

Fastenal Company (FAST)

\$47.46 (As of 08/03/20)

Price Target (6-12 Months): **\$50.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/03/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: C

Growth: A

Momentum: B

Summary

Fastenal reported second-quarter 2020 results, wherein the top and bottom lines topped analysts' expectations by 16.7% and 1.7%, respectively, courtesy of higher demand for personal protective equipment ("PPE") products. As strong SG&A leverage offset weaker gross margins, earnings and revenues grew year over year. Increased demand for PPE products more than offset the decline in the traditional business. Fastenal's shares have outperformed the industry year to date. However, unfavorable product and customer mix continues to impact its margins. Gross margin contracted 240 basis points (bps) year over year in the quarter. It also expects lower gross margin in the near term as the product mix has shifted abruptly toward lower-margin government/safety products from higher-margin manufacturing/fasteners.

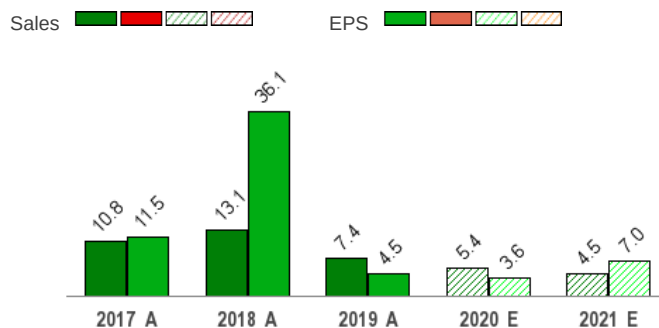
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$47.96 - \$26.72
20 Day Average Volume (sh)	4,280,991
Market Cap	\$27.2 B
YTD Price Change	28.4%
Beta	1.22
Dividend / Div Yld	\$1.00 / 2.1%
Industry	Building Products - Retail
Zacks Industry Rank	Top 9% (23 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	16.7%
Last Sales Surprise	1.7%
EPS F1 Est- 4 week change	5.1%
Expected Report Date	10/09/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,436 E	1,592 E	1,516 E	1,401 E	5,874 E
2020	1,367 A	1,509 A	1,412 E	1,308 E	5,622 E
2019	1,309 A	1,368 A	1,379 A	1,277 A	5,334 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.37 E	\$0.43 E	\$0.41 E	\$0.34 E	\$1.53 E
2020	\$0.35 A	\$0.42 A	\$0.37 E	\$0.32 E	\$1.43 E
2019	\$0.34 A	\$0.36 A	\$0.37 A	\$0.31 A	\$1.38 A

*Quarterly figures may not add up to annual.

P/E TTM	32.7
P/E F1	33.2
PEG F1	2.1
P/S TTM	4.9

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/03/2020. The reports text is as of 08/04/2020.

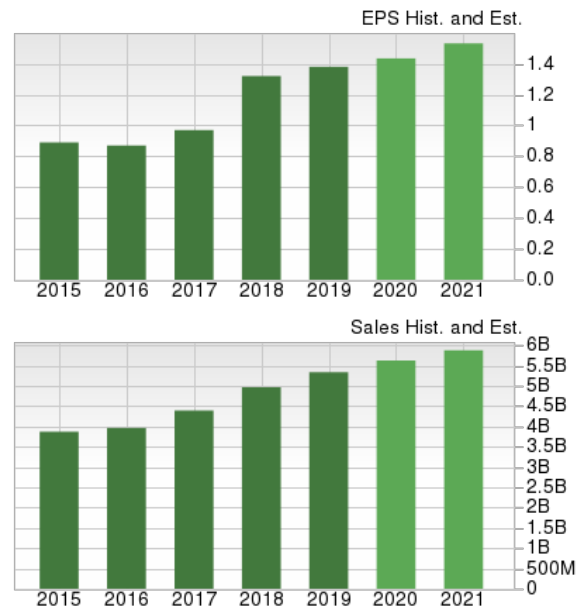
Overview

Based in Winona, MN, **Fastenal Company** is a national wholesale distributor of industrial and construction supplies. The company distributes its products through more than 3,000 company-owned stores mostly located in North America.

Fastenal derives sales from the fastener product line and the other product line. The fastener product line comprises two kinds of products, threaded fasteners, and miscellaneous industrial and construction supplies and hardware. Threaded fasteners include products like bolts, nuts, screws, studs and related washers, while miscellaneous industrial and construction supplies and hardware include various pins and machinery keys, concrete anchors, metal framing systems, wire rope, strut, rivets and related accessories. Threaded fasteners are used in most manufactured products and building projects, and for the maintenance and repair of machines and structures.

The other product line includes tools, cutting tools, material handling, janitorial, electrical, safety and welding supplies and many more. Non-fastener products now represent nearly 66.4% of the company's daily sales.

Fastenal mainly serves customers in the manufacturing and non-residential construction markets. In the manufacturing market, its customers include original equipment manufacturers (OEMs) and maintenance and repair operations (MRO), while in the non-residential construction market it serves general, electrical, plumbing, sheet metal and road contractors.



Reasons To Buy:

▲ **FAST Solutions is Revolutionary:** Fastenal has adopted FAST Solutions, an industrial vending process that has the potential to revolutionize the industrial distribution system and increase profitability. The company installs vending machines at the customer's location and keeps it filled with products they need. These vending machines inform customers what they are using and how they are using these products, which subsequently results in controlling the customer's inventory and administrative cost while reducing product consumption. Particularly, the non-fastener product line has benefited significantly from initiatives pertaining to industrial vending.

Fastenal's aggressive investment to increase Onsite locations, vending machines count and ecommerce business is expected to boost sales

Industrial vending is one of the primary growth drivers for Fastenal and has the potential to significantly increase sales and profits. Sales through vending machines grew at or near a double-digit pace in both 2017 and 2018. Sales through vending devices continued to grow at a double-digit pace in 2019, primarily due to higher installed base.

As of Jun 30, 2020, Fastenal operated 92,615 vending machines, up 7.9% year over year.

▲ **Onsite Locations:** In order to serve customers better, Fastenal provides Onsite location, in which a mini-Fastenal shop is basically located in the plant of a customer. Fastenal had signed 362 new Onsite locations during 2019, up from 336 signed in 2018. Fastenal signed 125 new Onsite locations during the first six months of 2020. As of Jun 30, 2020, the company had 1,212 active sites, up 18.1% from the comparable year-ago period. The increased number of onsite locations is likely to expand Fastenal's market share.

At the end of second-quarter 2020, total end-market locations were 3,272, up 2.5% year over year. It closed/converted 35 locations, including 35 traditional branches and 22 Onsites, to cut down on unhealthy businesses.

▲ **Cost-Control Efforts & Diversification Beyond Fasteners:** Fastenal is actively seeking to control costs to offset cost inflation due to tariffs and rising freight expenses. The strategies for the same include automating warehouses, increasing delivery efficiency through its trucking network, and selling more private-level products with higher margins. This will aid the company to improve efficiency level, thereby increasing returns.

Markedly, the company has gradually expanded from a fastener distributor to a full-line industrial supplier. It has expanded its product lines to include an internal manufacturing division, government sales, Internet sales, metalworking and industrial vending.

Fastenal has also built a national accounts team, which is dedicated to servicing corporate customers. These initiatives are gaining traction and will help to achieve future profitability. Second-quarter 2020 daily sales to national account customers (representing 55.1% of total revenues) increased 12% on a year-over-year basis.

▲ **Focus on E-commerce:** Fastenal has been focusing more on virtual platforms to boost customers' engagement. The company has slashed hundreds of branches since 2013 in favor of vending machines and online sales, in response to changes in customer dynamics. E-commerce sales grew 27% in the first quarter and 13.5% in second-quarter 2020, backed by promotion of its services/products. Although e-commerce growth slowed in April due to the COVID-19 pandemic, it rebounded to mid-teens growth in May/June 2020.

▲ **Driving Investors Value:** Fastenal has been driving investor value by providing regular dividends. The company began paying annual dividends in 1991 and semi-annual dividends in 2003, and then expanded to quarterly dividends in 2011.

The company had paid nearly \$500 million dividends in 2019. Notably, it increased first-quarter 2020 dividend by 13.6% to 25 cents. The company keeps on raising quarterly dividends on a regular basis. It returned \$286.8 million of capital to shareholders through dividends in the first half of 2020, up from \$246.1 million in the year-ago comparable period. Fastenal repurchased \$52 million of its common stock in the first quarter of 2020. This marked its first share repurchase since fourth-quarter 2018.

▲ **Healthy Balance Sheet:** In response to unfavorable demand trends owing to the pandemic, the company has been focusing on protecting liquidity and closely managing cash flows. It ended the second quarter with \$201.5 billion of cash, up from \$161 million at first quarter-end. Moreover, its debt to total capitalization decreased to 12.7% (as of Jun 30, 2020) from 14.6% at first quarter-end and 16.6% at the end of second-quarter 2019. As of the end of second-quarter 2020, Fastenal had substantially all its \$700-million bank revolver available. Overall, the company's cash position was sufficient to meet current portion of operating lease liabilities of about \$96.7 million as of Jun 30, 2020.

Reasons To Sell:

▼ **Margins Under Pressure:** Negative customer/product mix as a result of enhanced growth of lower-margin national accounts and lower proportion of higher margin fasteners have been the dampeners for Fastenal's gross margin since the past three years. The customer mix shifted toward the large-account end-market, which produces low-margin gross profit but stronger operating income. The product mix shifted from high-margin fastener products to lower margin non-fastener products.

Unfavorable product mix, pricing and competitive pressures are hurting gross margins

Gross margin in 2017 and 2018 had contracted 30 bps and 100 bps, respectively. Adding to the woes, Fastenal ended 2019 with a gross margin of 47.2%, down 110 bps from the year-ago level, mainly due to lower daily sales, price/cost deficit and higher freight expense. Operating margin also contracted 30 bps from the year-ago period due to the above-mentioned headwinds, despite undertaking various cost-cutting initiatives. In first-quarter 2020, the company's gross and operating margin contracted 110 bps and 10 bps, respectively, due to changes in product and customer mix, and deleveraging of fixed costs. In the second quarter as well, Fastenal's gross margin contracted 240 bps year over year owing to the above-mentioned headwinds.

▼ **Slowing Demand:** Slower end-market activity level throughout the business has been the primary cause of concern for Fastenal over the last few quarters. In second-quarter 2020, daily sales of Fastener products (which accounted for 26% of second-quarter sales) — mainly used for industrial production — declined 16.4% year over year. Market conditions improved as the second quarter progressed, a pattern exemplified by fastener daily sales, which declined 22.5% in April, 15.3% in May and 11.4% in June. However, June fastener growth still remains negative. Fastenal's demand in the traditional business is still 10-15% below first-quarter levels.

With weakening of activity and focus on supplying key products, Fastenal remains uncertain about its 2020 signing goals for Onsites (375-400) and vending (22k-24k). Hence, the company did not provide signing ranges at first-quarter 2020 earnings call.

While the company is making progress to mitigate its persisting weakness, the ongoing U.S.-China trade negotiations remain a significant headwind.

▼ **Coronavirus-Related Woes:** The coronavirus pandemic has caused shutdown of many companies' production units, retail stores and infrastructure activities. Fastenal is considered as "critical infrastructure" due to its presence with state/local governments, first responders, food processors, etc., and its supply chain capabilities. However, as the product mix has shifted abruptly toward lower margin government/safety products from higher margin manufacturing/fasteners, the company expects to temporarily experience sharply lower gross margin in the near term. Shipping costs have been rising and the supply chain has become less efficient, as Fastenal has identified non-traditional sources of supply.

Although Fastenal delivered a solid second-quarter performance, it faced enormous challenges owing to the coronavirus pandemic. The industrial economy has been negatively affected, with numerous manufacturing locations being shut down in March and April. As a consequence, onsite and vending machine sales declined.

▼ **Stiff Competition:** The industrial, construction, and maintenance supply industry, still remains a large, fragmented industry that is highly competitive. Fastenal faces increased competition from brick and mortar retailers or from online retailers (particularly major internet providers who can offer a wide range of products and rapid delivery). This could cause Fastenal to lose market share, reduce the prices or increase spending, thus eroding operating income.

▼ **Overvalued Compared to Peers:** The company's stretched valuation is another major concern. Its trailing 12-month price to earnings ratio is 32.73, higher than the industry's 25.24. This implies that the stock is overvalued than peers.

Last Earnings Report

Fastenal (FAST) Q2 Earnings & Sales Beat Estimates

Fastenal Company reported second-quarter 2020 results. The top and bottom lines topped the respective Zacks Consensus Estimate, courtesy of higher demand for PPE products.

Earnings & Sales in Detail

The company reported earnings of 42 cents per share, which beat the consensus mark of 36 cents by 16.7%. The reported figure also increased 16.7% from the year-ago profit level of 36 cents per share.

Net sales during the reported period were \$1,509 million, beating the consensus mark of \$1,483 million by 1.7% and increasing 10.3% from the year-ago figure of \$1,368.4 million. Increased demand for PPE products more than offset the decline in the traditional business.

It reported daily sales growth of 10.3%, higher than 2.8% and 7.9% increase registered in first-quarter 2020 and second-quarter 2019, respectively.

Sales of surge-type PPE were at its peak in April and May, before beginning to taper slightly in June. However, business activity appears to have bottomed in April, before improving in May and June. Notably, the daily sales rate trend for fasteners — the most cyclical product category — remained unaffected by the PPE surge. The company pointed also out that fastener daily sales were down 22.5% in April 2020. In May, the rate of decline moderated to 15.3% and again to 11.4% in June. Activity levels experienced in June were below the first quarter of 2020.

On a monthly basis, daily sales improved 9.5%, 14.8% and 6.7% in June, May and April compared with 7%, 9.5% and 7.4%, respectively, in the comparable months of the prior year.

Daily sales of Fastener products (mainly used for industrial production and accounting for 26% of second-quarter sales) declined 16.4% year over year. Sales of safety products (accounting for 34% of second-quarter sales) grew 116.3% on a daily basis. Sales of the remaining products (accounting for 40% of second-quarter sales) declined 7.5% on a daily basis.

In addition, the company's manufacturing and non-residential construction end markets were down 9.4% and 10.3% on a daily basis, respectively. Nonetheless, the government business was up 266.7% year over year on a daily basis. Moreover, sales to healthcare organizations more than quadrupled during the quarter.

Vending Trends and Other Growth Drivers

As of Jun 30, 2020, Fastenal operated 92,615 vending machines, up 7.9% year over year. During the first six months of 2020, the company signed 8,281 machine contracts, down from 11,042 reported in the year-ago period.

Fastenal signed 125 new Onsite locations during the first six months of 2020. The metric was 199 in the first six months of 2019. As of Jun 30, 2020, the company had 1,212 active sites, up 18.1% from the comparable year-ago period. Daily sales to national account customers (representing 55.1% of total revenues) increased 12% on a year-over-year basis.

Margins

Gross margin of 44.5% in the quarter contracted 240 basis points (bps) from the prior-year period due to the impact of product mix, as lower-margin safety sales increased sharply as a proportion of its total sales in comparison with higher-margin fastener sales.

Nonetheless, operating margin expanded 80 bps year over year to 20.9%.

Second-quarter 2020 operating and administrative expenses (including gains from sales of property and equipment) — as a percentage of net sales — improved 320 bps year over year to 23.6%, owing to the company's ability to leverage employee, occupancy, as well as general corporate expenses.

Financials

Cash and cash equivalents were \$201.5 million as of Jun 30, 2020, up from \$174.9 million on Dec 31, 2019. Long-term debt at quarter-end was \$405 million, up from \$342 million at 2019-end.

In the second quarter, cash provided by operating activities totaled \$491.8 million, up from \$333 million in the year-ago period.

Quarter Ending 06/2020

Report Date	Jul 14, 2020
Sales Surprise	1.74%
EPS Surprise	16.67%
Quarterly EPS	0.42
Annual EPS (TTM)	1.45

Valuation

Fastenal shares are up 28.4% in the year-to-date period and 66.2% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 22.2% and 25.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 36.5% and 40.4%, respectively.

The S&P 500 index is up 2.3% in the year-to-date period and 16.2% in the past year.

The stock is currently trading at 31.81X forward 12-month earnings, which compares with 23.78X for the Zacks sub-industry, 33.9X for the Zacks sector and 22.62X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.81X and as low as 17.72X, with a 5-year median of 22.31X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$50 price target reflects 33.55X forward 12-month earnings.

The table below shows summary valuation data for FAST.

Valuation Multiples - FAST					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	31.81	23.78	33.9	22.62
	5-Year High	31.81	23.78	33.9	22.62
	5-Year Low	17.72	16.02	19.07	15.25
	5-Year Median	22.31	18.95	23.44	17.55
P/S F12M	Current	4.72	1.69	1.24	3.59
	5-Year High	4.72	1.69	1.24	3.59
	5-Year Low	2.5	1.06	0.82	2.53
	5-Year Median	3.17	1.29	0.97	3.04
EV/EBITDA TTM	Current	21.9	14.36	18.58	12.67
	5-Year High	21.9	14.36	18.58	12.85
	5-Year Low	11.38	8.46	11.12	8.24
	5-Year Median	15.28	10.81	12.93	10.88

As of 08/03/2020

Industry Analysis Zacks Industry Rank: Top 9% (23 out of 254)



Top Peers

Company (Ticker)	Rec	Rank
Beacon Roofing Supply, Inc. (BECN)	Outperform	1
Systemax Inc. (SYX)	Outperform	2
Applied Industrial Technologies, Inc. (AIT)	Neutral	3
GMS Inc. (GMS)	Neutral	2
HD Supply Holdings, Inc. (HDS)	Neutral	3
Illinois Tool Works Inc. (ITW)	Neutral	3
MSC Industrial Direct Company, Inc. (MSM)	Neutral	3
WESCO International, Inc. (WCC)	Neutral	3

Industry Comparison Industry: Building Products - Retail				Industry Peers		
	FAST	X Industry	S&P 500	GWW	HDS	MSM
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	A	-	-	A	A	A
Market Cap	27.22 B	1.90 B	22.67 B	18.32 B	5.78 B	3.75 B
# of Analysts	11	5	13.5	12	6	9
Dividend Yield	2.11%	0.00%	1.77%	1.68%	0.00%	4.43%
Value Score	C	-	-	B	B	B
Cash/Price	0.01	0.07	0.07	0.09	0.03	0.10
EV/EBITDA	22.87	9.26	13.08	13.20	9.60	8.73
PEG Ratio	2.07	2.31	2.94	2.28	3.75	NA
Price/Book (P/B)	9.78	1.75	3.10	8.51	4.09	2.88
Price/Cash Flow (P/CF)	29.00	9.45	12.34	15.52	8.15	10.40
P/E (F1)	33.12	22.04	21.71	21.91	14.13	15.00
Price/Sales (P/S)	4.92	0.54	2.46	1.57	0.95	1.14
Earnings Yield	3.01%	4.53%	4.38%	4.56%	7.07%	6.66%
Debt/Equity	0.20	1.23	0.75	1.53	1.70	0.51
Cash Flow (\$/share)	1.64	2.88	6.94	22.04	4.37	6.51
Growth Score	A	-	-	A	A	C
Hist. EPS Growth (3-5 yrs)	13.96%	15.21%	10.46%	11.24%	18.17%	9.57%
Proj. EPS Growth (F1/F0)	3.95%	-18.90%	-7.08%	-9.73%	-29.32%	-14.74%
Curr. Cash Flow Growth	5.22%	0.60%	5.47%	-1.82%	-2.21%	2.24%
Hist. Cash Flow Growth (3-5 yrs)	10.64%	10.93%	8.55%	2.17%	8.25%	2.88%
Current Ratio	4.13	2.18	1.32	3.54	2.11	2.63
Debt/Capital	16.83%	58.86%	44.21%	60.53%	62.92%	33.91%
Net Margin	15.07%	2.61%	10.25%	5.34%	6.89%	8.07%
Return on Equity	31.19%	15.26%	14.72%	42.19%	40.62%	19.58%
Sales/Assets	1.42	1.83	0.52	1.77	1.27	1.35
Proj. Sales Growth (F1/F0)	5.41%	-0.01%	-1.79%	1.63%	-3.27%	-4.74%
Momentum Score	B	-	-	B	B	A
Daily Price Chg	0.89%	1.57%	0.27%	0.13%	1.57%	2.51%
1 Week Price Chg	2.84%	1.28%	0.14%	0.04%	-1.57%	-1.99%
4 Week Price Chg	7.33%	10.69%	2.96%	6.14%	3.47%	-9.62%
12 Week Price Chg	19.43%	32.53%	10.90%	19.32%	22.26%	9.46%
52 Week Price Chg	66.18%	17.83%	2.35%	27.20%	-6.87%	1.93%
20 Day Average Volume	4,280,991	426,624	2,043,624	389,545	821,517	616,116
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	5.13%	0.61%	0.82%	5.24%	0.00%	2.21%
(F1) EPS Est 12 week change	17.97%	11.78%	0.59%	7.14%	-1.14%	16.80%
(Q1) EPS Est Mthly Chg	4.01%	1.36%	0.25%	14.85%	0.00%	-5.44%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	A
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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