

One of the keys to Fastenal's success over the years has been our ability to operate profitable local stores in not only larger metro markets but also in small towns and rural communities. This may seem like a minor achievement, but it has truly set us apart in our industry, enabling us to get closer to our customers, provide superior service, and, in turn, achieve exceptional growth. The word 'local' isn't spelled out in our motto of *Growth Through Customer Service*[®], but it's implicit.

While others embraced e-commerce as their primary distribution model, adapting their businesses to direct-ship orders via remote warehouses, we've never stopped working to develop our local store network, bringing our people and products closer and closer to our customers. This approach has served us well for many years, and we believe it gives us an important structural advantage moving forward.

In response to customers' demand for ever-faster fulfillment, major internet retailers are racing to provide a same-day service option, opening local branches to transcend the 24 to 48 hour (or longer) lead times built into traditional e-commerce transactions. A similar race is shaping up in the industrial world, where same-day service isn't just a convenience but in many cases the key to keeping a production line running or fixing a critical piece of equipment. With far more store locations – and, by extension, more vending machines and 'keep-fill' programs in place at customer sites – than any of our competitors, we are well positioned to be the best same-day supplier of industrial and construction products in North America, and potentially the world. This will continue to be a strategic focus for our company, driving many of the initiatives and areas of the business we'll discuss later in this letter.

But first, let's focus on our 2014 financial performance. Overall, 2014 was a positive year for Fastenal. Following a sluggish start in January and February, we achieved double-digit daily sales growth in March, achieved 15.0% daily sales growth in August (a threshold we surpassed in November and again in December), and finished the year with sales of \$3.73 billion, a 12.2% increase over sales of \$3.33 billion in 2013.

Our return to solid double-digit growth was preceded by an initiative, launched in mid-2013, to increase labor hours in our stores, add district and regional sales leadership personnel, and ultimately generate more 'sales energy' within the organization. As part of this ongoing growth initiative, we plan to increase our store labor hours company-wide by an additional 10 to 15% in 2015, with a focus on adding part-time personnel to maximize scheduling flexibility and selling energy within our stores.

One point worth noting – at Fastenal, we don't really 'hire part-time help.' Our goal is to find, hire and train 'future full-time employees.' Recruiting and hiring great people is hard work. Finding truly service-minded people makes it even harder, and being a growth-centered company adds to the number of people we need to find. To satisfy these needs, we like to find full-time students looking for an opportunity, with a focus on individuals who meet three specific criteria: 1) they're interested in pursuing a career in sales

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or business, 2) they display the potential to someday assume a leadership role in the company, and 3) they're willing to relocate somewhere within the area in the future. As they complete their education, these individuals fill a critical short-term need – freeing up time in the store for our more seasoned personnel to sell and serve. Our end of the bargain is to provide these 'future full-time employees' with an opportunity.

Our pre-tax earnings in 2014 were \$787 million, or 10.4% above our 2013 pre-tax earnings of \$713 million. On an after-tax basis, our net earnings grew from \$449 million in 2013 to \$494 million in 2014, an increase of 10.1%. As a percentage of sales, our pre-tax earnings were 21.1% in 2014 versus 21.5% in 2013. The decline relates to a decrease in gross profit (50.8% in 2014 versus 51.7% in 2013), which was partially offset by a decline in operating and administrative expenses (29.8% in 2014 versus 30.3% in 2013).

Some of the headwinds we faced in terms of gross profit stem from the growth of our average store size in conjunction with our 'Pathway to Profit' initiative. Simply put, as our stores grow larger, they tend to have larger customers that merit more favorable pricing terms. That said, any slippage in gross profit margin due to increased store size should be counterbalanced by the lower relative operating costs typically associated with our larger stores. In recent years this has been the case, but in 2014 the improvement in our operating and administrative expenses, as a percentage of net sales, was not sufficient to provide that counterbalance. This was due to our push to add personnel and labor hours in our stores while also adding district and regional leadership to better serve our stores (after all, that's what leaders do – provide service). Unfortunately, it was also due to rising miscellaneous expenses. For much of 2014, we frankly didn't live up to our company's high standards for frugality and resourcefulness. The good news is that we did a much better job of expense control in the fourth quarter, and we'll be working very hard to maintain that discipline in the year ahead.

A summary of our financial performance in 2014 really boils down to three thoughts. First, the gross profit decline negatively impacted our business and created some challenges in our ability to grow earnings – this stood out in the first six to nine months of the year. Second, under the 'Pathway to Profit' we believe our ability to manage our operating and administrative expenses long-term will provide more than just an 'offset' to the gross profit decline and will allow us to grow net earnings faster than our net sales – this stood



out in the last three months of the year. (Remember, this is a comment about long-term trends, not a static quarter by quarter prediction.) Third, if we grow our business and manage our expenses, a distribution business like ours can have incredible cash flow characteristics. This stood out in 2014 as noted in the 'Cash Flow Summary' information, most notably our 'free cash flow' on page four of this annual report.

Earlier we framed Fastenal's same-day service advantage in terms of being able to react to unplanned customer needs – for example, an unforeseen stock outage or some broken equipment – but in fact, most of our customers' needs are very predictable and repetitive, and in these cases 'same-day service' describes our ability to proactively plan and manage the flow of supplies from our suppliers, to our distribution centers, to our stores, and finally to our customers' sites.

One of the most efficient ways we do this is through our FAST Solutions® (industrial vending) programs. In 2014, we signed agreements for 16,342 new vending devices and ended the year with a total of 46,855 devices in place at customer locations. Today, we vend more than \$40 million worth of product each month, but this only tells part of the story. In December 2014, our net sales to customers with vending devices (this includes both vended and non-vended items) represented around 39% of our total net sales (versus approximately 37% in the same period in 2013), and total sales to vending customers grew approximately 20% in 2014.

These latter two numbers reflect a couple of important concepts: 1) vending is not really a discrete area of our business but rather an extension of our stores, enabling our local teams to get even closer to the customer; and 2) vending supports a very broad range of customers – from manufacturers to contractors, from Fortune 500 companies to small businesses. With an expanded technology lineup, streamlined systems for machine setup and replenishment, and a new incentive program motivating our sales people to sign and install more devices, we'll continue to move aggressively in an effort to extend our industry lead in vending in the year ahead.

While our industrial vending solutions generally support the non-fastener side of our business, we provide a similar service for

fasteners through our FMI® ('keep-fill') program. The product and supply process are different, but the same basic value-add applies: we stock needed product locally, visit the customer regularly, and maintain a lean flow of inventory to their points of use, driving cost savings and productivity. As with our vending program, it's a level of service only Fastenal can provide on a national, and increasingly global scale, and it's a vital part of our same-day service advantage.

This brings us to another very important growth driver for our company – our national accounts programs, which provide a combination of corporate support and local service for larger, multi-site customers. In 2014, customers tied to a national agreement represented 43% of total company revenues and more than 50% of our sales growth. In our opinion, the keys to this success are: 1) our dedicated national account sales team, 2) the high-level support provided by our specialists in the areas of safety, metalworking, engineering, and other important areas for customers, 3) our on-site inventory management programs (FAST Solutions® and FMI®), and 4) the 'glue' that holds it all together, our local stores and their ability to service our national account customers everywhere they operate – from metro areas, to rural towns, to global factories.

Another very important type of contract customer is supported by our government sales team. The word 'government' may conjure images of Washington D.C., but while we do service several federal agencies, the vast majority of our government business is at the state and local level, with customers ranging from state departments of transportation and municipalities, to higher education and local K-12 schools. This is yet another area where our local presence gives us an important advantage. An example of our local presence would be the state of Kansas. While our national competitors have branches in Wichita, Topeka, and maybe one or two other locations, we're able to service customers locally at 36 stores statewide – all staffed by people who live in the community and pay local taxes (an important factor for many government customers). When you consider this scenario is playing out in states, cities, and towns across the country, it's not surprising that our annual net sales to state and local government customers increased 25% in 2014, and that we now have contracts with 44 states, up from just five such contracts five years ago.

In the opening statement, we made a distinction between the competition's focus on e-commerce versus our focus on local stores, but of course it's not an 'either/or' situation – to be the best, you have to excel in both areas. In 2014, our e-commerce and information technology teams did a nice job of leveraging our local presence to provide faster (in many cases, same-day) fulfillment via Fastenal.com and the custom e-commerce solutions we provide for our customers. A great example is our new web interface, which presents customers with not only the exact item they're searching for but also closely-related alternatives that are in stock at the local Fastenal store and our nearest distribution center – pointing the customer to the fastest solution. This ability to view local inventory isn't unique, but it's

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a lot more meaningful when ‘local’ means a short drive across town rather than a long haul to a distant metro area. In the year ahead, we’ll continue working to harness our brick-and-mortar footprint to maximize speed, service, and value for our e-commerce customers.

No matter how the product ends up in the customer’s hands – via the local store, an on-site FAST Solutions® or FMI® program, or an e-commerce transaction – it first has to move through our distribution system. In 2014, we continued to invest aggressively in our distribution infrastructure to support long-term growth. Major projects included the installation of automated storage and retrieval technology in our Jessup, Pennsylvania distribution center (which services stores in the northeast U.S.); the addition of 180,000 square feet to our master distribution center in Indianapolis, Indiana; a brand-new facility in Kitchener, Ontario (Canada) that includes 100,000 square feet of warehouse space and features automated storage and retrieval technology (along with new regional sales offices and a training facility); and finally, a new 46,000 square-foot facility in Apodaca, Nuevo Leon (Mexico) to support our international growth.

These investments in infrastructure and technology are essential, but the single most important investment we can make is in our people. For the past 15 years, one of the primary ways we’ve invested in the ‘Blue Team’ is by offering training and career development through the Fastenal School of Business (FSB). In 2014, our FSB team focused on not just what they have to offer our employees, but how they promote and present these learning opportunities to the field. This included a major redesign of our online training portal, making it far easier for employees to access all of the available training courses and resources we offer. Thanks in part to this initiative, our employees completed 8,689 instructor-led courses and 279,409 online courses in 2014, shattering our previous records for course participation. That’s a total of 288,098 opportunities to gain a better understanding of the industries we serve, the products we sell, and the resources available to serve our customers.

Every year, the scope of our business becomes larger – with more stores, departments, products, and solutions – yet the number of pages allotted for this letter remains the same. There’s simply no way to sum up all of the good things our team accomplished in 2014, so we’ll leave you with this: behind

all the numbers and charts published in this report is something much more human, and that is a desire among our people to exceed customer expectations, to solve problems, to offer new and better solutions – in a word, to serve. This applies not only to our store personnel but to all of the teams supporting our stores: distribution, transportation, manufacturing, quality, information technology, vending support, sales specialists, human resources, accounting, maintenance, product development, purchasing, marketing, and everyone else who works behind the scenes to keep the ‘Big Blue Machine’ rolling.

As leaders of the company, we can never forget the power of Fastenal people, and that our job boils down to two simple directives: 1) make sure that everybody who joins Fastenal understands our common goal, and 2) find ways to bring out and maximize the potential of everyone in the organization. If we can continue to do this, we’re confident that we’ll continue to achieve *Growth Through Customer Service®* for many years to come.

Last year, we closed this letter by laying out five reasons we were optimistic for 2014. This year, we’ll reiterate the same list with an eye toward 2015:

- We have a small percentage of the industrial market worldwide.
- We continue to generate cash flow to support growth.
- We continue to make wise investments to support future growth.
- We feel strongly that the highest level of service comes when we are face to face with our customers.
- We believe in our people and their ability to make the best decisions for Fastenal and for their customers.

Thank you to every employee for everything you do, and thank you to our shareholders for your continued support. We do not take it for granted.



Willard D. Oberton

WILLARD D. OBERTON
Chairman of the Board



Leland J. Hein

LELAND J. HEIN
President and CEO