

Fastenal Company (FAST)

\$36.80 (As of 01/17/20)

Price Target (6-12 Months): **\$39.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/17/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: C

Summary

Fastenal's shares have underperformed its industry in the past three months. The trend is likely to continue, given lower-than-expected fourth-quarter 2019 results. The top and bottom lines missed analysts' expectation by 1.3% and 3.1%, respectively, due to continued slower activity levels. This slowdown was exacerbated by holiday timing and longer-than-usual year-end plant shutdowns. Also, gross and operating margins contracted due to unfavorable product and customer mix, and freight. Estimates for 2020 have also declined over the past seven days, reflecting analysts' concern over its earnings prospects. Nonetheless, growth in the industrial vending business and existing Onsite locations drove unit sales growth. Fastenal projects to sign 22,000-24,000 vending devices in 2020, indicating an increase from 21,857 signed in 2019.

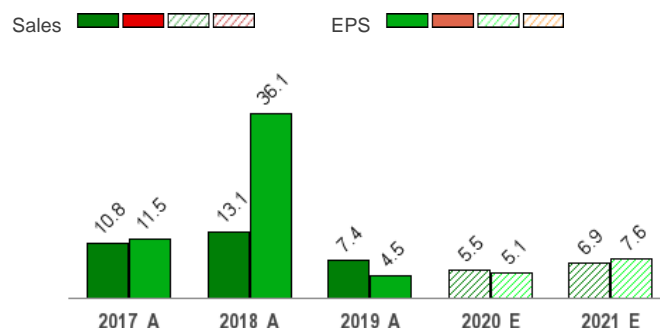
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$37.94 - \$28.38
20 Day Average Volume (sh)	3,125,417
Market Cap	\$21.1 B
YTD Price Change	-0.4%
Beta	1.25
Dividend / Div Yld	\$0.88 / 2.4%
Industry	Building Products - Retail
Zacks Industry Rank	Top 29% (73 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-3.1%
Last Sales Surprise	-1.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	21.4
P/E F1	25.4
PEG F1	1.6
P/S TTM	4.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,473 E	1,552 E	1,565 E	1,503 E	6,019 E
2020	1,382 E	1,439 E	1,433 E	1,365 E	5,628 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	\$0.38 E	\$0.41 E	\$0.41 E	\$0.37 E	\$1.56 E
2020	\$0.36 E	\$0.38 E	\$0.38 E	\$0.34 E	\$1.45 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/20/2020.

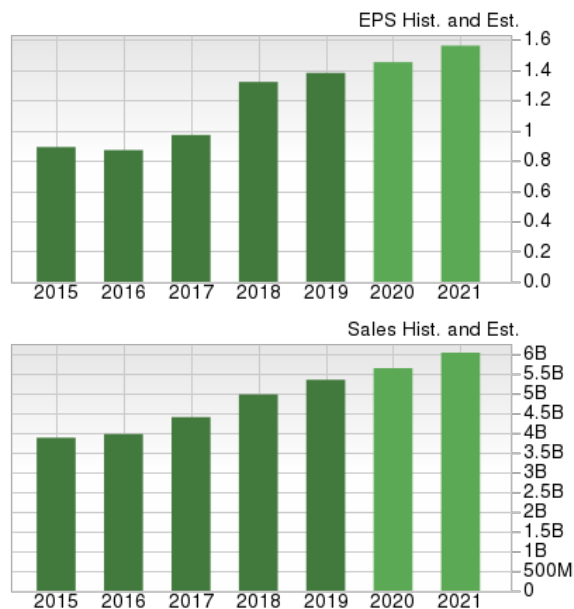
Overview

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 Dec 31, 2019, Fastenal operated 89,937 vending machines, up 10.8% year over year. In 2020, the company projects to sign 22,000-24,000 vending devices, suggesting an improvement from 21,857 signed in 2019.

▲ **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. The company signed 336 new Onsite locations in 2018 compared with 270 signings in 2017, reflecting an increase of 24.4%.

Fastenal had signed 362 new Onsite locations during 2019 and 79 in fourth-quarter 2019, up from 336 signed in 2018 and 67 in fourth-quarter 2018. As of Dec 31, 2019, the company had 1,114 active sites, up 24.6% from the comparable year-ago period. The increased number of onsite locations is likely to expand Fastenal's market share. For 2020, the company expects Onsite signings within 370-400.

Total end-market locations in 2019 were 3,228 compared with 3,121 in 2018. It closed/converted 36 locations, including traditional branches in 2019, and 26 Onsites in fourth-quarter 2019 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.

In fourth-quarter 2019, daily sales to national account customers (representing 54.8% of total revenues) had increased 8.2% on a year-over-year basis. E-commerce sales grew 32% in 2019, including 35% increase from national account customers.

▲ **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. This dividend will be paid in cash on Feb 28, 2020 to its shareholders of record at the close of business on Jan 31, 2020. The company keeps on raising quarterly dividends on a regular basis.

Reasons To Sell:

▼ **Slowing Demand, Weakened Freight Revenues:** Slower end-market activity level throughout the business has been the primary cause of concern for Fastenal over the last few quarters. The company's daily sales growth was recorded at 3.7%, lower than 13.2% and 6.1% increase registered in fourth-quarter 2018 and third-quarter 2019, respectively, due to slowing down of end-market activity.

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

On a monthly basis, daily sales improved 4.3%, 5.7% and 1% in October, November and December compared with 12.4%, 12.3% and 14.5%, respectively, in the comparable months of the prior year.

In addition to slower demand in end-markets served, Fastenal is experiencing lower freight revenues due to deleveraging of a freight network. In fourth-quarter 2019, freight sales fell 7.5%, which resulted in less absorption of fleet costs.

While the company is making progress to mitigate its persisting weakness, the ongoing U.S.-China trade negotiations remain a significant headwind. The company's regional leadership remains cautious about first-half 2020, given sluggish business conditions.

▼ **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.

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.

With Fastenal remaining optimistic about its performance in the forthcoming quarters, given improved pricing expectation as well as reasonable gross margin comparisons, we wait for better visibility.

▼ **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 26.67, which is higher than the industry's 22.66. This implies that the stock is overvalued than its peers.

Last Earnings Report

Fastenal Q4 Earnings and Sales Miss Estimates

Fastenal Company posted unsatisfactory results in fourth-quarter 2019. The top and bottom lines missed the respective Zacks Consensus Estimate due to continued slower activity levels. Moreover, this slowdown was exacerbated in December 2019 by holiday timing and longer-than-usual year-end plant shutdowns.

Earnings & Sales in Detail

The company reported earnings of 31 cents per share, which lagged the consensus mark of 32 cents by 3.1%. However, the reported figure increased 3.3% from the year-ago profit level of 30 cents.

Net sales during the reported period were \$1,276.9 million, missing the consensus mark of \$1,293.4 million by 1.3% but increasing 3.7% from the year-ago figure of \$1,231.6 million. The growth was driven by higher unit sales, primarily related to growth drivers, with notable contributions from industrial vending and Onsite locations.

The company reported daily sales growth of 3.7%, lower than 13.2% and 6.1% increase registered in fourth-quarter 2018 and third-quarter 2019, respectively, as end-market activity continued to slow down in the quarter.

On a monthly basis, daily sales improved 4.3%, 5.7% and 1% in October, November and December compared with 12.4%, 12.3% and 14.5%, respectively, in the comparable months of the prior year.

Daily sales of Fastener products (mainly used for industrial production and accounting for approximately 33.6% of fourth-quarter sales) rose 1.8% year over year.

Non-fastener products' daily sales (mainly used for maintenance and representing 66.4% of the quarterly sales) increased 5.1% year over year.

Vending Trends and Other Growth Drivers

As of Dec 31, 2019, Fastenal operated 89,937 vending machines, up 10.8% year over year. During 2019, the company signed 21,857 machine contracts, down from 22,073 reported in 2018. However, the metric in fourth-quarter 2019 was 5,144 compared with 4,980 contracts a year ago.

Fastenal signed 362 new Onsite locations during 2019 and 79 in fourth-quarter 2019. The metric was 336 in 2018 and 67 in fourth-quarter 2018. As of Dec 31, 2019, the company had 1,114 active sites, up 24.6% from the comparable year-ago period. Daily sales to national account customers (representing 54.8% of total revenues) increased 8.2% on a year-over-year basis during the quarter.

Higher Costs Hurting Margins

Gross margin of 46.9% in the quarter contracted 80 basis points (bps) from the prior-year period due to changes in product and customer mix, and freight.

Also, operating margin contracted 30 bps year over year to 18.7% in the quarter, owing to lower gross margin.

Financials

Cash and cash equivalents were \$174.9 million as of Dec 31, 2019, up from \$167.2 million on Dec 31, 2018. Long-term debt at the end of the quarter was \$342 million, down from \$497 million at 2018-end.

In 2019, cash provided by operating activities totaled \$842.7 million compared with \$674.2 million in the comparable year-ago period.

Company's Views

Fastenal acknowledged the fact that overall activity in end-markets served slowed down in the quarter. This offset the continued double-digit growth of vending and onsite locations. The company projects to sign 22,000-24,000 vending devices in 2020.

Quarter Ending **12/2019**

Report Date	Jan 17, 2020
Sales Surprise	-1.28%
EPS Surprise	-3.12%
Quarterly EPS	0.31
Annual EPS (TTM)	1.38

Valuation

Fastenal shares are up 27.3% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 30.8% and 19.8% in the past year, respectively.

The S&P 500 index is up 26.5% in the past year.

The stock is currently trading at 25.27X forward 12-month price to earnings, which compares to 20.57X for the Zacks sub-industry, 25.66X for the Zacks sector and 19.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.37X and as low as 17.72X, with a 5-year median of 22.04X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$39 price target reflects 26.7X 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	25.27	20.57	25.66	19.2
	5-Year High	28.37	21.61	26.23	19.34
	5-Year Low	17.72	16.02	19.07	15.17
	5-Year Median	22.04	19.2	22.95	17.44
P/S F12M	Current	3.74	1.56	1.09	3.57
	5-Year High	3.99	1.56	1.11	3.57
	5-Year Low	2.5	1.06	0.8	2.54
	5-Year Median	3.08	1.27	0.91	3
EV/EBITDA TTM	Current	21.53	12.38	15.6	12.38
	5-Year High	21.53	12.43	15.6	12.86
	5-Year Low	11.53	8.95	10.37	8.48
	5-Year Median	14.74	10.79	12.38	10.67

As of 01/17/2020

Industry Analysis Zacks Industry Rank: Top 29% (73 out of 254)



Top Peers

Applied Industrial Technologies, Inc. (AIT)	Neutral
Anixter International Inc. (AXE)	Neutral
GMS Inc. (GMS)	Neutral
HD Supply Holdings, Inc. (HDS)	Neutral
Illinois Tool Works Inc. (ITW)	Neutral
MSC Industrial Direct Company, Inc. (MSM)	Neutral
Systemax Inc. (SYX)	Neutral
WESCO International, Inc. (WCC)	Neutral

Industry Comparison Industry: Building Products - Retail				Industry Peers		
	FAST Neutral	X Industry	S&P 500	GWW Neutral	HDS Neutral	MSM Neutral
VGM Score	B	-	-	B	A	B
Market Cap	21.11 B	2.06 B	24.65 B	18.32 B	6.54 B	4.26 B
# of Analysts	11	5.5	13	12	7	8
Dividend Yield	2.39%	0.00%	1.73%	1.69%	0.00%	3.90%
Value Score	D	-	-	B	A	B
Cash/Price	0.01	0.03	0.04	0.02	0.01	0.01
EV/EBITDA	18.90	9.58	14.11	13.99	11.76	9.67
PEG Ratio	1.59	1.36	2.08	1.59	0.58	1.06
Price/Book (P/B)	8.16	1.87	3.39	8.84	5.03	2.81
Price/Cash Flow (P/CF)	23.57	10.12	13.81	15.85	9.90	11.81
P/E (F1)	25.38	14.57	19.19	18.00	11.61	15.83
Price/Sales (P/S)	3.96	0.50	2.69	1.61	1.05	1.27
Earnings Yield	3.94%	6.87%	5.21%	5.55%	8.61%	6.32%
Debt/Equity	0.23	1.44	0.72	0.93	1.85	0.18
Cash Flow (\$/share)	1.56	1.77	6.94	21.47	4.07	6.51
Growth Score	A	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	11.69%	17.10%	10.56%	8.24%	21.88%	9.60%
Proj. EPS Growth (F1/F0)	5.14%	7.60%	7.57%	8.20%	2.10%	-8.18%
Curr. Cash Flow Growth	30.99%	25.90%	14.73%	29.50%	33.27%	2.24%
Hist. Cash Flow Growth (3-5 yrs)	11.73%	12.62%	9.00%	3.77%	16.01%	2.88%
Current Ratio	4.51	1.98	1.24	2.16	1.98	2.90
Debt/Capital	18.50%	59.97%	42.99%	48.07%	64.95%	15.00%
Net Margin	14.77%	2.78%	11.14%	8.38%	7.51%	8.35%
Return on Equity	32.03%	11.71%	17.16%	46.07%	45.42%	19.67%
Sales/Assets	1.45	1.89	0.55	1.92	1.34	1.44
Proj. Sales Growth (F1/F0)	5.25%	3.62%	4.16%	3.96%	1.60%	-1.07%
Momentum Score	C	-	-	B	A	B
Daily Price Chg	-1.37%	-0.68%	0.27%	-0.29%	-0.98%	-1.98%
1 Week Price Chg	-0.66%	1.01%	0.39%	0.19%	-0.70%	-2.73%
4 Week Price Chg	0.01%	1.79%	2.95%	1.59%	0.72%	-0.61%
12 Week Price Chg	-1.02%	0.52%	7.76%	7.91%	0.65%	1.80%
52 Week Price Chg	28.36%	28.36%	22.29%	13.66%	1.82%	-5.82%
20 Day Average Volume	3,125,417	367,466	1,536,375	256,454	892,687	711,332
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.99%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-2.96%
(F1) EPS Est 12 week change	0.16%	0.14%	-0.40%	-1.18%	-1.10%	-9.00%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-12.68%

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	D
Growth Score	A
Momentum Score	C
VGM Score	B

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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