2007 President's Letter to Shareholders

Almost every day some one asks me, how is business at Fastenal? In 2007, it was a good year in most areas of our business, but there is a lot of work to do. The year started out very slowly with our daily sales growth at 12.6% in January. Our team worked hard and we ended 2007 on a stronger note by reporting daily sales growth of 15.3% for the fourth quarter and 16.8% daily sales growth for the month of December. This was also a year of great change at Fastenal with the introduction of our new growth strategy called 'Pathway to Profit.' I will discuss this strategy later in the letter.

Our 2007 sales growth was 14.0% and our total revenue for the year was approximately $2.1 billion. Two billion in revenue is a new milestone for Fastenal, and for me it represents a bit more. When I started with Fastenal in January 1980, we had annual revenue of two million dollars which means our revenue is now one thousand times greater than it was when I started with Fastenal. When I have the opportunity to speak with newer employees, I share this story to motivate them. I believe it gives them an example of our future and the potential they have with Fastenal.

Our net earnings for 2007 were $232.6 million; this represents a 16.9% increase over 2006. Although this rate of earnings growth is less than planned, I am proud of the fact we were able to produce earnings leverage despite historically low sales growth and increasing energy costs.

We opened 161 new stores in 2007 versus 245 stores in 2006. The lower number was the result of our decision to open fewer stores and to add more outside sales people to our existing stores. We also slowed the rollout of our CSP2 project. This decision is a reflection of what we learned from the CSP2 expansion. We now believe that the addition of inventory and sales people in a store should be separate decisions, not just one. In other words, some stores will benefit more from the inventory, while others will benefit from the addition of sales people. We feel by separating the decisions we will see greater sales growth and a better return on our investment.

PATHWAY TO PROFIT
ACCELERATED OUTSIDE SALES PROGRAM

As I stated earlier, we introduced a new long-term growth strategy in 2007 which we call the 'Pathway to Profit.' We developed this strategy by analyzing the profitability of our stores based on age, sales volume, geographic location, staffing, and sales growth. We also factored in many of the things we learned from our CSP projects over the last several years.

During this analysis, we confirmed some things and we learned some things. First off, we discovered the real 'sweet spot' for store profitability. This sweet spot is annual per store sales of approximately $1.5 million, or $125,000 per month. When our stores reach this sales level, they currently produce an average pretax operating margin of approximately 23.0%. By comparison, our pretax earnings margin was 17.7% in 2006, and our average annual per store sales were $955,000, or $79,500 per month.

The 'Pathway to Profit' strategy is very straightforward – to grow our average store sales to $125,000 per month and to drive our pretax operating margin to 23.0%. To drive our average store volume to this level, we have transitioned from a growth strategy primarily focused on store openings to a strategy that blends store openings with a heightened investment in additional outside sales personnel in existing stores.

We believe this new growth strategy will allow us to produce annual sales growth at, or above, 20.0% in a normal economic cycle. In addition, we believe it can produce an even greater profit growth and return on invested capital. Specifically, our plan is to slow the annual new store openings from our previously stated goal of 13.0-18.0% additional stores to approximately 7.0% to 10.0% additional stores. We will then use the money saved by opening fewer stores and will increase our investment in outside sales people. These additional outside sales people will be added to our strongest stores. We define our strongest stores as those that score well on our internal scorecard system.

Our research shows for every store we don't open, we can hire four sales people. Based on the results we had in our CSP2 stores, we believe we will achieve greater sales growth by adding these sales people to an existing store. If we are able to execute on the 'Pathway to Profit,' an 8.0% rate of new store openings, combined with 20.0% sales growth company-wide, would raise our average store to $125,000 per month in five years. Our stated plan is to grow our pretax earnings margin from the current 18.3% to 23.0% over this five year period. A simple way to think about this strategy – greater investment in people and lower investment in brick and mortar.

Another important finding is that a high percentage of the work done by our support staff is based more on the number of stores rather than sales volume. This means with lower store openings we will not have to add as much support help. So, we set a new goal of growing support labor at half the rate of sales growth, which will greatly help us manage operating and administrative expense growth. Even with lower sales growth in 2007, we were able to achieve this support labor goal.

We also learned from the CSP2 project that to get the sales productivity we need from our new sales hires, we needed to greatly improve our sales process. We started by determining what tools our sales people would need to be efficient and effective at serving their customers. We knew they needed access to operational and product information, needed access to CRM software, and also needed to be capable of communicating with both the customer and their store. We concluded that e-mail was a more efficient form of communication than telephone, so we asked our technology group to find the best tool on the market that would fit these needs. Their research concluded that the Symbol MC70 was the best choice as it could provide all of the functionality required and was also equipped with a barcode scanner for scanning customers' product bins. This would eliminate having two devices. By the close of 2007, our technology group had not only written and tested the software to run the MC70s, but they have also rolled out the devices to over 2,300 salespeople and have trained them on how to use it efficiently.

We also changed the sales territories to sales zones within each store. The CSP2 analysis revealed to us one simple fact: stores that do a good job of dividing up current and potential accounts achieve better sales growth. The sales zone allows us to measure the performance of each sales person using our outside sales scorecard. The scorecard measures the performance of every sales person against their peers in several categories on a monthly basis. To lead the development of this sales program we formed a new department within Fastenal whose sole focus is the improvement of our sales process and productivity. They are committed to developing the most professional and productive sales force in our industry.

The inventory expansion project in our Indianapolis Distribution Center was a big focus in 2007. As I stated in my 2006 President's Letter, we began to expand our inventory selection in that facility from 28,000 to approximately 120,000 items during 2005. We chose to do this project in Indianapolis due to its central location and because we can reach more than 70.0% of our customers in less than 48 hours using Fastenal's ground transportation. Because of the benefits we have seen from this program, we have continued to expand the number of stocked items at this location, and at year end there were approximately 140,000 different items available. In 2008, we plan to continue expanding the selection of inventory at this location by adding 25,000 to 50,000 more items throughout the year. This project is all about improving the service we provide to our customers.

Our accounting and purchasing people did a nice job of managing our assets in 2007. Both our inventory and accounts receivable grew at a lower rate than sales. Inventory grew $48.6 million, or 10.7%, and accounts receivable grew $26.8 million, or 12.8%. This allowed us to produce more free cash flow than ever before. We used this money to increase our stock buy-back program and purchased nearly 2.1 million shares during 2007.

The accounting team continues to find new and better ways to process the millions of transactions we handle every year. In 2006, we installed a new automated scanning system that electronically captures the information from incoming invoices and payments and automates both the bill paying and payment application processes. Throughout 2007, the accounting group continued to find new ways to speed up these processes, enabling them to process more transactions with fewer people. Meanwhile, the team at our accounts receivable call center worked on developing new ideas and better training, which allowed them to increase their call volume to a level 21.0% higher than just 12 months earlier. This is the main reason we continue to see improvement in our days outstanding.

The strategic accounts team continued to bring in new business in 2007. The environment for large manufacturers and contractors was somewhat challenging in 2007, but through hard work and dedication they continued to win new business. As a supplier, Fastenal is very well positioned to serve these large companies due to our multiple locations and our wide range of products and services.

We saw good success at our manufacturing division in 2007. For those of you not as familiar with Fastenal, our manufacturing division was started in 1982 to quickly produce hard-to-find parts for customers. This division has grown to four locations, Winona, MN, Rockford, IL, Indianapolis, IN, and Modesto, CA, and we have more than 350 people focused on solving customer problems as quickly as possible. Many of the orders received are produced within a day or less and shipped directly to the customer location. This is not a service most customers need often, but when a critical machine is down, one part can make a big difference.

Our marketing department continues to work hard promoting the Fastenal name. In 2007, we decided to increase our presence in the NASCAR racing program by agreeing to sponsor the No. 40 Dodge in the Nationwide Series (formerly the Busch Series). The team is owned by Chip Ganassi Racing with Felix Sabates and our lead driver will be Dario Franchitti, the reigning Indianapolis 500 and IndyCar points champion. Both our research and our experience have told us that racing is a very popular sport with a high percentage of our customer base. We are excited to have Dario and the entire Ganassi team associated with the Fastenal name.

Product development and purchasing continue to search for the best suppliers. This group is tasked with putting our sales people in a position of having high quality product at a competitive price. They have done a great job, and our sales people can be proud of the high quality products and service they bring to our customers. We continue to expand our foreign sourcing efforts and have greatly increased the number of field inspectors traveling to factories to check for both quality and social compliance. In 2007, we opened two quality control laboratories, one in Kan Shan, Taiwan and the other in Shanghai, China. These investments were made to help with quality assurance and to speed up the product development process. Both of these labs have received their A2LA quality certification.

During the first quarter, we completed the move into our new distribution center in Modesto, California. This facility services the California area and also acts as the regional distribution center for the western United States and Canada. We also designed a new distribution center that is being built in Denton, Texas to replace our facility in Carrollton, Texas. Although the construction was delayed due to wet weather in the Dallas area, we still plan to move into the facility in mid 2008.

Our transportation group continued to improve the delivery times of product to our stores and customers. As I have stated in previous years, transportation is a very important part of what we do as a distributor. Many of our best competitors rely on outside carriers such as UPS and FedEx to deliver product to their customers. By using our own transportation fleet, we are not only more cost effective, but we're also able to deliver the product earlier in the day. In fact, over 80.0% of our stores receive a delivery from the warehouse before 7:00 a.m., which allows us to get the product to the customer before their workday starts. Based on our research, the outside carriers typically arrive between 10:00 a.m. and noon; this gives us a distinct service advantage. Thanks to our investment in store inventory over the last five years, we also have the product on our local store shelves for over 60.0% of our sales transactions. This eliminates the need for rapid transportation on these items and allows us to provide same-day service.

The Information Systems (IS) group has not only kept up with the growth of Fastenal, they've also developed several customer solutions – all while growing their department by only a few people. In the last two years, the IS group has gone from mainly providing systems and support to being a producer of custom solutions for our people, and also for our customers. I spoke earlier about the rollout of the MC70 hand held device. They have also been working on several systems that will automate the tool cribs of our customers. The group set up a mock tool crib display at our employee product show in December, and the feedback from store personnel and our suppliers was tremendous. They demonstrated an automated scale system they have designed that allows the customer to know exactly how many pieces of a particular part they are using and who is using it, without having a person manning the crib. Bob Kierlin's original idea for Fastenal was to sell product through vending machines. Based on the display I saw at the employee product show, we are closer than we have ever been to that dream.

None of the progress I have written about would have been possible without great people. In 2007, we have continued to invest in our people, and because of our profit growth we will be able to contribute 50.0% more to our 401(k) plan than in 2006. Our people in the human resources keep looking for new and creative ways to improve the benefits for our people.

The Fastenal School of Business (FSB) trained more people, in more places, on more subjects than ever before, and our training just keeps getting better. Early in the year, I challenged some of the people in FSB to try and think of ways to make learning about products more fun. So they developed a game they named Product Prodigy. One copy was produced for each store. The quality of this game is as good, if not better, than any you can buy in a department store. We then challenged each region to put together a district team and multiple store teams of employees to compete in a large tournament during our employee product show. There were 186 store teams and 16 district teams that competed. Over two days and a single elimination process, teams advanced until Friday afternoon when it was down to the final two in each group. These teams had to compete in front of over 2,000 fellow employees. It was very fun and exciting. The winning team for the store tournament was Tom Gundlach's Salt Lake City, Utah district, and for the regional winners it was Ross Surratt's Ohio district managers. Each of these people won a nice cash prize, and the grand prize winners will receive a ten day trip to Asia to learn even more about products. I tell you this story because it's another good example of our people accepting a challenge and then far exceeding anyone's expectations.

Although I believe we could have grown faster in 2007, I hope it's clear that I am very proud of the accomplishments our team made in our effort to make Fastenal the best distributor of industrial and construction products in every market we serve. In the fourth quarter, I spent a great deal of time traveling to visit employees and I see the same thing wherever I go: great people pulling together to achieve a common goal – ***Growth Through Customer Service***. I want to thank everyone on the Fastenal team for their dedication and the hard work that makes our success possible. As the leader of our company, I believe that if we continue to hire great people, give them good leadership and training, and allow them to make the decisions to serve our customers, we will always be successful.

Finally, I want to also thank you, our shareholders, for your continued support. And, as always, I will commit to work hard to lead this team of more than 12,000 people and achieve even greater success in the coming year.

Willard D. Oberton

Willard D. Oberton
Chief Executive Officer and President