations (MRO) products we provide while at the same time, by virtue of their size and opportunity, have more negotiating power. We believe our local presence as part of a national, and increasingly international, footprint, our ability to provide a consistent level of high-touch service and broad product availability, and our ancillary capabilities around manufacturing, quality control, and product knowledge, are attractive to these larger customers. We believe our advantage with these customers has only been strengthened as we have added other channels, such as industrial vending, Onsite, Fastenal Managed Inventory ('FMI®'), digital solutions, and resources to serve these customers' unique demands. As a result, in 2018, national accounts represented 51.2% of our net sales, compared to 48.7% and 47.4% in 2017 and 2016, respectively. We believe we will continue to perform well with these customers.
We introduced industrial vending in 2008. Vending provides our customers the benefits of reduced consumption, reduced purchase orders, reduced product handling, and 24-hour product availability, and we believe our company has a market advantage by virtue of our extensive in-market network. For these reasons, the initiative began to gain significant traction in 2011 and we finished 2018 with over 96,000 devices in the field (81,000 generating product revenue and 15,000 in a locker lease program). Our discussion generally focuses on the 81,000 product revenue devices. We believe vending has proven its effectiveness in strengthening our relationships with customers and helped to streamline the supply chain where it has been utilized. We also believe there remains considerable room to grow our current installed base before it begins to approach the number of units we believe the market can support. We estimate the market could support as many as 1.7 million industrial vending devices, and as a result we anticipate continued growth in installed devices over time. We anticipate signing 23,000 to 25,000 new devices in 2019.
Our industrial vending portfolio consists of 23 different vending devices, with 15 of these being in either a helix or locker format. Our most utilized models include the helix-based FAST 5000, which is approximately 40% of our installed base of devices, and our 12- and 18-door lockers, which combined are approximately 35% of our installed base of devices. The lockers are available in multiple configurations and the helix format is configurable to accommodate the various sizes and forms of products that will be dispensed to match the unique needs of our customer. Target monthly revenues per device typically range from under $1,000 to in excess of $3,000, depending on the type of device and products dispensed. The following two tables provide two views of our data: (1) actual device count regardless of the type of device and (2) 'machine equivalent' count based on the weighted target monthly revenue of each device (compared to the FAST 5000 device, which has a $2,000 monthly revenue target). For example, the 12-door locker, with target monthly revenue of $750, would be counted as '0.375 machine equivalent'

(0.375 = $750/$2,000).

5

Table of Contents

The industrial vending (product revenue devices) information related to contracts signed during each period was as follows:

		Q1	Q2	Q3	Q4	Annual
Device count signed during the period	2018	5,679	5,537	5,877	4,980	22,073
	2017	5,437	4,881	4,771	4,266	19,355
	2016	4,647	4,869	4,783	3,760	18,059
'Machine equivalent' count signed during the period	2018	5,271	5,250	5,251	4,610	20,382
	2017	4,476	4,032	4,010	3,640	16,158
	2016	3,696	3,941	3,520	2,951	14,108

The industrial vending (product revenue devices) information related to installed devices at the end of each period was as follows:

		Q1	Q2	Q3	Q4
Device count installed at the end of the period	2018	73,561	76,069	78,706	81,137
	2017	64,430	66,577	69,058	71,421
	2016	56,889	58,346	60,400	62,822
'Machine equivalent' count installed at the end of the period	2018	58,571	61,405	64,205	66,784
	2017	49,921	51,950	54,215	56,436
	2016	43,329	44,707	46,399	48,399

In addition to industrial vending noted above, which primarily relates to our non-fastener business, we also provide Fastenal Managed Inventory ('FMI') programs, (also known as 'keep fill' or 'bin stock' programs in the industry) to numerous customers. This business relates to both our maintenance customers (MRO fasteners and non-fasteners) and original equipment manufacturers (OEM fasteners). FMI is like our industrial vending business in that it involves moving product closer to the point of customer use within their facilities. However, the device is typically an open bin which is clustered with other bins in a racking system, each of which holds OEM fasteners, MRO fasteners, and/or non-fastener products that are consumed in the customer's operations. These bins utilize a variety of technologies. For instance, some bins are set up with the latest scanning technologies to determine when product is at a minimum desired level and requires refill, while others utilize scales to measure the volume of a bin's content by its weight. We believe our fully integrated distribution network allows us to manage the supply chain for all sizes of customers. FMI programs tend to generate a higher frequency of business transactions and, coupled with our fully integrated distribution network that allows us to manage these programs for all sizes of customers, foster a strong relationship with customers, as we are often their preferred supplier.

We also invest in digital solutions that aim to deliver strategic value for our customers, leverage local inventory for same-day solutions, and provide efficient service. These solutions take many forms. For instance, the above noted technologies (vending and FMI), provide locational data that we can utilize to provide strategic value to our customers. An example of this is FAST 360, which surfaces data around our managed services, providing our customers with one central source of information as we manage their OEM and MRO products. We also provide eProcurement Solutions (Electronic Data Interface, or 'EDI' and 'punchouts'). These provide system-to-system exchange of documents (such as purchase orders, advance shipping notices, and invoices for direct and indirect spend) through a direct integration into our customer's Enterprise Resource Planning (ERP) systems or through a third party procurement network or marketplace. This creates an efficient, accurate, and streamlined procure-to-pay process. We also have an e-commerce offering that allows us to provide same-day solutions for online orders. We believe our integrated physical and virtual model, when paired with our national (and increasingly international) scope, represents a unique capability in industrial distribution when compared to e-commerce as an independent sales channel. One of our web solutions, Fastenal EXPRESS, guides our customers to products that are locally stocked, capitalizing on our existing location footprint, in order to provide same-day service for online orders. This positions us to outperform what is more typically a 24 to 48 hour fulfillment expectation for MRO and unplanned transactions. We expect to continue to build out and develop our digital solutions over time.

We believe our current growth drivers – Onsite locations, national accounts, industrial vending, FMI, and digital solutions – represent alternative means to address the requirements of certain customer groups. They get us closer to the customer and to where the product is actually consumed. This is consistent with our strategy and offers significant value by providing differentiated and 'sticky' service. Combined with ongoing strategic investments in end market initiatives (such as our Customer Service Project ('CSP') initiatives which expand inventory placement at our branches to enhance same-day capabilities) as well

Table of Contents

as selling (in-market and otherwise) and non-selling (engineering, product specialists, manufacturing, etc.) employees, we offer a range of capabilities that is difficult for large and small competitors to replicate.

We remain committed to a large, robust service network, including traditional branches; it remains the indispensable foundation of our business. In any given year, it is difficult to predict whether our total branch count will rise or fall. However, with the growth we anticipate in Onsite locations, we believe our total in-market locations will increase over time.

It has been our experience that our profitability is affected by the average revenue produced by each branch. While certain costs related to growth at a branch are at least partly variable, such as employee-related expenses, others, like rent and utility costs, tend to be fixed. As a result, it has been shown that as a branch increases its sales base over time it typically will achieve a higher operating profit margin. This ability to increase our average revenue per branch is influenced by: (1) general growth based on end market expansion and/or market share gains, (2) the age of the branch base (new branches tend to be less profitable due to start-up costs and the time necessary to generate a customer base; however, when these new branches mature and increase their sales base, their profitability similarly increases), and (3) rationalization actions – in the past several years the company has seen a net decline in its branch base. There are many reasons why local or regional management might decide to close a branch. Key customers may have migrated to a different part of the market or transitioned to our Onsite model, factories may have closed, or our own supply chain capabilities in a market may have evolved to allow us to service some areas with fewer traditional branches. In the short term, the Onsite program can hurt the profitability of our existing branch network as it can pull established revenue away from an existing branch.

We operate 11 regional distribution centers in the United States – Minnesota, Indiana, Ohio, Pennsylvania, Texas, Georgia, Washington, California, Utah, North Carolina, and Kansas – and three outside the United States – Ontario, Canada; Alberta, Canada; and Nuevo Leon, Mexico. These 14 distribution centers give us approximately 3.9 million square feet of distribution capacity. These distribution centers are located so as to permit deliveries of two to five times per week to our in-market locations using our trucks and overnight delivery by surface common carrier, with approximately 84% of our North American in-market locations receiving service four to five times per week. The distribution center in Indiana also serves as a 'master' hub, with those in California, North Carolina, and Kansas serving as 'secondary' hubs to support the needs of the in-market locations in their geographic regions as well as provide a broader selection of products for the in-market locations serviced by the other distribution centers.

We currently operate our Minnesota, Indiana, Ohio, Pennsylvania, Texas, Georgia, California, North Carolina, Kansas, and Ontario, Canada distribution centers with automated storage and retrieval systems (ASRS). These ten distribution centers operate with greater speed and efficiency, and currently handle approximately 94% of our picking activity. The Indiana facility also contains our centralized replenishment facility for a portion of our industrial vending business. This operation is also highly automated. Construction of a new distribution center in Washington, which will include ASRS technology, began in 2018, and we expect this project to be completed in the fourth quarter of 2019. Construction of a new distribution center in Mississippi also began in 2018, and we expect this project to be completed in the third quarter of 2019. We would expect to add and/or expand new distribution centers over time as our scale and the number of our in-market locations increases.

Our information systems department develops, implements, and maintains the computer based technology used to support business functions within Fastenal. Corporate, digital, distribution center, and vending systems are primarily supported from central locations, while each selling location uses a locally installed Point-Of-Sale (POS) system. The systems consist of both customized, purchased, and licensed software. A dedicated Wide Area Network (WAN) is used to provide connectivity between systems and authorized users.

Trademarks and Service Marks

We conduct business under various trademarks and service marks, and we utilize a variety of designs and tag lines in connection with each of these marks, including Growth Through Customer Service®. Although we do not believe our operations are substantially dependent upon any of our trademarks or service marks, we consider the 'Fastenal' name and our other trademarks and service marks to be valuable to our business.

Products

Fastenal was founded as a distributor of fasteners and related industrial and construction supplies. This includes threaded fasteners, which represent approximately 84% of total fastener sales and includes bolts, nuts, screws, studs, and related washers, as well as miscellaneous supplies and hardware, such as pins, machinery keys, concrete anchors, metal framing systems, wire rope, strut, rivets, and related accessories. Our fastener product line, which is primarily sold under the Fastenal product name, represented 34.9%, 35.6%, and 36.6% of our consolidated net sales in 2018, 2017, and 2016, respectively. Of this, threaded fasteners represented approximately 29%, 30%, and 33% of our consolidated net sales in 2018, 2017, and 2016, respectively.

Fastener distribution is complex. In most cases, the product has low per unit value but high per unit weight. This presents challenges in moving product from suppliers, most of whom are outside of North America, to our distribution centers, as well

Table of Contents

as from our distribution centers to our branch, Onsite, and customer locations. At the same time, fasteners are ubiquitous in manufactured products, construction projects, and maintenance and repair while at the same time exhibiting great geometric variability based on use and application. In many cases, a fastener is a critical part in machine uptime and/or effective use. These features have greatly influenced our logistical development, training and educational programs, support capabilities, and inventory decisions, which we believe would be difficult for competitors to replicate.

In 1993, we began to aggressively add additional product lines, and these represented 65.1%, 64.4%, and 63.4% of our consolidated sales in 2018, 2017, and 2016, respectively. These products, which we refer to as non-fastener product lines, tend to move through the same distribution channel, get used by the same customers, and utilize the same logistical capabilities as the original fastener product line. This logic is as true today as it was when we first began to diversify our product offering. However, over time, the supply chain for these product lines has evolved in ways independent of the fastener line. For instance, non-fastener product lines benefit disproportionately from our development of industrial vending.

The most significant category of non-fastener products is our safety supplies product line, which accounted for 17.2%, 16.3%, and 16.0% of our consolidated sales in 2018, 2017, and 2016, respectively. This product line has enjoyed dramatic sales growth in the last ten years (nearly tripling as a percentage of sales over that ten-year time frame). This is directly related to our success in industrial vending. Our tools product line now accounts for 10% of consolidated net sales, representing 10.0%, 10.1%, and 9.9% in 2018, 2017, and 2016, respectively. Also, in the last several years we added 'private label' brands (often referred to as 'Fastenal brands') to our offering, and these represented approximately 13%, 12%, and 12% of our consolidated net sales in 2018, 2017, and 2016, respectively.

We plan to continue to add other product lines in the future.

Detailed information about our sales by product line is provided in Note 2 of the Notes to Consolidated Financial Statements included later in this Form 10-K. Each product line may contain multiple product categories.

Inventory Control

Our inventory stocking levels are determined using our computer systems, by our sales personnel at in-market locations, by our district and regional leadership, and by our product managers. The data used for this determination is derived from sales activity from all of our selling locations, from individual selling locations, and from different geographic areas. It is also derived from supplier information and from customer demographic information. The computer system monitors the inventory level for all stock items and triggers replenishment, or prompts a buyer to purchase, as necessary, based on an established minimum-maximum level. All branches stock a base inventory and may expand beyond preset inventory levels as deemed appropriate by the district and branch personnel. Non-branch selling locations (primarily Onsites) stock inventory based on customer-specific arrangements. Inventories in distribution centers are established from computerized data for the selling locations served by the respective distribution center. Inventory quantities are continuously re-balanced utilizing an automated transfer mechanism we call 'inventory re-distribution'.

Inventory held at our selling locations, close to customers and available on a same-day basis, accounted for approximately 61%, 65%, and 64% of our total inventory at the end of 2018, 2017, and 2016, respectively. Inventory held at our distribution centers and manufacturing locations accounted for approximately 39%, 35%, and 36% of our total inventory at the end of 2018, 2017, and 2016, respectively. The distribution center and manufacturing location inventory, when combined with our trucking network, allows for fast, next-day service at a very competitive cost.

Manufacturing and Support Services Operations

In 2018, approximately 96% of our consolidated net sales were attributable to products manufactured by other companies to industry standards or to customer specific requirements. The remaining 4% related to products manufactured, modified or repaired by our manufacturing businesses or our support services. The manufactured products consist primarily of non-standard sizes of threaded fasteners made to customers' specifications or standard sizes manufactured under our Holo-Krome® and Cardinal Fasteners® product lines. The services provided by the support services group include, but are not limited to, the repair of tools and hoists, the fabrication of chain sling and hose, band saw blade welding, and other light manufacturing and fabrication. We may add additional services in the future. However, we engage in these activities primarily as a service to our customers and expect them to continue to contribute in the range of 4% to 6% of our consolidated net sales in the future.

Sources of Supply

We use a large number of suppliers for the standard stock items we distribute. Most items distributed by our network can be purchased from several sources, although preferred sourcing is used for some stock items to facilitate quality control. No single supplier accounted for more than 5% of our inventory purchases in 2018.

Table of Contents

Beyond inventory, we have some concentration of purchasing activity. For example, we utilize a limited number of suppliers for distribution equipment, two main suppliers for our vehicle fleet, and primarily one supplier for our industrial vending equipment. However, we believe there are viable alternatives to each of these, if necessary.

Customers and Marketing

We believe our success can be attributed to our ability to offer customers a full line of quality products, our convenient locations and diverse methods of providing those products, and the superior service orientation and expertise of our employees. Most of our customers are in the manufacturing and non-residential construction markets. The manufacturing market includes both OEM and MRO customers. The non-residential construction market includes general, electrical, plumbing, sheet metal, and road contractors. Other users of our products include farmers, truckers, railroads, oil exploration, production, and refinement companies, mining companies, federal, state, and local governmental entities, schools, and certain retail trades.

During the fourth quarter of 2018, our total number of active customer accounts (defined as accounts having purchase activity totaling at least $100 within the last 90 days) was approximately 256,000, while our total 'core accounts' (defined as the average number of accounts with purchase activity of at least $500 per month within the last 90 days) was approximately 80,000. In 2018, we changed our definitions of active customer accounts and 'core accounts' and the figures below are the comparable figures in 2017, which reflects those changes. In 2017, an active account was defined as having spend in the preceding 90 days of $1 (versus the new $100) while 'core accounts' was defined as the average number of accounts with spend in the preceding 90 days of $250 (versus the new $500). Applying the same definitions to 2017 as we now apply to 2018, our active customer accounts would have been 263,000 and our 'core accounts' would have been 77,000 during the fourth quarter of 2017. In addition to providing information externally about the size of our customer base, the concepts of active customer accounts and core accounts are used internally to understand customer size and potential. As our business generally has gotten larger and national accounts have grown in the mix, our historical definitions of these customers has become less informative. The changes in definition were intended to realign our customer base into size categories that more closely align with the profile of our company today. In 2018, no one customer accounted for more than 5% of our sales.

Based on our customer profile being oriented toward manufacturing and non-residential construction, our business has historically been cyclical. However, we believe our model has certain protections that moderate the volatility of our results around cyclical changes. First, we have a large number of customers that serve a wide range of segments within the broader manufacturing and non-residential construction market, although slumps in one industry served by us can rapidly spread to other, interrelated industries, locally or globally. However, we still believe this customer and market segment diversity provides some insulation from economic changes that are not across multiple industries and geographic regions. In addition, a meaningful part of our revenue is derived from products that are incorporated into final products. However, we also have a significant portion of revenue that is derived from products used to maintain facilities, and while this revenue tends to be directly influenced by cyclical changes, its rate of change tends to be less dramatic.

Direct marketing continues to be the backbone of our business through our local in-market selling personnel, as well as our non-branch selling personnel. We support our sales team with multi-channel marketing including direct mail and digital marketing, print and radio advertising, catalogs, promotional flyers, events, and branch signage. In recent years, our national advertising has been focused on a NASCAR® sponsorship through our partnership with Roush Fenway Racing® as the primary sponsor of Ricky Stenhouse Jr.'s No. 17 car in the Monster Energy® NASCAR® Cup Series.

Seasonality

Seasonality has some impact on our sales. The first and fourth quarters are typically our lowest volume periods, given their overlap with winter months in North America during which our sales to customers in the non-residential construction market typically slow due to inclement weather. The fourth quarter also tends to be more greatly affected by the Thanksgiving (October in Canada and November in the United States), Christmas, and New Year holiday periods, due to plant shut downs. In contrast, the second and third quarters typically have higher revenues due to stronger non-residential construction activity and relatively fewer holidays (although Good Friday will sometimes fall in the second quarter and the 4th of July will always fall in the second quarter).

Competition

Our business is highly competitive, and includes large competitors located primarily in large cities and smaller distributors located in many of the same smaller markets in which we have branches. We believe the principal competitive factors affecting the markets for our products, in no particular order, are customer service, price, convenience, product availability, and cost saving solutions.

Market strategies in industrial distribution are varied. Where products are concerned, while many larger distributors have trended toward a broad-line offering over time, they are often still closely associated with a specific product that can influence their ability to capture market share. This association with a specific product line is often even more pronounced among smaller competitors, though many smaller competitors do deploy a broad-line model. Means of serving the customer are even more

Table of Contents

diverse. For instance, many competitors maintain a local, branch-based presence in their markets, while others use vans to sell products in markets away from their main warehouses, while still others rely on catalogs or telemarketing sales. Recent years have seen the emergence of e-commerce solutions, such as websites, and while this channel has been embraced by many traditional distributors it also has introduced non-traditional, web-based competitors into the marketplace. The diversity of product and service models supported in the marketplace is a reflection of the equally diverse product and service needs of the customer base. The large majority of our customers utilize multiple channels, from a single distributor where they are offered or from a range of distributors, to procure the products they need in their operations.

We believe that better service, and a competitive selling advantage, can be provided by maintaining a physical presence closer to the customer's location(s). As a result, we maintain branches in small, medium, and large markets, each offering a wide variety of products. The convenience of a large number of branches in a given area, combined with our ability to provide frequent deliveries to such branches from centrally located distribution centers, facilitates the prompt and efficient distribution of products. We also believe our industrial vending and bin stock solutions, supported from an in-market (branch or Onsite) location, provides a unique way to provide our customers convenient access to products and cost saving solutions using a business model not easily replicated by our competitors. Having trained personnel at each in-market location also enhances our ability to compete (see 'Employees' below).

Our Onsite service model provides us with a strategic advantage with our larger customers. Building on our core business strategy of the local branch, the Onsite model provides value to our customers through customized service while giving us a competitive advantage through stronger relationships with those customers, all with a relatively low investment given the existing branch and distribution structure.

Employees

At the end of 2018, we employed 21,644 full and part-time employees. Of these, approximately 73% held an in-market or non-branch selling role. We characterize these personnel as follows:

	2018	2017
In-market locations	14,015	13,424
Non-branch selling	1,772	1,711
Selling subtotal	15,787	15,135
Distribution	3,830	3,575
Manufacturing	736	652
Administrative	1,291	1,203
Non-selling subtotal	5,857	5,430
Total	21,644	20,565

Note – In materials released on January 17, 2019 related to our fourth quarter and full year 2018 earnings results, we undercounted our total employees by 25. We corrected this in the table above, and throughout this document, and as a result some of the figures will not match the comparable figures in our previously published fourth quarter and full year 2018 earnings results.

We believe the quality of our employees is critical to our ability to compete successfully in the markets we currently serve and to our ability to develop new markets and customer relationships. We foster the growth and education of skilled employees throughout the organization by operating training programs and by decentralizing decision-making. Wherever possible, our goal is to 'promote from within'. For example, most new branch and Onsite managers are promoted from an outside sales position and district managers (who supervise a number of in-market locations) are usually former branch managers.

The Fastenal School of Business (our internal corporate university program, known as FSB) develops and delivers a comprehensive array of industry and company-specific training and development programs that are offered to our employees. The programs are offered through a combination of both classroom training and online learning. FSB provides core curricula focused on key competencies determined to be critical to the success of our employees' performance. In addition, we provide specialized educational tracks within various institutes of learning. These institutes of learning are advanced levels that provide specific concentrations of education and development and have been designed to focus on critical aspects of our business, such as leadership, effective branch best practices, sales and marketing, product education, and distribution.

Our selling personnel are compensated with a base salary and an incentive bonus arrangement that places emphasis on achieving increased sales on a branch, Onsite, district, regional, and national account basis, while still attaining targeted levels of, among other things, gross profit and trade accounts receivable collections. As a result, a significant portion of our total employment cost varies with sales volume. We also pay incentive bonuses to our leadership personnel based on one or more of

Table of Contents

the following factors: sales growth, earnings growth (before and after taxes), profitability, and return on assets improvement, and to our other personnel for achieving predetermined departmental, project, and cost-containment goals.

Our employees are not subject to any collective bargaining agreements and we have experienced no work stoppages. We believe our employee relations are good.

Available Information

Our Internet address for corporate and investor information is www.fastenal.com. The information contained on our website or connected to our website is not incorporated by reference into this annual report on Form 10-K and should not be considered part of this report.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are available free of charge on or through our website at www.fastenal.com as soon as reasonably practicable after such reports have been filed with or furnished to the SEC.

Table of Contents

ITEM 1A. RISK FACTORS

In addition to the other information in this Form 10-K, the following factors should be considered in evaluating our business. Our operating results depend upon many factors and are subject to various risks and uncertainties. The most significant risks and uncertainties known to us which may cause our operating results to vary from anticipated results or which may negatively affect our operating results and profitability are as follows:

Company Risks

Products that we sell may expose us to potential material liability for property damage, environmental damage, personal injury, or death linked to the use of those products by our customers. Some of our customers operate in challenging industries where there is a material risk of catastrophic events. We are actively seeking to expand our sales to certain categories of customers, some of whose businesses may entail heightened levels of such risk. If any of these events are linked to the use by our customers of any of our products, claims could be brought against us by those customers, by governmental authorities, and by third parties who are injured or damaged as a result of such events. In addition, our reputation could be adversely affected by negative publicity surrounding such events regardless of whether or not claims against us are successful. While we maintain insurance coverage to mitigate a portion of this risk and may have recourse against our suppliers for losses arising out of defects in products procured from them, we could experience significant losses as a result of claims made against us to the extent adequate insurance is not in place, the products are manufactured by us or legal recourse against our suppliers is otherwise not available, or our insurers or suppliers are unwilling or unable to satisfy their obligations to us.

Interruptions in the proper functioning of information systems or the inability to maintain or upgrade our information systems, or convert to alternate systems in a timely and efficient manner, could disrupt operations, cause unanticipated increases in costs and/or decreases in revenues, and result in less efficient operations. The proper functioning of our information systems is critical to many aspects of our business and we could be adversely affected if we experience a disruption or data loss relating to our information systems and are unable to recover in a timely manner. Our information systems are protected with robust backup systems and processes, including physical and software safeguards and remote processing capabilities. Still, information systems are vulnerable to natural disasters, power losses, unauthorized access, telecommunication failures, and other problems. In addition, certain software used by us is licensed from, and certain services related to our information systems are provided by, third parties who could choose to discontinue their products or services or their relationship with us. It is also possible that we are unable to improve, upgrade, maintain, and expand our information systems. Our ability to process orders, maintain proper levels of inventories, collect accounts receivable, pay expenses, and maintain the security of company and customer data, as well as the success of our growth drivers, is dependent in varying degrees on the effective and timely operation and support of our information technology systems. If critical information systems fail or these systems or related software or services are otherwise unavailable, or if we experience extended delays or unexpected expenses in securing, developing, and otherwise implementing technology solutions to support our growth and operations, it could adversely affect our profitability and/or ability to grow.

In the event of a cyber security incident, we could experience certain operational interruptions, incur substantial additional costs, become subject to legal or regulatory proceedings, or suffer damage to our reputation in the marketplace. The nature of our business requires us to receive, retain, and transmit certain personally identifying information that our customers provide to purchase products or services, register on our websites, or otherwise communicate and interact with us. While we have taken and continue to undertake significant steps to protect our customer and confidential information, a compromise of our data security systems or those of businesses we interact with could result in information related to our customers or business being obtained by unauthorized persons. We develop and update processes and maintain systems in an effort to try to prevent this from occurring and have established and maintained disclosure controls and procedures that would permit us to make accurate and timely disclosures of any material event, including any cyber security event, but the development and maintenance of these processes and systems are costly and require ongoing monitoring and updating as technologies change and efforts to overcome security measures become more sophisticated. Consequently, despite our efforts, the possibility of cyber security incidents cannot be eliminated entirely. We have not encountered any meaningful incidents but there can be no assurance that we will not experience a cyber security incident that may materially impact our consolidated financial statements. While we also seek to obtain assurances that third parties we interact with will protect confidential information, there is a risk the confidentiality of data held or accessed by third parties may be compromised. If a compromise of our data security were to occur, it could interrupt our operations, subject us to additional legal, regulatory, and operating costs, and damage our reputation in the marketplace.

We may be unable to meet our goals regarding the growth drivers of our business. Our sales growth is dependent primarily on our ability to attract new customers and increase our activity with existing customers. Historically, the most effective way to attract new customers has been opening new branches. In recent years, however, we have devoted increased resources to other growth drivers, including our industrial vending business, our Onsite business, our national accounts team, and our international operations. While we have taken steps to build momentum in the growth drivers of our business, we cannot assure you those steps will lead to additional sales growth. Failure to achieve any of our goals regarding industrial vending, FMI,

Table of Contents

Onsite locations, national accounts signings, digital solutions, international operations, or other growth drivers could negatively impact our long-term sales growth. Further, failure to identify appropriate targets for our Onsite and industrial vending businesses or failure to find suitable locations for them once appropriate targets are identified may adversely impact our goals regarding the number of new Onsite locations we are able to open or the number of industrial vending devices we are able to deploy.

Changes in customer or product mix, downward pressure on sales prices, and changes in volume of orders could cause our gross profit percentage to fluctuate or decline in the future. Changes in our customer or product mix could cause our gross profit percentage to fluctuate or decline. For example, the portion of our sales attributable to fasteners has been decreasing in recent years. That has adversely affected our gross profit percentage as our non-fastener products generally carry lower gross profit margins than our fastener products. Similarly, in recent years, revenues from national accounts customers, which typically have lower gross profit margins by virtue of their scale and available business, have tended to grow faster than revenues from smaller customers. This factor has become more significant as revenues from Onsite locations has grown in the mix. If our customer or product mix continues to change, our gross profit percentage may decline further. Downward pressure on sales prices and changes in the volume of our orders could also cause our gross profit percentage to fluctuate or decline. We can experience downward pressure on sales prices as a result of deflation, pressure from customers to reduce costs, or increased competition. Reductions in our volume of purchases can adversely impact gross profit by reducing supplier volume allowances. Customer and product mix have contributed to the decline in our gross profit percentage over time, including in 2018 and 2017, and will likely continue to affect our gross profit percentage in 2019 and beyond. However, whether this adverse mix impact will result in a decline of our gross profit percentage in any given year will depend on the extent to which they are, or are not, offset by positive impacts to gross profit margin during such year.

Our operating and administrative expenses could grow more rapidly than net sales which could result in failure to achieve our goals related to leveraging revenue growth into higher net earnings. Over time, we have generally experienced an increase in our operating and administrative expenses, including costs related to payroll, occupancy, freight, and information technology, among others, as our net sales have grown. However, historically, a portion of these expenses has not increased at the same rates as net sales, allowing us to leverage our growth and sustain or expand our operating profit margins. There are various scenarios where we may not be able to continue to achieve this leverage as we have been able to do in the past. For instance, it is typical that when demand declines, most commonly from cyclical factors (though it could be due to customer losses or some other company-specific event), our operating and administrative expenses do not fall as quickly as net sales. It is also possible that in the future we will elect to make investments in operating and administrative expenses that would result in costs growing faster than net sales. In addition, market variables, such as labor rates, energy costs, and legal costs, could move in such a way as to cause us to not be able to manage our operating and administrative expenses in a way that would enable us to leverage our revenue growth into higher net earnings. Should any of these scenarios, or a combination of them, occur in the future, it is possible that our operating and pre-tax profit margins could decline even if we are able to grow revenue.

Our competitive advantage in our industrial vending business could be eliminated and the loss of key suppliers of equipment and services for that business could be disruptive and could result in failure to deploy devices. We believe we have a competitive advantage in industrial vending due to our vending hardware and software, our local branch presence (allowing us to service devices more rapidly), our 'vendible' product depth, and in North America, our distribution strength. These advantages have developed over time; however, other competitors could respond to our expanding industrial vending business with highly competitive platforms of their own. Such competition could negatively impact our ability to expand our industrial vending business or negatively impact the economics of that business. In addition, we currently rely on a limited number of suppliers for the vending devices used in, and certain software and services needed to operate, our industrial vending business. While these devices, software, and services can be obtained from other sources, loss of our current suppliers could be disruptive and could result in us failing to meet our goals related to the number of devices we are able to deploy in the next twelve to eighteen months.

The ability to identify new products and product lines, and integrate them into our selling locations and distribution network, may impact our ability to compete, our ability to generate additional sales, and our profit margins. Our success depends in part on our ability to develop product expertise at the selling location level and identify future products and product lines that complement existing products and product lines and that respond to our customers' needs. We may not be able to compete effectively unless our product selection keeps up with trends in the markets in which we compete or trends in new products. In addition, our ability to integrate new products and product lines into our branches and distribution network could impact sales and profit margins.

Our ability to successfully attract and retain qualified personnel to staff our selling locations could impact labor costs, sales at existing selling locations, and the successful execution of our growth drivers. Our success depends in part on our ability to attract, motivate, and retain a sufficient number of qualified employees, including inside and outside branch associates, Onsite managers, national account sales representatives, and support personnel, who understand and appreciate our culture and are able to adequately represent this culture to our customers. Qualified individuals of the requisite caliber and number needed to fill these positions may be in short supply in some areas, and the turnover rate in the industry is high. If we are unable to hire

Table of Contents

and retain personnel capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and product knowledge, our sales could be materially adversely affected. Additionally, competition for qualified employees could require us to pay higher wages to attract a sufficient number of employees. An inability to recruit and retain a sufficient number of qualified individuals in the future may also delay the planned expansion of our various selling channels.

Our inability to attract or transition key executive officers may divert the attention of other members of our senior leadership and adversely impact our existing operations. Our success depends on the efforts and abilities of our key executive officers and senior leadership. In the event of voluntary or involuntary vacancies in our executive team in the future, the extent to which there is disruption in the oversight and/or leadership of our business will depend on our ability to either transition internal, talented individuals or recruit suitable replacements to serve in these roles. In addition, difficulties in smoothly implementing any transition to new members of our executive team, or recruiting suitable replacements, could divert the attention of other members of our senior leadership team from our existing operations.

We may not be able to compete effectively against traditional or non-traditional competitors, which could cause us to lose market share or erode our operating income profit and/or percentage. The industrial, construction, and maintenance supply industry, although slowly consolidating, still remains a large, fragmented, and highly competitive industry. Our current or future competitors may include companies with similar or greater market presence, name recognition, and financial, marketing, technological, and other resources, and we believe they will continue to challenge us with their product selection, financial resources, technological advancements, and services. Increased competition from brick-and-mortar retailers could cause us to lose market share or reduce our prices or increase our spending. Similarly, the emergence of on-line retailers, whether as extensions of our traditional competition or in the form of major, non-traditional competitors, could result in easier and quicker price discovery and the adoption of aggressive pricing strategies and sales methods. These pressures could have the effect of eroding our operating income profit and/or percentage over time.

Our business is subject to a wide array of operating laws and regulations in every jurisdiction where we operate. Compliance with these laws and regulations increases the cost of doing business and failure to comply could result in the imposition of fines or penalties and the termination of contracts. We are subject to a variety of laws and regulations including without limitation; import and export requirements, anti-bribery and corruption laws, product compliance laws, environmental laws, foreign exchange controls and cash repatriation restrictions, advertising regulations, data privacy and cyber security requirements, regulations on suppliers regarding the sources of supplies or products, labor and employment laws, and anti-competition regulations. In addition, as a supplier to federal, state, and local government agencies, we must comply with certain laws and regulations relating specifically to the formation, administration, and performance of our governmental contracts. We are also subject to governmental audits and inquiries in the normal course of business. Ongoing audit activity and changes to the legal and regulatory environments could increase the cost of doing business, and such costs may increase in the future as a result of changes in these laws and regulations or in their interpretation. While we have implemented policies and procedures designed to facilitate compliance with these laws and regulations, there can be no assurance that our employees, contractors, or agents will not violate such laws and regulations, or our policies. Any such violations could result in the imposition of fines and penalties, damage to our reputation, and, in the case of laws and regulations relating specifically to governmental contracts, the loss of those contracts.

Tax laws and regulations require compliance efforts that can increase our cost of doing business and changes to these laws and regulations could impact financial results. We are subject to a variety of tax laws and regulations in the jurisdictions in which we operate. Maintaining compliance with these laws can increase our cost of doing business and failure to comply could result in audits or the imposition of fines or penalties. Further, our future effective tax rates in any of these jurisdictions could be affected, positively or negatively, by changing tax priorities, changes in statutory rates, or changes in tax laws or the interpretation thereof. The most significant recent example of this is the comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the 'Tax Act'), which was enacted in the United States in December 2017. The Tax Act reduced the U.S. federal corporate income tax rate, included a one-time tax on accumulated offshore earnings, eliminated certain deductions for which we had previously qualified, requires a current inclusion in U.S. federal income of certain earnings of controlled foreign corporations, allows a domestic corporation an immediate deduction in U.S. taxable income for a portion of its foreign-derived intangible income, and introduced a base erosion anti-abuse tax. There is also a longer term risk that the beneficial aspects of the Tax Act on our business could be reversed depending on changes in future fiscal or political priorities.

We may not be successful in integrating acquisitions and achieving intended benefits and synergies. We have completed several acquisitions of businesses in recent years. We expect to continue to pursue strategic acquisitions that we believe will either expand or complement our business in new or existing markets or further enhance the value and offerings we are able to provide to our existing or future potential customers. Acquisitions involve numerous risks and challenges, including, among others, a risk of potential loss of key employees of an acquired business, inability to achieve identified operating and financial synergies anticipated to result from an acquisition, diversion of our capital and our management's attention from other business issues, and risks related to the integration of the acquired business including unanticipated changes in our business, our industry, or general economic conditions that affect the assumptions underlying the acquisition. Any one or more of these factors could cause us to not realize the benefits anticipated to result from the acquisitions.

Table of Contents

Industry and General Economic Risks

A downturn in the economy or in the principal markets served by us and other factors may affect customer spending, which could harm our operating results. In general, our sales represent spending on discretionary items or consumption needs by our customers. This spending is affected by many factors, including, among others:

- general business conditions,
- business conditions in our principal markets,
- interest rates,
- inflation,
- liquidity in credit markets,
- taxation,
- government regulations and actions, including around trade policy,
- energy and fuel prices and electrical power rates,
- unemployment trends,
- terrorist attacks and acts of war,
- weather conditions, and
- other matters that influence customer confidence and spending.

A downturn in either the national or local economy where we operate, or in the principal markets served by us, or changes in any of the other factors described above, could negatively impact sales at our in-market locations, sales through our other selling channels, and the level of profitability of those in-market locations and other selling channels.

This risk was most recently demonstrated in 2015 and 2016. We have significant exposure to companies involved in the manufacture of capital goods and heavy equipment. In 2015, our business was impacted by lower commodity prices, including oil, lower corporate capital spending, and a strong U.S. dollar. These variables resulted in some of our customers exhibiting a reduced level of business activity and confidence. When this happens, these customers tend to cut back on spending which yields a slowdown in our business with these customers. These same dynamics carried into 2016. In 2017, these conditions mostly reversed. Certain commodity prices recovered and corporate investment improved, leading to better capital spending trends among our customers. This improvement in customer spending helped to improve our net sales and sales growth in 2017 and throughout 2018.

New trade policies could make sourcing product from overseas more difficult and/or more costly, and could adversely impact our operating profit percentage. We source a significant amount of the products we sell from outside of the United States, primarily Asia. We have made significant structural investments over time to be able to source both directly from Asia through our wholly-owned, Asia-based subsidiary, FASTCO Trading Co., Ltd. and indirectly from suppliers that procure product from international sources. This was initially necessary due to the absence of significant domestic fastener production, but over time we have expanded our non-fastener sourcing as well, and at this time it may be difficult to adjust our sourcing in the short term. In light of this, changes in trade policies could affect our sourcing operations, our ability to secure sufficient product to serve our customers and/or impact the cost or price of our products, with potentially adverse impacts on our gross and operating profit percentages and financial results. These risks are particularly acute currently in light of an increase in tariffs, either directly on products we trade in or indirectly on industries we sell into, between the United States and its trading partners, as well as greater uncertainty around regional and global trade agreements generally. China and Canada represent significant sources of product and Canada and Mexico represent our two largest markets in terms of revenue generation after the United States, and each of these countries are currently and/or have been previously subject to disruption due to historical trade policies. There can be no assurances that these disruptions will not continue or increase in the future, with the previously mentioned countries or additional countries with which we do business. The degree to which these changes in the global marketplace affect our financial results will be influenced by the specific details of the changes in trade policies, their timing and duration, and our effectiveness in deploying tools to address these issues. In particular, the tariffs levied on certain products originating in China, including many that we source and sell, that went into effect on September 24, 2018, have caused us to review and implement potential solutions to the increase in our product costs with our customers. However, it is too early to determine the ultimate impact and effectiveness of these discussions.

New trade policies could have an adverse impact on industries we sell into, negatively affecting our net sales and profits. Considerable political uncertainty in the United States may result in changes to trade policies that could create disruption in geographic demand trends. To the extent that the United States government enacts tariffs or taxes that penalize imports to benefit domestic manufacturing, we may improve our domestic sales which may have an overall positive impact on us given that 86% of our total revenue is derived from the United States. However, any such action may adversely impact our foreign sales, which may, in turn, adversely impact our ability to expand our overseas branches in the future. In addition, should a foreign government engage in its own trade protection, independent of or in response to another nation's action, it could have a negative direct or, more likely, indirect effect on our net sales and profits by reducing demand for exports by United States companies. Such changes could adversely affect our financial results.

Table of Contents

Products manufactured in foreign countries may cease to be available for reasons unrelated to trade policy, which could adversely affect our inventory levels and operating results. We obtain certain of our products, and our suppliers obtain certain of their products, from China, Taiwan, South Korea, Mexico, and other foreign countries. Our suppliers could discontinue selling products manufactured in foreign countries at any time for reasons that may or may not be in our control or our suppliers' control, including foreign government regulations, domestic government regulations, political unrest, war, disruption or delays in shipments, or changes in local economic conditions. Additionally, the shipment of goods from foreign countries could be delayed by container shipping companies encountering financial or other difficulties. Our operating results and inventory levels could suffer if we are unable to promptly replace a supplier or shipper who is unwilling or unable to satisfy our requirements with another supplier or shipper providing equally appealing products and services.

Changes in energy costs and the cost of raw materials used in our products could impact our net sales, cost of sales, gross profit percentage, distribution expenses, and occupancy expenses, which may result in lower operating income. Costs of raw materials used in our products (e.g., steel) and energy costs can fluctuate significantly over time. Increases in these costs result in increased production costs for our suppliers. These suppliers typically look to pass their increased costs along to us through price increases. The fuel costs of our distribution and branch operations have fluctuated as well. While we typically try to pass higher supplier prices and fuel costs through to our customers or to modify our activities to mitigate the impact, we may not be successful, particularly if supplier prices or fuel costs rise rapidly. Failure to fully pass any such increased prices and costs through to our customers or to modify our activities to mitigate the impact would have an adverse effect on our operating income. While increases in the cost of fuel or raw materials could be damaging to us, decreases in those costs, particularly if severe, could also adversely impact us by creating deflation in selling prices, which could cause our gross profit to deteriorate, or by negatively impacting customers in certain industries, which could cause our sales to those customers to decline.

The industrial, construction, and maintenance supply industry is consolidating, which could cause it to become more competitive and could negatively impact our market share, gross profit, and operating income. The industrial, construction, and maintenance supply industry in North America is consolidating. This consolidation is being driven by customer needs and supplier capabilities, which could cause the industry to become more competitive as greater economies of scale are achieved by suppliers, or as competitors with new business models are willing and able to operate with lower gross profit on select products. Customers are increasingly aware of the total costs of fulfillment and of the need to have consistent sources of supply at multiple locations. We believe these customer needs could result in fewer suppliers as the remaining suppliers become larger and capable of being a consistent source of supply. There can be no assurance we will be able in the future to take effective advantage of the trend toward consolidation. The trend in our industry toward consolidation could make it more difficult for us to maintain our current gross profit and operating income. Furthermore, as our industrial customers face increased foreign competition, and potentially lose business to foreign competitors or shift their operations overseas in an effort to reduce expenses, we may face increased difficulty in growing and maintaining our market share.

Inclement weather and other disruptions to the transportation network could adversely impact our distribution system and demand for our products. Our ability to provide efficient distribution of core business products to our branch network is an integral component of our overall business strategy. Disruptions at distribution centers or shipping ports may affect our ability to both maintain core products in inventory and deliver products to our customers on a timely basis, which may in turn adversely affect our results of operations. In addition, severe weather conditions could adversely affect demand for our products in particularly hard hit regions. In August and September 2017, we experienced temporary disruptions in our distribution network in our Gulf Coast, Florida, Georgia, and Puerto Rico regions due to hurricanes Harvey, Irma, and Maria. These storms adversely impacted our product demand and revenues, as well as our gross and operating profit percentages, due to an increase in demand for storm-related products which have a lower gross profit margin, and inefficiencies in delivery services in the immediate aftermath of the storms. In September 2018, hurricane Florence had a similar impact in our Carolinas region.

Our current estimates of total market potential as well as the market potential of our business strategies could be incorrect. We believe we have a significant opportunity for growth based on our belief that North American market demand for the products we sell is estimated to exceed $140 billion. This figure is not derived from an independent organization or data source that aggregates and publishes widely agreed-upon demand and market share statistics. Instead, we have identified this figure based on our own experience in the marketplace for our products and by evaluating estimates from other sources. If we have overestimated the size of our market, and in doing so, underestimated our current share of it, the size of our opportunity for growth may not be as significant as we currently believe. Similarly, we have provided estimates of the opportunities we have with some of our specific growth strategies, such as industrial vending and Onsite locations. We believe the potential market opportunity for industrial vending is approximately 1.7 million devices and we have identified over 15,000 customer locations with the potential to implement our Onsite service model. Similar to the case for total market size, we use our own experience and data to arrive at the size of these potential opportunities and not independent sources. These estimates are based on our business model today, and the introduction or expansion of other business strategies, such as on-line retailing, could cause them to change. In addition, the market potential of a particular business strategy may vary from expectations due to a change in the marketplace (such as changes in customer concentration or needs), a change in the nature of that business strategy, or weaker

Table of Contents

than anticipated acceptance by customers of that business strategy. We cannot guarantee that our market potential estimates are accurate or that we will ultimately decide to expand our industrial vending or Onsite service models as we anticipate to reach the full market opportunity.

We are exposed to foreign currency exchange rate risk, and changes in foreign exchange rates could increase the cost of purchasing products and impact our foreign sales. Because the functional currency related to most of our foreign operations is the applicable local currency, we are exposed to foreign currency exchange rate risk arising from transactions in the normal course of business. Fluctuations in the relative strength of foreign economies and their related currencies could adversely impact our ability to procure products overseas at competitive prices and our foreign sales. Historically, our primary exchange rate exposure has been with the Canadian dollar. There can be no assurance that currency exchange rate fluctuations with the Canadian dollar and other foreign currencies will not adversely affect our results of operations, financial condition, and cash flows. While the use of currency hedging instruments may provide us with protection from adverse fluctuations in currency exchange rates, we are not currently using these instruments and we have not historically hedged this exposure. If we decide to do so in the future, we could potentially forego the benefits that might result from favorable fluctuations in currency exchange rates.

Tight credit markets could impact our ability to obtain financing on reasonable terms or increase the cost of existing or future financing and interest rate fluctuations could adversely impact our results. As of December 31, 2018, we had $500.0 of outstanding debt obligations, including loans outstanding under our revolving credit facility (the 'Credit Facility') of $365.0 and senior unsecured promissory notes issued under our master note agreement (the 'Master Note Agreement') in the aggregate principal amount of $135.0. Loans under the Credit Facility bear interest at a rate per annum based on the London Interbank Offered Rate ('LIBOR') and mature on November 30, 2023. The notes issued under our Master Note Agreement consist of three series. The first is in an aggregate principal amount of $40.0, bears interest at a fixed rate of 2.00% per annum, and is due and payable on July 20, 2021. The second is in an aggregate principal amount of $35.0, bears interest at a fixed rate of 2.45% per annum, and is due and payable on July 20, 2022. The third is in an aggregate principal amount of $60.0, bears interest at a fixed rate of 3.22% per annum, and is due and payable on March 1, 2024. Our aggregate borrowing capacity under the Credit Facility is $700.0. Our aggregate borrowing capacity under the Master Note Agreement is $600.0; however, none of the institutional investors that are parties to that agreement are committed to purchase notes thereunder.

During periods of volatility and disruption in the United States credit markets, financing may become more costly and more difficult to obtain. Although the credit market turmoil of 2008 and 2009 did not have a significant adverse impact on our liquidity or borrowing costs given our low level of indebtedness at that time, the availability of funds tightened and credit spreads on corporate debt increased. Our indebtedness has increased since 2009 and we have the capacity under our Credit Facility and Master Note Agreement to increase borrowings in the future. If credit market volatility were to return or if interest rates continue to rise, the cost of servicing our existing debt could increase due to the LIBOR-based interest rate provided for under our Credit Facility. In addition, borrowing additional amounts to finance stock purchases, dividends, capital expenditures, and other liquidity needs or to refinance our existing indebtedness could be difficult and the cost of doing so could be high.

Investment Risk

There can be no assurance that our stock price will continue to reflect the current multiple of earnings over time. Stock prices, including ours, are commonly thought to be a function of earnings multiplied by a multiple. Historically, investors have given our earnings a higher multiple, or premium, than is typical of the broader industrial sector of which we are typically associated. We believe we have earned this premium by virtue of a long history of superior growth, profitability, and returns. However, to the extent that we fail to successfully execute our growth strategies and/or poorly navigate the risks that surround our business, including those described throughout this section, or to the extent our industry (industrial distribution, or industrial stocks in general) loses favor in the marketplace, there can be no assurance that investors will continue to afford a premium multiple to our earnings which could adversely affect our stock price.

We cannot provide any guaranty of future dividend payments or that we will continue to purchase shares of our common stock pursuant to our share purchase program. Although our board of directors has historically authorized the payment of quarterly cash dividends on our common stock and indicated an intention to do so in the future, there are no assurances that we will continue to pay dividends in the future or continue to increase dividends at historic rates. In addition, although our board of directors has authorized share purchase programs and we purchased shares in 2018, 2017 and prior years through these programs, we may discontinue doing so at any time. Any decision to continue to pay quarterly dividends on our common stock, to increase those dividends, or to purchase our common stock in the future will be based upon our financial condition and results of operations, the price of our common stock, credit conditions, and such other factors as are deemed relevant by our board of directors.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Table of Contents

ITEM 2. PROPERTIES

Note – Information in this section is as of December 31, 2018, unless otherwise noted.

We own the following facilities in Winona, Minnesota:

Purpose	Tote Locations (ASRS)[1]	Approximate Square Feet
Distribution center and home office [2]	246,000	259,000
Manufacturing facility		100,000
Computer support center		13,000
Winona branch		15,000
Winona product support facility		55,000
Rack and shelving storage		42,000
Multi-building complex which houses certain operations of the distribution group, the support services group, and the home office support group		30,000
Customer support center		100,000

[1] Total number of tote locations for small parts storage included in facilities with an ASRS.

[2] During 2018, we acquired land for future expansion of our home office.

We own the following facilities, excluding selling locations, outside of Winona, Minnesota:

Purpose	Location	Tote Locations (ASRS)[1]		Approximate Square Feet
Distribution center	Indianapolis, Indiana	561,000	[2]	1,039,000
Manufacturing facility	Indianapolis, Indiana			220,000
Distribution center	Akron, Ohio	103,000		182,000
Distribution center	Scranton, Pennsylvania	104,000		189,000
Distribution center	Denton, Texas	41,000	[3]	176,000
Distribution center	Atlanta, Georgia	77,000		198,000
Distribution center [4]	Seattle, Washington	—		—
Distribution center and manufacturing facility	Modesto, California	69,000		328,000
Distribution center	High Point, North Carolina	132,000		301,000
Distribution center [5]	High Point, North Carolina	—		350,000
Distribution center	Kansas City, Kansas	170,000		300,000
Distribution center	Kitchener, Ontario, Canada	128,000		142,000
Distribution center [6]	Jackson, Mississippi	—		—
Manufacturing facility	Wallingford, Connecticut			187,000
Manufacturing facility	Rockford, Illinois			100,000
Local re-distribution center and manufacturing facility	Johor, Malaysia			27,000

[1] Total number of tote locations for small parts storage included in facilities with an ASRS.

[2] This property contains an ASRS with capacity of 52,000 pallet locations, in addition to the 561,000 tote locations for small parts; 105,000 of these small part tote locations are located in the industrial vending automated replenishment facility, which is also located on this property.

[3] This facility contains an ASRS with capacity of 14,000 pallet locations, in addition to the 41,000 tote locations for small parts.

[4] Construction of a new distribution center in Washington, which will include ASRS technology, began in 2018 and we expect this to be completed in the fourth quarter of 2019.

[5] In late December 2018, we purchased an additional distribution center in High Point, North Carolina with approximately 750,000 total square feet. Approximately 400,000 square feet will continue to be leased by the previous owner for three years. We began utilizing approximately 350,000 square feet for distribution activities in early 2019.

(6) Construction of a new distribution center in Mississippi began in 2018, and we expect this project to be complete in the third quarter of 2019.

Table of Contents

In addition, we own 172 buildings that house our in-market locations in various cities throughout North America. All other buildings we occupy are leased. Leased branches range from approximately 3,000 to 10,000 square feet, with lease terms of up to 60 months (most initial lease terms are for 36 to 48 months). In addition to our leased branch locations, we also lease the following facilities:

Purpose	Location	Approximate Square Feet	Lease Expiration Date	Remaining Lease Renewal Options
Distribution center	Seattle, Washington [1]	100,000	April 2022	None
Distribution center	Salt Lake City, Utah	74,000	July 2019	One
Distribution center and packaging facility	Salt Lake City, Utah	26,000	July 2019	One
Distribution center and manufacturing facility	Edmonton, Alberta, Canada	45,000	July 2020	None
Distribution center	Apodaca, Nuevo Leon, Mexico	46,000	March 2020	Three
Manufacturing facility	Houston, Texas	21,000	July 2019	None
Local re-distribution center and manufacturing facility	Modrice, Czech Republic	15,000	April 2022	None

[1] We currently own land in the Seattle, Washington area for the construction of a new distribution center, which began in 2018, and when completed, will replace the current leased facility.

We currently own land for future distribution center expansion and development. If economic conditions are suitable in the future, we will consider purchasing branch locations to house our older branches. It is anticipated the majority of new branch locations will continue to be leased. It is our policy to negotiate relatively short lease terms to facilitate relocation of particular branch operations, when desirable. Our experience has been that there is sufficient space suitable for our needs and available for leasing.

ITEM 3. LEGAL PROCEEDINGS

A description of our legal proceedings, if any, is contained in Note 10 of the Notes to Consolidated Financial Statements.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock Data

Dollar amounts in this section are stated in whole numbers.

Our shares are traded on The Nasdaq Stock Market under the symbol 'FAST'. As of January 18, 2019, there were approximately 1,100 record holders of our common stock, which includes nominees or broker dealers holding stock on behalf of an estimated 283,000 beneficial owners.

Issuer Purchases of Equity Securities

The table below sets forth information regarding purchases of our common stock during each of the last three months of 2018:

	(a)	(b)	(c)	(d)
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 1-31, 2018	1,200,000	$52.16	0	2,400,000
November 1-30, 2018	0	—	0	2,400,000
December 1-31, 2018	0	—	0	2,400,000
Total	1,200,000	$52.16	0	2,400,000

(1) On July 11, 2017, our board of directors established a new authorization for us to repurchase up to 5,000,000 shares of our common stock. As of December 31, 2018, we had remaining authority to repurchase 2,400,000 shares under this authorization.

Purchases of shares of our common stock throughout 2018 are described later in this Form 10-K under the heading 'Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations'.

Table of Contents

Fastenal Company Common Stock Comparative Performance Graph

Set forth below is a graph comparing, for the five years ended December 31, 2018, the yearly cumulative total shareholder return on our common stock with the yearly cumulative total shareholder return of the S&P 500 Index and the Dow Jones US Industrial Suppliers Index.

The comparison of total shareholder returns in the performance graph assumes that $100 was invested on December 31, 2013 in Fastenal Company, the S&P 500 Index, and the Dow Jones US Industrial Suppliers Index, and that dividends were reinvested when and as paid.

Comparison of Five-Year Cumulative Total Return Among Fastenal Company, the S&P 500 Index, and the Dow Jones US Industrial Suppliers Index

	2013	2014	2015	2016	2017	2018
Fastenal Company	$100.00	102.36	90.26	106.97	128.01	126.01
S&P 500 Index	100.00	113.69	115.26	129.05	157.22	150.33
Dow Jones US Industrial Suppliers Index	100.00	99.94	81.47	100.08	104.35	101.83

Note - The graph and index table above were obtained from Zachs SEC Compliance Services Group.

ITEM 6. SELECTED FINANCIAL DATA

Incorporated herein by reference is Ten-Year Selected Financial Data on pages 4 and 5 of Fastenal's 2018 Annual Report to Shareholders of which this Form 10-K forms a part, a portion of which is filed as Exhibit 13 to this annual report on
Form 10-K.

Table of Contents

ITEM 7. 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.

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 3,100 in-market locations. Most of our customers are in the manufacturing and non-residential construction markets. The manufacturing market includes both OEM and MRO customers. The non-residential construction market includes general, electrical, plumbing, sheet metal, and road contractors. Other users of our products include farmers, truckers, railroads, oil exploration, production and refinement companies, mining companies, federal, state, and local governmental entities, schools, and certain retail trades. Geographically, our branches and customers are primarily located in North America.

It is helpful to appreciate several aspects of our marketplace: (1) It's big. We estimate the North American marketplace for industrial supplies is in excess of $140 billion per year (and we have expanded beyond North America) and no company has a significant portion of this market. (2) Many of the products we sell are individually inexpensive, but the cost and time to manage, procure, and transport these products can be quite meaningful. (3) Purchasing professionals often expend disproportionate effort managing the high SKU count of low-volume, low value MRO supplies which is better allocated to their higher volume, higher value OEM supplies. (4) Many customers prefer to reduce their number of suppliers to simplify their business, while also utilizing various technologies and models (including our local branches when they need something quickly or unexpectedly) to improve availability and reduce waste. (5) We believe the markets are efficient. To us, this means we can grow our market share if we provide the greatest value to our customer.

Our approach to addressing these aspects of our marketplace is captured in our motto Growth through Customer Service. The concept of growth is simple: find more customers every day and increase our 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 have a great team behind our customer-facing resources to operate efficiently and to help identify new business solutions. Fourth, we strive to generate strong profits, which produce the cash flow necessary to fund our growth and to support the needs of our customers. Lastly, we identify drivers that allow us to get closer to our customers and gain market share.

We believe our ability to grow is amplified if we can serve our customers at the closest economic point of contact. At one point, the closest economic point of contact was the local branch. Today, in some cases, we have moved the branch inside the customer's facility. We also are frequently positioned right at the point of consumption within customers' facilities through our industrial vending or FMI capabilities. Therefore, our focus centers on understanding our customers' day, their opportunities, and their obstacles. By doing these things every day, Fastenal remains a growth-centric organization.

Executive Overview

Net sales increased $574.6, or 13.1%, in 2018 relative to 2017. Our gross profit as a percentage of net sales declined to 48.3% in 2018 from 49.3% in 2017. Our operating income as a percentage of net sales in 2018 was comparable to 2017 at 20.1% in both years.

Our net earnings in 2018 were $751.9, an increase of 29.9% when compared to 2017. Our diluted net earnings per share were $2.62 in 2018 compared to $2.01 in 2017, an increase of 30.5%. Both periods included discrete tax items, primarily related to the Tax Act. Excluding these discrete items (a benefit of $7.1 in 2018 and a benefit of $24.4 in 2017), our net earnings in 2018 would have been $744.8, an increase of 34.4% when compared to 2017. Further, our diluted net earnings per share would have been $2.59 in 2018 compared to $1.92 in 2017, an increase of 34.9%. A portion of this increase relates to a lower tax rate in 2018 that is a feature of the Tax Act.

We continued to focus on our growth drivers in 2018. We signed 152 new national account contracts (defined as new customer accounts with a multi-site contract) and our national accounts revenues grew 18.1% in the period. Additionally, we signed 336 new Onsite customer locations (defined as dedicated sales and service provided from within, or in close proximity to, the customer's facility) and 22,073 new industrial vending devices. Sales growth in 2018 exceeded 20% through both our vending devices and our Onsite locations (excluding sales transferred from a branch).

Table of Contents

The table below summarizes our total employee headcount, our investments in in-market locations (defined as the sum of the total number of public branch locations and the total number of active Onsite locations), and industrial vending devices at the end of the periods presented and the percentage change compared to the end of the prior period.

	Q4 2018	Q4 2017	Twelve-month % Change
In-market locations - absolute employee headcount	14,015	13,424	4.4 %
Total absolute employee headcount	21,644	20,565	5.2 %
Number of public branch locations	2,227	2,383	-6.5 %
Number of active Onsite locations	894	605	47.8 %
Number of in-market locations	3,121	2,988	4.5 %
Industrial vending devices (installed count) (1)	81,137	71,421	13.6 %
Ratio of industrial vending devices to in-market locations	26:1	24:1	

(1) This number primarily represents devices which principally dispense product and produce product revenues, and excludes approximately 15,000 devices that are part of a locker lease program where the devices are principally used for the check-in/check-out of equipment.

During the last twelve months, we increased our absolute employee headcount by 591 people in our in-market locations and 1,079 people in total. This increase is mostly a function of additions we have made to support customer growth in the field as well as investments in our growth drivers.

We opened 11 branches and closed 157 branches in 2018. Additionally, ten branches were converted from public branches to non-public locations. Our in-market network forms the foundation of our business strategy, and we will continue to open or close locations as is deemed necessary to sustain and improve our network and support our growth drivers.

Results of Operations

The following sets forth consolidated statements of earnings information (as a percentage of net sales) for the periods ended December 31:

	2018	2017	2016
Net sales	100.0 %	100.0 %	100.0 %
Gross profit	48.3 %	49.3 %	49.6 %
Operating and administrative expenses	28.2 %	29.2 %	29.5 %
Gain on sale of property and equipment	0.0 %	0.0 %	0.0 %
Operating income	20.1 %	20.1 %	20.1 %
Net interest expense	-0.3 %	-0.2 %	-0.2 %
Earnings before income taxes	19.9 %	19.9 %	19.9 %

Note – Amounts may not foot due to rounding difference.

Net Sales

Note – Daily sales are defined as the total net sales for the period divided by the number of business days (in the United States) in the period. The table below sets forth net sales and daily sales for the periods ended December 31, and changes in such sales from the prior period to the more recent period:

	2018	2017	2016
Net sales	$4,965.1	4,390.5	3,962.0
Percentage change	13.1 %	10.8 %	2.4 %
Business days	254	254	255
Daily sales	$19.5	17.3	15.5
Percentage change	13.1 %	11.3 %	2.0 %
Daily sales impact of currency fluctuations	0.1 %	0.1 %	-0.4 %
Daily sales impact of acquisitions	0.4 %	1.0 %	0.6 %

Table of Contents

The increase in net sales noted above for 2018 was a result of higher unit sales and, to a lesser degree, higher prices. Higher product prices were realized throughout 2018 as a result of actions (beginning initially in late 2017) taken to offset increases in product costs, and we believe these increases contributed 0.7% to 0.8% to growth for the year. The increases in net sales for 2017 and 2016 were driven primarily by higher unit sales. Price increases were not a material factor in 2017 or 2016.

The higher unit sales in 2018 and 2017 resulted primarily from two sources. The first is improvement in underlying market demand. We believe the improvement in general business activity is reflected in a number of metrics. For instance, the U.S. Purchasing Managers Index, published by the Institute for Supply Chain Management, averaged 58.8 in 2018 and 57.6 in 2017. Readings above 50 are indicative of growing demand, and we believe the levels described above were consistent with favorable business conditions and consistent with an increase in our sales growth rates. This was reflected as well in daily sales of fasteners, our most cyclical product line, which grew 11.2% and 8.4% in 2018 and 2017, respectively. We also experienced growth in sales to 84 of our top 100 customers in 2018, which compares to growth in sales to 79 of our top 100 customers in 2017.

The second source is success within our growth initiatives. We signed 22,073 industrial vending devices during 2018, an increase of 14.0% over 2017. In addition to an increase in our installed base, we achieved a low-single digit increase in average sales per device. These variables combined to generate sales growth through our vending devices in excess of 20% in 2018. We signed 336 new Onsite locations in 2018, an increase of 24.4% over 2017, and had 894 active sites on December 31, 2018, an increase of 47.8% over December 31, 2017. We signed 152 new national account contracts in 2018. The contribution of these new contracts and strong penetration of existing national account customers resulted in daily sales from our national account customers growing 18.1% in 2018 compared to 2017.

We signed 19,355 industrial vending devices during 2017, an increase of 7.2% over 2016. In addition to an increase in our installed base, we were also more efficient with the existing base, resulting in a modest increase in average sales per device and a decrease in our device removals of 3.8%. Combined sales through our vending devices accelerated throughout 2017, finishing with growth in the high teens. We signed 270 new Onsite locations in 2017, an increase of 53.4% over 2016, and had 605 active sites on December 31, 2017, an increase of 50.9% over December 31, 2016. We signed 168 new national account contracts in 2017. The contribution of these new contracts and strong penetration of existing national account customers resulted in daily sales from our national account customers growing 14.5% in 2017 compared to 2016.

In 2016, we saw relative weakness from non-residential construction and heavy manufacturing customers and in demand for our fastener products, speaking to the sustained softness in heavy and general industrial markets. Business with our largest customers was also relatively weak, with sales to our top 100 customers rising modestly in the first half of 2016 and falling modestly in the second half of 2016. While these trends were representative of conditions in the United States and Canada, total sales outside of these geographic areas were relatively strong and improved over the course of 2016. Net sales in 2016 were also impacted by slight inflationary price changes in our non-fastener products and some price deflation in our fastener products, with the net impact being a slight drag on growth. We experienced success with our growth initiatives in 2016, similar to 2017 and 2018; however, their impact to our net sales growth in 2016 was largely offset by a weaker economic environment.

Sales by Product Line

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

	2018	2017	2016
Fastener product line	34.9%	35.6%	36.6%
Other product lines	65.1%	64.4%	63.4%

The decrease in our fastener sales as a percentage of total sales arises from two factors. First, we believe non-fastener products represent a larger market opportunity than fasteners, and that we are relatively under-represented in this market. Over time, this has led to faster growth in the non-fastener product lines, a trend amplified by the growth of our industrial vending program through which we sell primarily non-fastener products. We believe this factor impacted each year shown and will continue to promote a lower mix of fasteners in our total sales over time. Second, a weak industrial production environment has a disproportionately negative effect on fastener sales relative to non-fastener sales (which relates more to plant operations than production). This weakness is more of a cyclical factor than a structural one, and as such was relevant in 2016, but not in 2017 or 2018 when a better economic environment at least partially mitigated the first factor discussed.

Table of Contents

Annual Sales Changes, Sequential Trends, and End Market Performance

This section focuses on three distinct views of our business – annual sales changes by month, sequential trends, and end market performance. The first discussion regarding sales changes by month provides a good mechanical view of our business. The second discussion provides a framework for understanding the sequential trends (that is, comparing a month to the immediately preceding month, and also looking at the cumulative change from an earlier benchmark month) in our business. Finally, we believe the third discussion regarding end market performance provides insight into activities with our various types of customers.

Annual Sales Changes, by Month

During the months noted below, all of our selling locations, when combined, had daily sales growth rates of (compared to the same month in the preceding year):

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
2018	12.0%	14.8%	13.1%	13.4%	12.5%	13.5%	12.0%	13.7%	13.5%	12.4%	12.3%	14.5%
2017	3.8 %	6.1 %	8.4 %	8.9 %	9.7 %	13.0%	12.9%	12.8%	15.3%	13.8%	15.4%	14.7%
2016	3.3 %	2.6 %	0.0 %	3.8 %	1.1 %	0.0 %	2.1 %	0.3 %	2.8 %	3.9 %	1.2 %	3.2 %

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 where certain holidays impair business days and/or seasons impact certain end markets, particularly non-residential construction. The first landing centers on Easter and the Good Friday holiday that precedes it, which alternates between March and April (Good Friday occurred in March 2018, April 2017, and March 2016, and will fall in April in 2019), the second landing centers on July 4th, and the third landing centers on the approach of winter with its seasonal impact on primarily our non-residential 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 'Benchmark' is an historical average of our sequential daily sales change for the trailing five year average (2013-2017). We believe this time frame serves to show the historical pattern and could serve as a benchmark for current performance. The '2018', '2017', and '2016' lines represent our actual sequential daily sales changes. The '18Delta', '17Delta', and '16Delta' lines indicate the difference between the 'Benchmark' and the actual results in the respective year.

It is important to note that these benchmarks are historical averages. In a year where demand is strong, our daily sales growth rates will tend to have more months that exceed the benchmark than fall below it. In a year where demand is weak, we will tend to have more months that fall short of the benchmark than exceed it. In both cases, there is a random element that makes it difficult to know how any single month will perform.

	Jan.(1)	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Cumulative Change from Jan. to Oct.
Benchmark	-1.0 %	1.1 %	3.9 %	-0.6 %	2.1 %	1.9 %	-3.7 %	4.0 %	1.7 %	-1.9 %	8.6 %
2018	-1.3 %	4.0 %	2.1 %	2.4 %	0.6 %	3.7 %	-3.6 %	3.8 %	3.6 %	-3.0 %	13.9 %
18Delta	-0.4 %	2.9 %	-1.9 %	3.1 %	-1.5 %	1.9 %	0.0 %	-0.2 %	1.9 %	-1.2 %	5.3 %
2017	0.2 %	1.5 %	3.6 %	2.2 %	1.4 %	2.8 %	-2.4 %	2.2 %	3.8 %	-2.1 %	13.5 %
17Delta	1.2 %	0.4 %	-0.4 %	2.8 %	-0.7 %	1.0 %	1.3 %	-1.8 %	2.1 %	-0.3 %	4.9 %
2016	0.4 %	-0.8 %	1.5 %	1.7 %	0.6 %	-0.2 %	-2.3 %	2.4 %	1.5 %	-0.9 %	3.6 %
16Delta	1.3 %	-1.9 %	-2.5 %	2.3 %	-1.5 %	-2.0 %	1.4 %	-1.7 %	-0.1 %	1.0 %	-5.1 %

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

Note – Amounts may not foot due to rounding difference.

25

Table of Contents

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

End Market Performance

The sequential trends noted above were directly linked to fluctuations in our end markets. To place this in perspective – we estimate approximately 65% of our business has historically been with customers engaged in some type of manufacturing, a significant subset of which finds its way into the heavy equipment market. The daily sales growth rates to these manufacturing customers, when compared to the same period in the prior year, were as follows(1):

	Q1	Q2	Q3	Q4	Annual
2018	14.3%	13.3%	13.0%	13.3%	13.5 %
2017	6.2 %	11.5%	15.3%	16.6%	12.3 %
2016	1.3 %	1.4 %	1.1 %	2.8 %	1.6 %

(1) In July 2017, we reclassified certain end market designations. The daily sales growth rates in the above table for all periods through the second quarter of 2017 differ from prior disclosures.

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 is sometimes referred to as OEM - original equipment manufacturing) and the maintenance portion (this is business where we supply products that maintain the facility or the equipment of our customers engaged in manufacturing and is sometimes referred to as MRO - maintenance, repair, and operations). The industrial business is more fastener centered, while the maintenance portion is represented by all product categories.

The best way to understand the change in our industrial production business is to examine the results in our fastener product line (approximately 35% of our business) which is heavily influenced by changes in our business with heavy equipment manufacturers. From a company perspective, daily sales growth rates of fasteners, when compared to the same period in the prior year, were as follows (note: this information includes all end markets):

	Q1	Q2	Q3	Q4	Annual
2018	11.8 %	11.1 %	10.8 %	11.3 %	11.2 %
2017	0.8 %	7.9 %	12.1 %	13.4 %	8.4 %
2016	-1.7 %	-2.4 %	-2.9 %		