

FASTENAL CO
Form 10-Q
July 17, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2017, or
 Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission file number 0-16125

FASTENAL COMPANY
(Exact name of registrant as specified in its charter)

Minnesota 41-0948415
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
2001 Theurer Boulevard 55987-1500
Winona, Minnesota
(Address of principal executive offices) (Zip Code)
(507) 454-5374
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company
Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

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Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date.

Class	Outstanding at July11, 2017
Common Stock, par value \$.01 per share	287,978,174

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PART I — FINANCIAL INFORMATION

ITEM 1 — FINANCIAL STATEMENTS

FASTENAL COMPANY AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Amounts in millions except share and per share information)

	(Unaudited)	
	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 115.1	112.7
Trade accounts receivable, net of allowance for doubtful accounts of \$11.6 and \$11.2, respectively	613.5	499.7
Inventories	1,044.3	993.0
Prepaid income taxes	—	12.9
Other current assets	100.0	102.5
Total current assets	1,872.9	1,720.8
Property and equipment, net	895.2	899.7
Other assets	83.3	48.4
Total assets	\$ 2,851.4	2,668.9
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of debt	\$ 8.8	10.5
Accounts payable	141.2	108.8
Accrued expenses	180.4	156.4
Income taxes payable	11.9	—
Total current liabilities	342.3	275.7
Long-term debt	436.2	379.5
Deferred income tax liabilities	81.4	80.6
Stockholders' equity:		
Preferred stock: \$0.01 par value, 5,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock: \$0.01 par value, 400,000,000 shares authorized, 287,978,174 and 289,161,924 shares issued and outstanding, respectively	2.9	2.9
Additional paid-in capital	1.2	37.4
Retained earnings	2,023.7	1,940.1
Accumulated other comprehensive loss	(36.3) (47.3
Total stockholders' equity	1,991.5	1,933.1
Total liabilities and stockholders' equity	\$ 2,851.4	2,668.9

See accompanying Notes to Condensed Consolidated Financial Statements.

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FASTENAL COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(Amounts in millions except earnings per share)

	(Unaudited)		(Unaudited)	
	Six Months Ended June 30,		Three Months Ended June 30,	
	2017	2016	2017	2016
Net sales	\$2,169.2	2,001.0	\$1,121.5	1,014.3
Cost of sales	1,092.7	1,007.9	563.0	512.7
Gross profit	1,076.5	993.1	558.5	501.6
Operating and administrative expenses	627.5	582.8	321.6	292.6
Gain on sale of property and equipment	(1.0)	(0.1)	(0.6)	(0.2)
Operating income	450.0	410.4	237.5	209.2
Interest income	0.2	0.2	0.1	0.1
Interest expense	(3.9)	(2.9)	(2.2)	(1.5)
Earnings before income taxes	446.3	407.7	235.4	207.8
Income tax expense	163.2	150.0	86.5	76.3
Net earnings	\$283.1	257.7	\$148.9	131.5
Basic net earnings per share	\$0.98	0.89	\$0.52	0.46
Diluted net earnings per share	\$0.98	0.89	\$0.52	0.45
Basic weighted average shares outstanding	288.9	288.9	288.7	288.9
Diluted weighted average shares outstanding	289.1	289.1	288.8	289.1

See accompanying Notes to Condensed Consolidated Financial Statements.

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FASTENAL COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Amounts in millions)

	(Unaudited) Six Months Ended June 30,		(Unaudited) Three Months Ended June 30,	
	2017	2016	2017	2016
Net earnings	\$283.1	257.7	\$148.9	131.5
Other comprehensive income, net of tax:				
Foreign currency translation adjustments (net of tax of \$0.0 in 2017 and 2016)	11.0	12.2	8.1	(1.5)
Comprehensive income	\$294.1	269.9	\$157.0	130.0
See accompanying Notes to Condensed Consolidated Financial Statements.				

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FASTENAL COMPANY AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Amounts in millions)

	(Unaudited) Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net earnings	\$283.1	257.7
Adjustments to reconcile net earnings to net cash provided by operating activities, net of acquisition:		
Depreciation of property and equipment	60.8	47.9
Gain on sale of property and equipment	(1.0)	(0.1)
Bad debt expense	4.0	3.9
Deferred income taxes	0.8	2.3
Stock-based compensation	2.8	1.7
Amortization of intangible assets	1.8	0.3
Changes in operating assets and liabilities, net of acquisition:		
Trade accounts receivable	(108.0)	(70.6)
Inventories	(32.1)	(68.1)
Other current assets	2.5	18.5
Accounts payable	30.0	32.7
Accrued expenses	24.0	(8.5)
Income taxes	24.8	36.3
Other	(0.2)	(0.5)
Net cash provided by operating activities	293.3	253.5
Cash flows from investing activities:		
Purchases of property and equipment	(57.4)	(88.7)
Proceeds from sale of property and equipment	4.6	3.0
Cash paid for acquisition	(58.7)	—
Other	1.8	(0.2)
Net cash used in investing activities	(109.7)	(85.9)
Cash flows from financing activities:		
Proceeds from debt obligations	550.0	435.0
Payments against debt obligations	(495.0)	(370.0)
Proceeds from exercise of stock options	3.3	22.4
Purchases of common stock	(56.7)	(59.5)
Payments of dividends	(185.1)	(173.2)
Net cash used in financing activities	(183.5)	(145.3)
Effect of exchange rate changes on cash and cash equivalents	2.3	4.1
Net increase in cash and cash equivalents	2.4	26.4
Cash and cash equivalents at beginning of period	112.7	129.0
Cash and cash equivalents at end of period	\$115.1	155.4

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Supplemental disclosure of cash flow information:

Cash paid for interest	\$3.5	2.9
Net cash paid for income taxes	\$137.1	110.9

See accompanying Notes to Condensed Consolidated Financial Statements.

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Fastenal Company and subsidiaries (collectively referred to as the Company, Fastenal, or by terms such as we, our, or us) have been prepared in accordance with U.S. generally accepted accounting principles ('GAAP') for interim financial information. They do not include all information and footnotes required by U.S. GAAP for complete financial statements. However, except as described herein, there has been no material change in the information disclosed in the Notes to Consolidated Financial Statements included in our consolidated financial statements as of and for the year ended December 31, 2016. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

Recently Adopted Accounting Pronouncements

Effective January 1, 2017, we adopted the Financial Accounting Standards Board ('FASB') Accounting Standards Update ('ASU') 2016-09, Improvements to Employee Share-Based Payment Accounting. The standard simplifies several aspects of the accounting for employee share-based payment transactions, including accounting for income taxes, forfeitures, and statutory withholding requirements, as well as classification in the Condensed Consolidated Statements of Cash Flows. As a result of the adoption, on a prospective basis, for the six and three month periods ended June 30, 2017, we recognized \$0.5 and \$0.0, respectively, of excess tax benefits from stock-based compensation as a discrete item in our income tax expense. Historically, these amounts were recorded as additional paid-in capital. Upon adoption, we elected to apply the change retrospectively to our Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2016, which resulted in a reclassification of excess tax benefits from stock-based compensation of \$5.5 from cash flows from financing activities to cash flows from operating activities. We elected not to change our policy on accounting for forfeitures and will continue to estimate a requisite forfeiture rate. Additional amendments to the accounting for income taxes and minimum statutory withholding requirements had no impact on our results of operations.

Recently Issued Accounting Pronouncements

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for all entities by one year. This update is effective for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. ASU 2014-09 was to become effective for us beginning January 2017; however, ASU 2015-14 defers our effective date until January 2018, which is when we plan to adopt this standard. The ASU permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the cumulative catch-up transition method). The ASU also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required for customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. While we are still in the process of evaluating the effect of adoption on our consolidated financial statements and are currently assessing our contracts with customers, we do not currently expect a material impact on our results of operations, cash flows or financial position. We anticipate we will expand our consolidated financial statement disclosures in order to comply with the ASU. We have not yet decided on our transition method upon adoption, but plan to select a transition method in the third quarter of 2017.

In February 2016, the FASB issued ASU 2016-02, Leases, which introduces the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The update is effective for

annual reporting periods beginning after December 15, 2018, including interim periods within those reporting periods, with early adoption permitted. The guidance will be applied on a modified retrospective basis with the earliest period presented. Based on the effective date, this guidance would apply beginning January 2019 which is when we plan to adopt this ASU. While we are still in the process of evaluating the effect of adoption on our consolidated financial statements and are currently assessing our leases, we expect the adoption will lead to a material increase in the assets and liabilities recorded on our Condensed Consolidated Balance Sheets. As part of our assessment, we will need to determine the impact of lease extension provisions provided in our facility and vehicle leases which will impact the amount of the right of use asset and lease liability recorded under the ASU.

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

(2) Acquisition

On March 31, 2017, we acquired certain assets and assumed certain liabilities of Manufacturers Supply Company ('Mansco'). Mansco, headquartered in Hudsonville, Michigan, is a distributor of industrial and fastener supplies with a particularly strong market position with commercial furniture original equipment manufacturers. As such, this acquisition gives us a presence in a market where we have not meaningfully contributed in the past, while providing Mansco with additional tools with which to service its customer base and reduce costs through economies of scale. The total purchase price for this acquisition consisted of \$57.9 paid in cash at closing, \$0.8 paid in cash after closing pursuant to a post-closing purchase price adjustment, and a contingent consideration arrangement which requires us to pay the former owner up to a maximum of \$2.5 (undiscounted) in cash after closing based on sales growth of the acquired business. The fair value of the contingent consideration arrangement as of June 30, 2017, estimated by applying the income approach, which is a level 3 measurement under the fair value hierarchy, was \$0.6. Assuming payment of \$0.6 of the contingent consideration arrangement, the total consideration for the acquisition will be \$59.3. We funded the purchase price for the acquisition with the proceeds from the issuance during the first quarter of 2017 of a new series of senior unsecured promissory notes under our master note agreement in the aggregate principal amount of \$60.0.

The fair value of the assets acquired and liabilities assumed is summarized below.

Current assets	\$21.7
Property and equipment	0.9
Identifiable intangible assets	20.1
Current liabilities	(1.8)
Total identifiable net assets	40.9
Goodwill	18.4
Total fair value of assets acquired and liabilities assumed	\$59.3

The estimated fair values are preliminary and subject to adjustment. The identifiable intangible assets consist mainly of the value of the customer relationships that were acquired and the goodwill consists largely of the synergies and economies of scale expected from combining the Mansco operations with our existing operations. The identifiable intangible assets and goodwill are deductible for income tax purposes.

The amount of net sales and net earnings of the acquired business included in our condensed consolidated statement of earnings for the periods ended June 30, 2017, and the pro forma net sales and net earnings of the combined entity had the acquisition occurred on January 1, 2016, are:

	Six-month Period 2017	Three-month Period 2016	Six-month Period 2017	Three-month Period 2016
Net sales	\$27.0	\$24.0	\$13.5	\$12.8
Net earnings	\$3.2	\$2.5	\$1.6	\$1.3

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

(3) Stockholders' Equity

Dividends

On July 11, 2017, our board of directors declared a dividend of \$0.32 per share of common stock. This dividend is to be paid in cash on August 23, 2017 to shareholders of record at the close of business on July 26, 2017. Since 2011, we have paid quarterly dividends. Our board of directors expects to continue paying quarterly dividends, provided the future determination as to payment of dividends will depend on the financial needs of the Company and such other factors as deemed relevant by the board of directors.

The following table presents the dividends either paid previously or declared by our board of directors for future payment on a per share basis:

	2017	2016
First quarter	\$0.32	0.30
Second quarter	0.32	0.30
Third quarter	0.32	0.30
Fourth quarter		0.30
Total	\$0.96	1.20

Stock Options

The following tables summarize the details of options granted under our stock option plan that were still outstanding as of June 30, 2017, and the assumptions used to value these grants. All such grants were effective at the close of business on the date of grant.

Date of Grant	Options Granted	Option Exercise (Strike) Price	Closing June 30, 2017		
			Stock Price on Date of Grant	Options Outstanding	Options Exercisable
January 3, 2017	764,789	\$ 47.00	\$ 46.95	747,772	—
April 19, 2016	845,440	\$ 46.00	\$ 45.74	771,432	—
April 21, 2015	893,220	\$ 42.00	\$ 41.26	712,290	—
April 22, 2014	955,000	\$ 56.00	\$ 50.53	582,500	116,250
April 16, 2013	205,000	\$ 54.00	\$ 49.25	110,000	57,250
April 17, 2012	1,235,000	\$ 54.00	\$ 49.01	965,125	778,603
April 19, 2011	410,000	\$ 35.00	\$ 31.78	73,800	48,800
April 20, 2010	530,000	\$ 30.00	\$ 27.13	110,300	84,050
April 21, 2009	790,000	\$ 27.00	\$ 17.61	224,150	224,150
Total	6,628,449			4,297,369	1,309,103

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

Date of Grant	Risk-free Interest Rate	Expected Life of Option in Years	Estimated Fair Value of Stock Option			
			Expected Dividend Yield	Expected Stock Volatility	Estimated Fair Value of Stock Option	
January 3, 2017	1.9 %	5.00	2.6 %	24.49 %	\$ 8.40	
April 19, 2016	1.3 %	5.00	2.6 %	26.34 %	\$ 8.18	
April 21, 2015	1.3 %	5.00	2.7 %	26.84 %	\$ 7.35	
April 22, 2014	1.8 %	5.00	2.0 %	28.55 %	\$ 9.57	
April 16, 2013	0.7 %	5.00	1.6 %	37.42 %	\$ 12.66	
April 17, 2012	0.9 %	5.00	1.4 %	39.25 %	\$ 13.69	
April 19, 2011	2.1 %	5.00	1.6 %	39.33 %	\$ 11.20	
April 20, 2010	2.6 %	5.00	1.5 %	39.10 %	\$ 8.14	
April 21, 2009	1.9 %	5.00	1.0 %	38.80 %	\$ 3.64	

All of the options in the tables above vest and become exercisable over a period of up to eight years. Generally, each option will terminate approximately nine years after the grant date.

The fair value of each share-based option is estimated on the date of grant using a Black-Scholes valuation method that uses the assumptions listed above. The risk-free interest rate is based on the U.S. Treasury rate over the expected life of the option at the time of grant. The expected life is the average length of time over which we expect the employee groups will exercise their options, which is based on historical experience with similar grants. The dividend yield is estimated over the expected life of the option based on our current dividend payout, historical dividends paid, and expected future cash dividends. Expected stock volatilities are based on the movement of our stock price over the most recent historical period equivalent to the expected life of the option.

Compensation expense equal to the grant date fair value is recognized for all of these awards over the vesting period. The stock-based compensation expense for the six-month periods ended June 30, 2017 and 2016 was \$2.8 and \$1.7, respectively. Unrecognized stock-based compensation expense related to outstanding unvested stock options as of June 30, 2017 was \$17.2 and is expected to be recognized over a weighted average period of 4.58 years. Any future changes in estimated forfeitures will impact this amount.

Earnings Per Share

The following tables present a reconciliation of the denominators used in the computation of basic and diluted earnings per share and a summary of the options to purchase shares of common stock which were excluded from the diluted earnings per share calculation because they were anti-dilutive:

Reconciliation	Six-month Period		Three-month Period	
	2017	2016	2017	2016
Basic weighted average shares outstanding	288,948,734	288,863,482	288,655,020	288,918,945
Weighted shares assumed upon exercise of stock options	150,582	268,820	133,943	200,525
Diluted weighted average shares outstanding	289,099,316	289,132,302	288,788,963	289,119,470

Summary of Anti-dilutive Options Excluded	Six-month Period		Three-month Period	
	2017	2016	2017	2016
Options to purchase shares of common stock	3,603,851	1,941,864	3,897,173	2,253,343
Weighted average exercise price of options	\$49.81	50.39	\$49.18	49.91

Any dilutive impact summarized above related to periods when the average market price of our stock exceeded the exercise price of the potentially dilutive stock options then outstanding.

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

(4) Income Taxes

Fastenal files income tax returns in the United States federal jurisdiction, all states, and various local and foreign jurisdictions. With limited exceptions, we are no longer subject to income tax examinations by taxing authorities for taxable years before 2014 in the case of United States federal and foreign examinations and 2012 in the case of state and local examinations.

As of June 30, 2017 and 2016, liabilities recorded related to gross unrecognized tax benefits were \$4.3 and \$5.1, respectively. Included in these liabilities for gross unrecognized tax benefits is an immaterial amount for interest and penalties, both of which we classify as a component of income tax expense. We do not anticipate significant changes in total unrecognized tax benefits during the next twelve months.

(5) Operating Leases

Certain operating leases for pick-up trucks contain residual value guarantee provisions which would generally become due at the expiration of the operating lease agreement if the fair value of the leased vehicles is less than the guaranteed residual value. The aggregate residual value guarantee related to these leases is approximately \$83.5. We believe the likelihood of funding the guarantee obligation under any provision of the operating lease agreements is remote other than where we have established an accrual for estimated losses, which is immaterial at June 30, 2017. To the extent our fleet contains vehicles we estimate will settle at a gain, such gains on these vehicles will be recognized when we sell the vehicle.

(6) Debt Commitments

Credit Facility, Notes Payable, and Commitments

Debt obligations and letters of credit outstanding at the end of each period consisted of the following:

	June 30, December 31,	
	2017	2016
Outstanding loans under unsecured revolving credit facility	\$305.0	305.0
2.00% senior unsecured promissory note payable	40.0	40.0
2.45% senior unsecured promissory note payable	35.0	35.0
3.22% senior unsecured promissory note payable	60.0	—
Note payable under asset purchase agreement	5.0	10.0
Total debt	445.0	390.0
Less: Current portion of debt	(8.8)	(10.5)
Long-term debt	\$436.2	379.5

Outstanding letters of credit under unsecured revolving credit facility - contingent obligation \$36.3 36.3

Unsecured Revolving Credit Facility

We have a \$700.0 committed unsecured revolving credit facility ('Credit Facility'). The Credit Facility includes a committed letter of credit subfacility of \$55.0. The commitments under the Credit Facility will expire (and any borrowings outstanding under the Credit Facility will become due and payable) on March 10, 2020. In the next twelve months, we have the ability and intent to repay a portion of the outstanding loans using cash; therefore, we have classified this portion as a current liability. The Credit Facility contains certain financial and other covenants, and our right to borrow under the Credit Facility is conditioned upon, among other things, our compliance with these covenants. We are currently in compliance with these covenants.

Borrowings under the Credit Facility generally bear interest at a rate per annum equal to the London Interbank Offered Rate ('LIBOR') for interest periods of various lengths selected by us, plus 0.95%. Based on the interest periods we

have chosen, our weighted per annum interest rate at June 30, 2017 was approximately 2.2%. We pay a commitment fee for the unused portion of the Credit Facility. This fee is either 0.10% or 0.125% per annum based on our usage of the Credit Facility.

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FASTENAL COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Amounts in millions except share and per share information and where otherwise noted)

June 30, 2017 and 2016

(Unaudited)

Senior Unsecured Promissory Notes Payable

On July 20, 2016 (the 'Effective Date'), we entered into a master note agreement (the 'Master Note Agreement') with certain institutional lenders, pursuant to which, during the period commencing on the Effective Date and ending three years thereafter, we may issue at our discretion in private placements, and the institutional lenders may purchase at their discretion, senior unsecured promissory notes of the Company (the 'Notes') in the aggregate principal amount outstanding from time to time of up to \$200.0. The Notes will bear interest at either a fixed rate, or a floating rate based on LIBOR for an interest period of one, three, or six months. The Notes will mature no later than 12 years after the date of issuance thereof, in the case of fixed rate Notes, or 10 years after the date of issuance thereof, in the case of floating rate Notes. All of the Notes will be prepayable at our option in whole or in part. The Master Note Agreement contains certain financial and other covenants. We are currently in compliance with these covenants.

Three series of senior unsecured Notes are currently outstanding under the Master Note Agreement. The first series of Notes ('Series A'), was issued on the Effective Date, is in an aggregate principal amount of \$40.0, is due and payable in full on July 20, 2021, and bears interest at a fixed rate of 2.00% per annum. The second series of Notes ('Series B'), was issued on the Effective Date, is in an aggregate principal amount of \$35.0, is due and payable in full on July 20, 2022, and bears interest at a fixed rate of 2.45% per annum. The third series of Notes ('Series C'), was issued on March 1, 2017, is in an aggregate principal amount of \$60.0, is due and payable in full on March 1, 2024, and bears interest at a fixed rate of 3.22% per annum. There is no amortization of these Notes prior to their maturity dates.

Interest on the Notes is payable quarterly in arrears on January 20, April 20, July 20, and October 20 of each year. The carrying value of the Notes approximates fair value. The fair value was based on available external pricing data and current market rates for similar debt instruments, among other factors, which are classified as a level 2 measurement under the fair value hierarchy.

Note Payable Under Asset Purchase Agreement

On December 7, 2015, we signed an agreement to purchase, effective January 2, 2017 ('Asset Purchase Effective Date'), certain assets related to the collection and management of certain portions of our business and financial data from Apex Industrial Technologies, LLC ('Apex'), a provider of automated point-of-use dispensing and supply chain technologies. The agreement includes a transition arrangement which requires us to assume responsibility for certain software that is licensed by Apex. The total consideration for the assets is \$27.0, of which \$12.0 was paid in cash in December 2015 in advance of the Asset Purchase Effective Date. The remaining \$15.0 is payable in installments pursuant to an unsecured note. The first \$5.0 installment was paid in December 2016, the second \$5.0 installment was paid in June 2017, and the final installment of \$5.0 will be paid in December 2017. The note bears interest at an annual rate of 0.56%. Interest on the unpaid principal balance of the note is due and payable on the last day of each calendar quarter.

(7) Legal Contingencies

The nature of our potential exposure to legal contingencies is described in our 2016 annual report on Form 10-K in Note 9 of the Notes to Consolidated Financial Statements. As of June 30, 2017, there were no litigation matters that we consider to be probable or reasonably possible to have a material adverse outcome.

(8) Subsequent Events

We evaluated all subsequent event activity and concluded that no subsequent events have occurred that would require recognition in the condensed consolidated financial statements or disclosure in the Notes to Condensed Consolidated Financial Statements, with the exception of the dividend disclosed in Note 3 'Stockholders' Equity'.

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ITEM 2 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of certain significant factors which have affected our financial position and operating results during the periods included in the accompanying condensed consolidated financial statements. Dollar amounts are stated in millions except for share and per share amounts and where otherwise noted. Throughout this document, percentage calculations, which are based on non-rounded dollar values, may not be able to be recalculated using the dollar values in this document due to the rounding of those dollar values.

Business

Fastenal is a North American leader in the wholesale distribution of industrial and construction supplies. We distribute these supplies through a network of approximately 2,450 company-owned branches. Most of our customers are in the manufacturing and non-residential construction markets. The manufacturing market includes both original equipment manufacturers (OEM) and maintenance, repair, and operations (MRO). The non-residential construction market includes general, electrical, plumbing, sheet metal, and road contractors. Other users of our products include farmers, truckers, railroads, oil exploration, production, and refinement companies, mining companies, federal, state, and local governmental entities, schools, and certain retail trades. Geographically, our branches and customers are primarily located in North America.

Our motto is Growth through Customer Service[®]. We are a growth-centric organization focused on identifying 'drivers' that will allow us to get closer to our customers and gain market share in what we believe remains a fragmented industrial distribution market. Our growth drivers have evolved, and can be expected to continue to evolve, over time.

Executive Overview

Net sales increased \$107.2, or 10.6%, in the second quarter of 2017 relative to the second quarter of 2016. Our gross profit as a percentage of net sales improved to 49.8% in the second quarter of 2017 from 49.5% in the second quarter of 2016. Our operating income as a percentage of net sales improved to 21.2% in the second quarter of 2017 from 20.6% in the second quarter of 2016. Our net earnings during the second quarter of 2017 were \$148.9, an increase of 13.2% when compared to the second quarter of 2016. Our diluted net earnings per share were \$0.52 during the second quarter of 2017 compared to \$0.45 during the second quarter of 2016.

We continue to focus on our growth drivers to facilitate growth. During the second quarter of 2017, we signed 51 new national account contracts (defined as new customer accounts with a multi-site contract). Additionally, we signed 68 new Onsite customer locations (defined as dedicated sales and service provided from within, or in close proximity to, the customer's facility) and 4,881 new industrial vending machines in the second quarter of 2017.

The table below summarizes our branch and Onsite employee count and our total employee count at the end of the periods presented, and changes in that count from the end of the prior periods to the end of the most recent period. The final three items below summarize our cumulative investments in branch locations, Onsite locations, and industrial vending machines.

	Q2	Q4	Change	Q2	Change
	2017	2016	Since:	2016	Since:
			Q4	Q2	Q2
			2016	2016	2016
End of period total branch and Onsite employee count	13,335	12,966	2.8 %	13,499	-1.2 %
End of period total employee count	20,174	19,624	2.8 %	20,324	-0.7 %
Number of branch locations	2,451	2,503	-2.1 %	2,605	-5.9 %
Number of active Onsite locations	486	401	21.2 %	333	45.9 %
Number of in-market units ⁽¹⁾	2,937	2,904	1.1 %	2,938	0.0 %
Industrial vending machines (installed device count) ⁽²⁾	66,577	62,822	6.0 %	58,346	14.1 %
Ratio of industrial vending machines to in-market units	23:1	22:1		20:1	

⁽¹⁾ 'In-market units' is defined as the sum of the total number of public branch locations and the total number of active Onsite locations.

⁽²⁾ In February 2016, we signed an agreement to lease a significant number of industrial vending lockers to one of our customers. These devices do not generate product revenue and are excluded from the count noted above.

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During the last twelve months, we have reduced our headcount by 164 people in our branches and 150 people in total. These reductions can be primarily attributed to natural attrition rather than an active headcount reduction program. However, we allowed this attrition to reduce our overall headcount throughout 2016. This was a reaction to a staffing buildup in 2015 in anticipation of better growth that did not happen as quickly as we anticipated. We continue to add headcount where necessary to support our growth initiatives, notably our Onsite business, and would expect to see our headcount grow in the second half of 2017.

We opened five branches and closed 31 branches in the second quarter of 2017. Our branch network forms the foundation of our business strategy, and we will continue to open or close branches in 2017 as is deemed necessary to sustain and improve our network and support our growth drivers.

Results of Operations

The following sets forth statement of earnings information (as a percentage of net sales) for the periods ended June 30:

	Six-month Period		Three-month Period	
	2017	2016	2017	2016
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Gross profit	49.6 %	49.6 %	49.8 %	49.5 %
Operating and administrative expenses	28.9 %	29.1 %	28.7 %	28.8 %
Gain on sale of property and equipment	0.0 %	0.0 %	0.1 %	0.0 %
Operating income	20.7 %	20.5 %	21.2 %	20.6 %
Net interest expense	-0.2 %	-0.1 %	-0.2 %	-0.1 %
Earnings before income taxes	20.6 %	20.4 %	21.0 %	20.5 %

Note – Amounts may not foot due to rounding difference.

Net Sales

Note – Daily sales are defined as the total net sales for the period divided by the number of business days (in the United States) in the period.

The table below sets forth net sales and daily sales for the periods ended June 30, and changes in such sales from the prior period to the more recent period:

	Six-month Period		Three-month Period		
	2017	2016	2017	2016	
Net sales	2,169.2	2,001.0	1,121.5	1,014.3	
Percentage change	8.4 %	2.6 %	10.6 %	1.6 %	%
Business days	128	128	64	64	
Daily sales	16.9	15.6	17.5	15.8	
Percentage change	8.4 %	1.8 %	10.6 %	1.6 %	%
Impact of currency fluctuations	-0.1 %	-0.6 %	-0.3 %	-0.4 %	%
Impact of acquisitions	0.7 %	0.7 %	1.3 %	0.6 %	%

The increases in net sales in the periods noted for 2017 and 2016, were driven primarily by higher unit sales. The higher unit sales resulted primarily from two sources. The first is improvement in underlying market demand. We believe the improvement in general business activity is reflected in a number of metrics. For instance, the Purchasing Managers Index, published by the Institute for Supply Chain Management, averaged 57.0 in the first quarter of 2017, and 55.8 in the second quarter of 2017, well above 49.8 in the first quarter of 2016 and 51.5 in the second quarter of 2016 (readings above 50 suggest demand is growing). Sales of fasteners, our most cyclical product line, continued to grow in the second quarter of 2017. We also experienced growth in sales to 64 and 68 of our top 100 customers in the first and second quarters of 2017, respectively. As recently as the fourth quarter of 2016, this count was 51. As business conditions strengthen, they tend to lift our net sales growth rates as well.

The second source is success within our growth initiatives, four of which stand out. We signed 10,318 industrial vending machines during the first six months of 2017, an increase of 8.4% over the first six months of 2016. We

signed 4,881 industrial vending machines during the second quarter of 2017, an increase 0.3% over the second quarter of 2016. Sales through our vending machines continued to grow at or near a double-digit pace during the first and second quarters of 2017. We signed 132 new Onsite locations during the first six months of 2017 and had 486 active sites on June 30, 2017, an increase of 45.9% over

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June 30, 2016. We signed 68 new Onsite locations during the second quarter of 2017, an increase of 54.5% over the second quarter of 2016. We signed 94 new national account contracts in the first six months of 2017; 51 of these were signed in the second quarter of 2017. Sales from our national account customers grew 11.2% in the first six months of 2017 over the first six months of 2016, and grew 13.2% in the second quarter of 2017 over the second quarter of 2016. At the end of 2015 and through much of 2016, we infused additional product SKUs into many of our branches as a means to enhance our ability to service customers on a same-day basis. This initiative, which we refer to as CSP 16, builds on similar initiatives we have implemented since our original Customer Service Project ('CSP') rollout in 2002. In the first six months of 2017, products added as part of our various CSP initiatives, including CSP 16, accounted for 15.0% of net sales and daily sales of these products grew 13.2% compared to the first six months of 2016. In the second quarter of 2017, these CSP products accounted for 15.0% of net sales, and daily sales of these products grew 12.3% compared to the second quarter of 2016.

Pricing did not have a meaningful impact on growth of our net sales in the second quarter or first six months of 2017 versus the same periods of 2016. However, we do believe the economic environment has become increasingly inflationary over the periods.

Sales by Product Line

The approximate mix of sales from our fastener product line and from our other product lines was as follows for the periods ended June 30:

Six-month Period	Three-month Period
2017	2016