

2006

President's Letter to Shareholders

In most respects, 2006 was a good year for Fastenal. The year started out strong but as the overall economy in North America slowed in the second half of the year, so did Fastenal. This caused us to have lower sales and earnings growth than predicted. Even though this was not a stellar year for Fastenal, there are several initiatives in which we made great progress. These initiatives are like pieces of a puzzle we are putting together. Individually they do not do much, but when linked together correctly they help execute our overall strategy; to become the best distributor of industrial and construction products in each of the markets we serve. I would like to share some of these initiatives with you as I believe they are key contributors to our continued growth.

Our 2006 sales growth was 18.8%. This gave us total revenue of \$1.8 billion which is an increase of more than \$286 million over 2005. Our reported net earnings for 2006 was \$199 million, an increase of 19.3% over 2005. We thought we would be able to produce more earnings leverage than we did, but with the slowing of sales growth in the second quarter, combined with the CSP2 expansion, this was not possible.

We opened 245 stores in 2006. We opened 222 stores in 2005. We started the year opening stores on schedule but fell behind in the second quarter and had to work hard to catch up in the fourth quarter. This is a very inefficient way to open our stores, and we lose sales contribution from these stores when they are opened late. I believe the plan we put in place to prevent this from happening in the future is a good plan. A milestone for Fastenal in 2006 was the opening of our 2,000th store in Seattle, Washington. This is a significant accomplishment for Fastenal and it was a very proud moment for our team. I traveled to Seattle for the grand opening and enjoyed visiting with some of our local customers. This opening is also special for me because I was born in Seattle and have spent a lot of time in the Northwest.

The people working on the CSP2 store conversions are doing a very good job of staying on schedule and the project is going well. However, I believe the number of conversions completed in 2006 may have contributed to the delay in new store openings. We converted 163 stores to this format in 2006. This team continues to improve the store conversion

process. These improvements have served to lower some costs and reduce the existing store inventory before we convert them to CSP2.

Another new store project called CSP3 was started in 2006. At this time, this project will be limited to 8 to 10 stores. It is much like CSP2, only larger. The store size will average 12,000 square feet and stock more than 14,000 different items. Because of the low number of stores in this project, we will develop a labor model as we learn more. Our plan is to continue working on this project, but not to increase the number of conversions in 2007.

Our sales people did a great job of increasing the account activity in 2006. During the fourth quarter we increased our active accounts by 18.5% over the same period in 2005. This is one of the largest increases in our history.

We saw mixed results in the area of asset management. We continued to lower our days outstanding for accounts receivable as the people in our call center continue to speed up the collection process. We reduced our days outstanding by four days since December 2004, when we first implemented the central collection process.

Our overall inventory grew faster than we had planned. Most of this growth was due to our aggressive plans of opening stores, converting CSP2 stores, and expanding the stocking levels in distribution. In 2006 we added \$94 million in inventory, an increase of 26.1%. We have put plans in place to slow this growth and I believe we will improve our inventory turns in 2007.

In 2006 our Chief Operating Officer, Nick Lundquist, reorganized the National Accounts group, our National Construction Group and any other people that were assigned to large account business. The key accounts program began in 1995 and became fragmented from an organizational standpoint as it grew. This reorganized group is now referred to as our Strategic Accounts Group and is lead by Steve Rucinski. Steve is a 26 year employee with a proven track record in key account sales.

This group is charged with signing up large accounts for the entire company. The early results show a large increase in the number of quotes to potential customers, but the real measure will come in the first half of 2007 when we review how this piece of our business is growing.

Over the last several years we have taken many steps to strengthen our name recognition in the marketplace. Four of the larger steps are: 1) lease better store locations, 2) add better signage to increase customer awareness, 3) place decals on our large fleet of vehicles creating moving billboards, and 4) develop better packaging.

In addition, in 2006 we took a much bigger step and became the primary sponsor of a NASCAR Craftsman Truck Series race truck. After doing research on the demographics of racing, we determined the truck series provided the best demographic match to our customers and was a good entry point into motor sports marketing. We signed a two year sponsorship deal with Bobby Hamilton Racing and became the sponsor of the #18 Dodge driven by Bobby Hamilton, Sr., the 2004 Truck Series Champion. We invited some of our larger product suppliers to help co-sponsor the team. Our marketing goal is to familiarize people with Fastenal and our quality brands like Bosch Power tools, Lenox saw blades, Craftsman hand tools, etc. The season started off well and we received great television coverage as a new sponsor. Then, less than a month into the season, our driver Bobby Hamilton, Sr. was diagnosed with cancer. After a courageous battle, Bobby passed away, and on that day we lost a great friend.

As part of our motor sports marketing initiative our marketing team worked hard to produce and direct our first television commercial. Although I am no marketing expert, I believe they did a great job creating a very high quality commercial with a clear message about who Fastenal is. The main focus on all of our marketing efforts is two-fold. First, is to tell our story with the goal of driving traffic to our stores and second, is to create brand awareness for our sales people when they are making calls on potential customers. We have found it much easier to get an appointment with a potential customer if they have heard of Fastenal in the past.

The biggest project we started in 2006 and the one that will produce the most to improve our

customer service is the inventory expansion project we undertook in our Indianapolis warehouse. We chose Indianapolis for this project because of its central location to our customer base and the good interstate highway system out of Indianapolis. In mid 2005 we started studying the feasibility of expanding our stocking model in Indianapolis to include all of the items in our catalog. Up until this time, we had only stocked the best selling items and the stores bought the other items as they needed them. We estimated we would save 9% on the product and another 13% on freight if we purchased it centrally and hauled it with our own fleet. Based on this information, and our strong commitment to continually improve our customer service, we made the decision to expand the number of items we stock in that facility from 28,000 to more than 120,000. We estimated it would require about \$25 million of additional inventory in Indianapolis to accomplish this. The project started late in 2005 and has made steady progress throughout the year. This has been a very difficult project and has caused many service problems in 2006.

For us to gain the maximum benefit from the inventory expansion project we need to continue to improve our transportation system. We worked hard on this goal in 2006 by improving our delivery times, providing five-day a week delivery service to more stores and developing scanning hardware to better track the shipments. We also started our first consolidated air shipments from Indianapolis to our facility in Seattle. By contracting with commercial airlines, we are able to provide second day shipments at very reasonable prices. We plan to expand this service in 2007 to all of our distribution centers in western North America. Although I am pleased with the progress in our transportation system, there are still many areas we are working to improve that will provide better service and make us more efficient.

We completed many projects in distribution in 2006, but the largest project was the opening of our new distribution center in California. In November 2005, we purchased a 320,000 square foot warehouse in Modesto, California. We currently occupy 140,000 square feet of the building and have leased out the remaining space.

2006

President's Letter to Shareholders

Our distribution team spent most of the year designing and installing the most efficient warehouse system in our network. The project was completed in November 2006 and we started operation in December. This new facility replaced our existing warehouse in Fresno, California.

The Information Systems people worked on many projects, but I believe the most exciting area of development is hand-held sales devices. They are currently testing hand-held computers that will give our sales people much better information. Armed with this new device, a sales person in the field can price product, check order status, check product availability and do almost anything else they can do from their desk. This is another big step in both customer service and labor productivity.

The people in our accounting department have been busy developing and implementing new systems to increase efficiency in both accounts receivable and payable. Using a new automated scanning system we are able to collect data from incoming checks and invoices and shorten the time it takes to process the transaction. This new system has not only helped us improve our labor efficiency, but has also allowed us to improve our ability to take advantage of early pay discounts offered by our suppliers.

Product development continues to be a big part of our growth strategy. Our product managers had a very busy 2006 splitting their time between CSP2, CSP3 and the Indianapolis expansion project. I believe they have done a very good job of determining not only which brands to support, but also which products we should stock in each area and in what quantity. In 2007 they will focus on streamlining the process.

Many of the products we buy in North America were originally produced in Southeast Asia and then imported by one of our suppliers. Since the early 1990's, we have worked to go-direct to the manufacturer when volume justified. The go-direct strategy took a huge leap forward in 2003 when we established a trading company in Shanghai, China called FASTCO Trading Company. FASTCO Trading Company continues its rapid growth. In 2006 they imported 4,500 containers, an increase of 32% over 2005. At this point, I believe the only thing

that will limit the growth of this business will be our ability to find the quality suppliers we need to produce our product.

We now have a second office in Kang Shan, Taiwan where we installed a product testing laboratory. This investment was made to improve our turnaround time in quality control; which will speed up shipping time from our Asian suppliers.

Our manufacturing division had another good year. They produced sales growth in 2006 of 26%. They also moved our manufacturing facilities in both Indianapolis and Fresno. Indianapolis moved within our current facility to a much larger space to accommodate the growth. The Fresno facility moved to our new building in Modesto. Both of these moves provide us with larger and improved manufacturing space.

I have talked about many areas of Fastenal, and even more projects, but none of this would be possible without great people. In 2006 we hit another milestone by surpassing 10,000 employees for the first time. Our dedicated staff in the Fastenal School of Business had another record training year. They developed new training programs for the CSP2 managers, additional product trainings, and more than doubled the training that is done in the training centers outside of Winona. Our commitment to training our people continues to be one of the main reasons we perform at a high level.

We have made great progress in 2006 in our effort to build the best distribution organization in our industry. But no matter how good our systems are, they cannot perform without our great people. I am very proud of everything our dedicated employees accomplished. I strongly believe if we continue to hire people that share our values, give them strong support and put them in a position to make good decisions, we will always be successful.

Thank you for your belief in us and we promise to work hard for the continued success of Fastenal.

/s/ Willard D. Oberton

Willard D. Oberton
CEO and President