

Fastenal Company

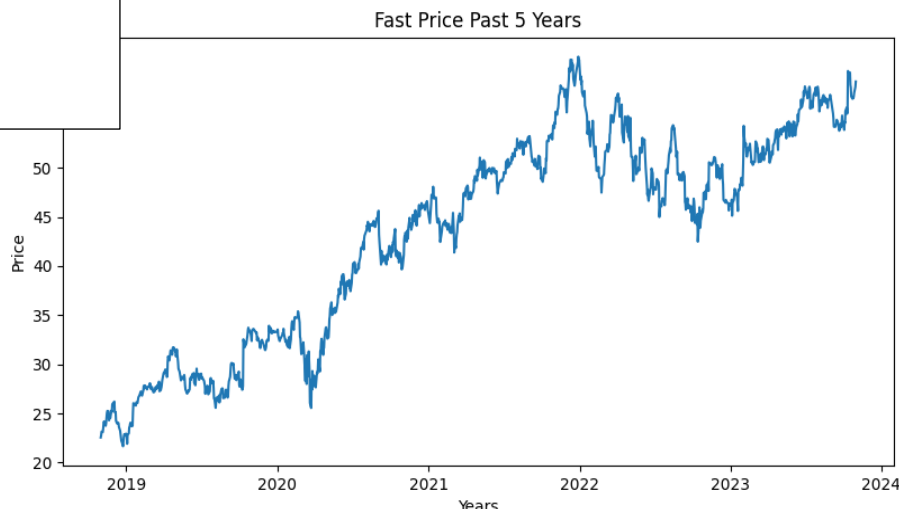
Current Price: \$59.80

Market Cap: 34.17B

P/E Ratio: 30.05

Dividend Yield: \$1.40 (2.34%)

Target Price: \$66.39



Executive Overview

This report provides coverage on Fastenal Company (NASDAQ: FAST) with a BUY recommendation based on a 12-month price target of \$66.39 estimated through the average of a discounted cashflow valuation, Monte Carlo Simulation, and a comparable analysis. This target represents a 11.02% upside from the last close of \$59.80 as of November 3, 2023. Though U.S. production is relatively flat, Fastenal has been able to increase inventory efficiency and slightly grow revenue which is produced in U.S., Puerto Rico, Canada, Mexico, Singapore, China, and the Netherlands maintaining financial strength through diversification.

Investment Thesis

Continuous demand for product

Fastenal Company sells products for both original equipment manufacturing (OEM) and manufacturing, repair, and operations (MRO). This means Fastenal can benefit from both a growth in demand because of original equipment and recurring revenue because of parts that need to be continually replaced. The company motto, "Growth Through Customer Service" is a clear indicator that management acknowledges the benefits of high customer retention, which will be used to insulate the company from economic instabilities, and competitive risks. Combining this with the product portfolio itself being diverse, Fastenal is expected to grow alongside but not far exceeding the growth of encompassing economies.

Stable and reliable dividend

The dividend payout has increased consecutively for the past 25 years with an average annual growth rate of 12.3%. This strong dividend growth is an exact reflection of the companies stable recurring demand. Though there may not be room for much growth with a payout ratio hovering at 70%. Though there is limited upside potential for price appreciation, a portion of safer returns can be attributed to this company being a dividend aristocrat.

Highly competent management

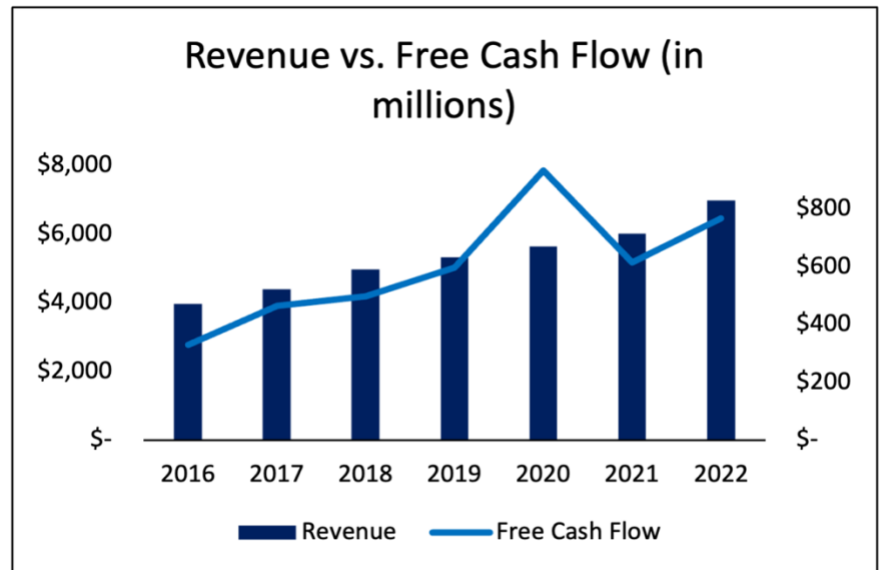
The competency of Fastenal is reflected in stellar financial reports that are seemingly built to sustain economic downturns. Out of 15 United States companies that represent the industrial distribution industry, Fastenal has the third highest return on equity at 34.2%. A debt/equity ratio below 1, a current ratio over 4, and interest coverage of 108.62 should make an investor wonder why so much cash is sitting on the balance sheet despite continued profitability and demand.

Company Analysis

Fastenal Company sells industrial and construction supplies products. The Company offers fasteners, cutting tools, metal working, lifting, hardware, plumbing, lubricant, and other related products. Fastenal Company serves weld-to-length bandsaw blades, custom sling fabrication, inspection, custom packaging, calibration, tool repairing, and custom logo program worldwide.

Expanding upon financial competency, the figure to the right shows a steady growth trend in both revenue and free cash flow. Interestingly, free cash flow spiked during 2020 while revenue stayed steady. This could reflect the ability to increase cost efficiency despite a period of high inflation and wage increases. Though not glamorous, financial growth quickly returned to follow the preceding steady trends.

Year-over-year, revenue saw a 16% increase in 2022. Free cash flow saw growth of 25% over the same period.



Industry Analysis

Predictable Costs

In 2022, approximately 96% of their net sales were attributable to products manufactured by other companies. This is important because while operating from the industrial sector, Fastenal Company is insulated from potentially volatile raw materials costs. Instead, a great portion of costs are attributable to fixed rent and utility.

Competitive Landscape

W.W. Grainger, Incorporated (NYSE: GWW):

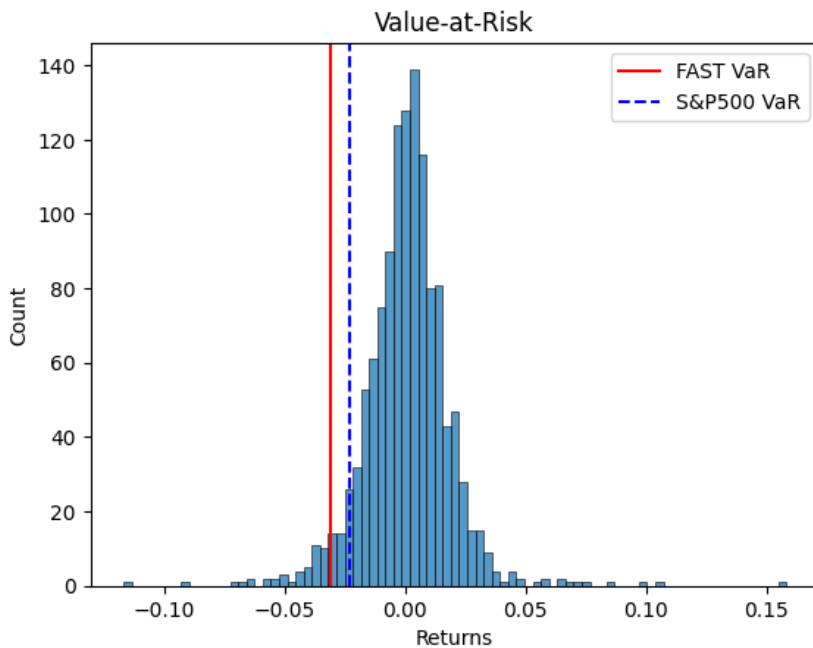
W.W. Grainger, Inc. distributes maintenance, repair, and operating products and services in the United States and internationally. The company serves businesses, corporations, government entities, and other institutions through sales and service representatives, and electronic and ecommerce channels.

Watsco, Incorporated (NYSE: WSO):

Watsco, Inc., together with its subsidiaries, engages in the distribution of specialized equipment. It also offers parts comprising replacement compressors, evaporator coils, motors, and other component parts, etc. The company serves contractors and dealers that service the replacement and new construction markets for residential and light commercial central air conditioning, heating, and refrigeration systems.

MSC Industrial Direct Co., Inc. (NYSE: MSM):

MSC Industrial Direct Co., Inc., together with its subsidiaries, distributes metalworking and maintenance, repair, and operations (MRO) products and services in the United States, Canada, Mexico, the United Kingdom, and internationally. It offers stock-keeping units through its catalogs and brochures; e-commerce channels, including its website, mscdirect.com; inventory management solutions; and customer care centers, customer fulfillment centers, regional inventory centers, and warehouses.



Given 95% confidence the maximum expected loss for 1 day into the future is 3.06% for Fastenal Company. As opposed to 2.29% for the S&P 500 Index.

While clearly more volatile as per this recent calculation, Fastenal has far outperformed the S&P 500 over this same period with 140.38% in price appreciation, as opposed to a meager 62.05% for the S&P index.

Combine the prior with dividends that can provide returns to an investor's portfolio during a market

Qualitative Risks

Operational

Products manufactured in foreign countries may cease to be available, which could adversely affect Fastenal's inventory levels and operating results. The company and its suppliers obtain certain products from China, Taiwan, South Korea, and other foreign countries. Suppliers could discontinue or experience disruption in selling products manufactured in foreign countries at any time for reasons that may or may not be in Fastenal's control.

General and Economic

A downturn in the economy or in the principal markets served by Fastenal Company and other factors may affect customer spending, which could harm the company's operating results. Fastenal is 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. Changes in energy costs and the cost of raw materials used in products could impact net sales, cost of sales, gross profit percentage, distribution expenses, and occupancy expenses, which may result in lower operating income.

Legal and regulatory

Fastenal Company is 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 (including protection of information and incident responses), regulations on suppliers regarding the sources of supplies or products, labor and employment laws, and anti-competition regulations.

Risks Summarized

To conclude the risk analysis, the main contributing risk factor is lack of growth opportunities. Any other risks seem to be systematic and only form because of a diversifying portfolio, as opposed to an imminent setback. Currently, the most powerful and commonly mentioned mitigation of these risks is done using operational efficiency. In other words, mitigating costs.

Business Valuation

	2019A	2020A	2021A	2022F	2023F	2024F	2025F	2026F	2027F	Terminal
Profit Metrics										
EBITDA Growth		8.21%	6.36%	17.51%	10.69%	10.69%	10.69%	10.69%	10.69%	8.00%
EBITDA	1,206.00	1,305.00	1,388.00	1,631.00	1,805.39	1,998.42	2,212.10	2,448.62	2,710.42	2,927.26
Amortization and Depreciat	148.70	162.40	170.70	176.60	198.59	219.83	243.33	269.35	298.15	322.00
Operating Profit	1,057.30	1,142.60	1,217.30	1,454.40	1,606.80	1,778.60	1,968.77	2,179.27	2,412.28	2,605.26
Tax Rate	24.22%	24.14%	23.41%	24.52%	24.07%	24.07%	24.07%	24.07%	24.07%	24.07%
Current Tax					386.80	428.15	473.93	524.60	580.70	627.15

Unlevered Free Cash Flow

EBITDA	1,805.39	1,998.42	2,212.10	2,448.62	2,710.42	2,927.26
Current Taxes	(386.80)	(428.15)	(473.93)	(524.60)	(580.70)	(627.15)
CapEx	(198.59)	(219.83)	(243.33)	(269.35)	(298.15)	(322.00)
Cash From Working Capital	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)
Unlevered Free Cash Flow	1,120.00	1,250.44	1,394.83	1,554.66	1,731.58	1,878.11

Assumptions	Valuation	Discreet Forecast						Term
	1/1/22	12/26/22	12/26/23	12/26/24	12/26/25	12/26/26	12/26/27	12/26/28
First Year of Forecast	2022							
Terminal Growth Rate	8.0%							
WACC	11.04%							
Discrete Forecast	1,120.00	1,250.44	1,394.83	1,554.66	1,731.58	1,878.11		
Terminal Value	-	-	-	-	-	-	61,779.87	

Enterprise Value		
PV of Discrete	6,092	16%
PV of Terminal	32,959	84%
Enterprise Value	39,051	100%

Equity Value Per Share	
Equity Value	38,726
Shares	595
Equity Value	65.09

Equity Value	
Enterprise Value	39,050.64
Net Debt	(324.90)
Equity Value	38,725.74

Premium (Discount)	
Equity Value	65.09
Current Price	59.8
Premium (Discount)	8.84%

Bull Intrinsic Valuation: 68.51

Base Intrinsic Valuation: 65.09

Bear Intrinsic Valuation: 61.87

Average Intrinsic Upside (Downside): 8.06%

Terminal growth Rate	8.0%
WACC	11.04%
Net Debt	325
Enterprise Value	39,051

Shares Outstanding	595
Current Price	59.8

Enterprise Value					
	7.00%	7.50%	8.00%	8.50%	9.00%
10.04%	41086	47936	58143	74979	108003
10.54%	35270	40052	46719	56652	73036
11.04%	30893	34395	39051	45539	55207
11.54%	27479	30138	33548	38079	44395
12.04%	24743	26818	29406	32726	37137

Equity Value					
	7.00%	7.50%	8.00%	8.50%	9.00%
10.04%	40,761	47,611	57,818	74,654	107,678
10.54%	34,945	39,728	46,394	56,327	72,711
11.04%	30,568	34,071	38,726	45,214	54,882
11.54%	27,154	29,813	33,223	37,754	44,070
12.04%	24,418	26,493	29,081	32,401	36,812

Equity Value Per Share					
	7.00%	7.50%	8.00%	8.50%	9.00%
10.04%	68.51	80.02	97.17	125.47	180.97
10.54%	58.73	66.77	77.97	94.67	122.20
11.04%	51.37	57.26	65.09	75.99	92.24
11.54%	45.64	50.11	55.84	63.45	74.07
12.04%	41.04	44.53	48.88	54.46	61.87

Premium/Discount To Current Price					
	7.00%	7.50%	8.00%	8.50%	9.00%
10.04%	14.56%	33.81%	62.50%	109.81%	202.63%
10.54%	-1.79%	11.65%	30.39%	58.31%	104.35%
11.04%	-14.09%	-4.25%	8.84%	27.07%	54.25%
11.54%	-23.68%	-16.21%	-6.63%	6.11%	23.86%
12.04%	-31.37%	-25.54%	-18.27%	-8.94%	3.46%

Business Valuation

Fastenal	
Revenue	6,981.00
EBIT	1,454.00
Depreciation & Amortization	176.60
Amortization	0.40
EBITDA	1,631.00
Cash and Cash equivalents	230.10
Total Debt	802.10
Shares Outstanding	595.00
Forward EPS (Annual)	2.00
Expected 5 year growth of EPS	48.24

Comparable Company	Enterprise Value/EBITDA	Enterprise Value/Revenue	P/E Ratio	PEG	Price/Sales
W.W. Grainger, Incorporated (NYSE: GWW):	14.77	2.47	21.40	1.44	2.34
Watsco, Incorporated (NYSE: WSO):	18.14	2.06	25.72	4.62	2.02
MSC Industrial Direct Co., Inc. (NYSE: MSM):	10.55	1.51	15.99	1.87	1.39
Aggregates					
High	18.14	2.47	25.72	4.62	2.34
Median	14.77	2.06	21.40	1.87	2.02
Mean	14.49	2.01	21.04	2.64	1.92
Low	10.55	1.51	15.99	1.44	1.39
Implied for Fastenal	39.53	23.21	42.80	180.42	23.70

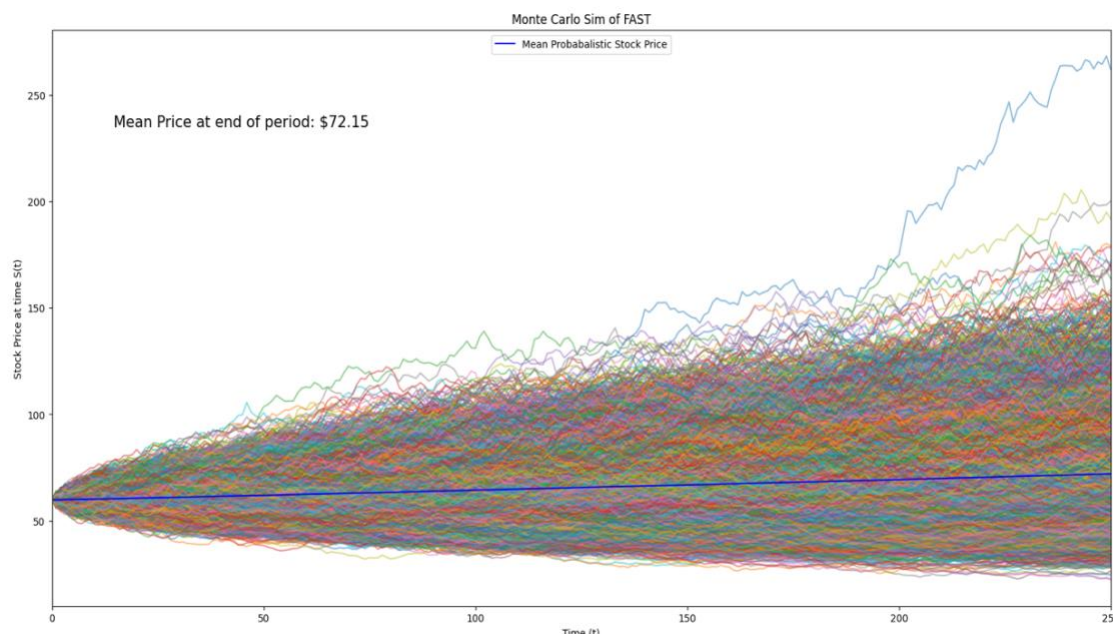
Comps Average Valuation	61.93
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Market Valuation: 61.93

Market Upside: 3.56%

Simulated Valuation: 72.15

Quantitative Upside: 20.56%



Aggregate Valuation

Investment Positives

Fastenal's revenue and free cash flow growth have weathered COVID-19, inflation, wage increases, and maintained strong financial positions via operational efficiency.

Investment Negatives

Risks associated with operations in foreign countries and macroeconomic cycles can weather upside potential. Combine this with a historically outperforming stock price can lead to overvaluation, making it difficult to increase an investors position at the target stock price.

Catalysts for Recommendation Change

The Purchasing Managers Index (PMI), Federal Funds Rate increases, and other governmental policies that could affect distribution costs are all indicators that could affect the operational efficiency of Fastenal. In extreme cases, increases in energy costs could also wain on profitability.