

FASTENAL CO
Form 10-Q
April 25, 2008
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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 March 31, 2008, 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

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(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

2001 Theurer Boulevard

Winona, Minnesota
(Address of principal executive offices)

55987-1500
(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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

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

Class
Common Stock, \$.01 par value

Outstanding at April 20, 2008
149,120,712

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FASTENAL COMPANY

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FASTENAL COMPANY AND SUBSIDIARIES

Consolidated Balance Sheets

(Amounts in thousands except share information)

	(Unaudited) March 31, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	\$ 75,212	57,220
Marketable securities	207	159
Trade accounts receivable, net of allowance for doubtful accounts of \$2,229 and \$2,265, respectively	273,360	236,331
Inventories	494,360	504,592
Deferred income tax assets	14,702	14,702
Other current assets	60,534	67,767
Total current assets	918,375	880,771
Marketable securities	1,924	1,950
Property and equipment, less accumulated depreciation	298,553	276,627
Other assets, less accumulated amortization	3,723	3,713
Total assets	\$ 1,222,575	1,163,061
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 59,573	55,353
Accrued expenses	66,690	75,565
Income taxes payable	40,851	6,873
Total current liabilities	167,114	137,791
Deferred income tax liabilities	15,109	15,109
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized		
Common stock, 200,000,000 shares authorized, 149,120,712 shares issued and outstanding, respectively	1,491	1,491
Additional paid-in capital	900	227
Retained earnings	1,026,864	996,050
Accumulated other comprehensive income	11,097	12,393
Total stockholders' equity	1,040,352	1,010,161
Total liabilities and stockholders' equity	\$ 1,222,575	1,163,061

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidated Statements of Earnings

(Amounts in thousands except earnings per share)

	(Unaudited)	
	Three months ended	
	March 31,	
	2008	2007
Net sales	\$ 566,210	489,157
Cost of sales	269,580	239,642
Gross profit	296,630	249,515
Operating and administrative expenses	186,562	160,851
Loss on sale of property and equipment	104	115
Operating income	109,964	88,549
Interest income	221	222
Earnings before income taxes	110,185	88,771
Income tax expense	42,091	34,738
Net earnings	\$ 68,094	54,033
Basic and diluted net earnings per share	\$ 0.46	0.36
Basic weighted average shares outstanding	149,121	151,179
Diluted weighted average shares outstanding	149,121	151,179

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents**FASTENAL COMPANY AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

(Amounts in thousands)

	(Unaudited)	
	Three months ended	
	March 31,	
	2008	2007
Cash flows from operating activities:		
Net earnings	\$ 68,094	54,033
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of property and equipment	9,524	9,226
Loss on sale of property and equipment	104	115
Bad debt expense	1,895	1,516
Stock based compensation	673	
Amortization of non-compete agreement	17	17
Changes in operating assets and liabilities:		
Trade accounts receivable	(38,924)	(30,641)
Inventories	10,232	9,805
Other current assets	7,233	3,316
Accounts payable	4,220	3,443
Accrued expenses	(8,875)	376
Income taxes payable	33,978	32,362
Other	(1,435)	887
Net cash provided by operating activities	86,736	84,455
Cash flows from investing activities:		
Purchase of property and equipment	(32,641)	(12,697)
Proceeds from sale of property and equipment	1,087	1,484
Net (increase) decrease in marketable securities	(22)	1,837
Increase in other assets	(27)	(106)
Net cash used in investing activities	(31,603)	(9,482)
Cash flows from financing activities:		
Purchase of common stock		(3,435)
Payment of dividends	(37,280)	(31,584)
Net cash used in financing activities	(37,280)	(35,019)
Effect of exchange rate changes on cash	139	88
Net increase in cash and cash equivalents	17,992	40,042
Cash and cash equivalents at beginning of period	57,220	19,346
Cash and cash equivalents at end of period	\$ 75,212	59,388
Supplemental disclosure of cash flow information:		
Cash paid during each period for:		
Income taxes	\$ 8,113	2,376

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The accompanying notes are an integral part of the consolidated financial statements.

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FASTENAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

March 31, 2008 and 2007

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited 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 United States generally accepted accounting principles for interim financial information. They do not include all information and footnotes required by United States generally accepted accounting principles for complete financial statements. However, 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, 2007. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

(2) Stockholders' Equity and Stock-Based Compensation

On April 17, 2007, the Compensation Committee of our Board of Directors approved the grant under our employee stock option plan, effective at the close of business that day, of options to purchase approximately 2.2 million shares of our common stock at a strike price of \$45 per share. The closing stock price on the date of grant was \$40.30 per share. These options vest and become exercisable over a period of up to eight years. Each option will terminate, to the extent not previously exercised, 13 months after the end of the relevant vesting period. No options under this grant were vested as of March 31, 2008. Compensation expense equal to the grant date fair value will be recognized for these awards over the vesting period. The stock-based compensation expense for the three month periods ended March 31, 2008 and 2007 was \$673 and \$0, respectively. Unrecognized compensation expense related to outstanding stock options as of March 31, 2008 was \$15,535, pre-tax, and is expected to be recognized over a weighted average period of 6.45 years. Any future changes in estimated forfeitures will impact this amount.

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Table of Contents**FASTENAL COMPANY AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

March 31, 2008 and 2007

(Unaudited)

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 noted in the following table. The expected life is the most significant assumption as it determines the period for which the risk-free interest rate, volatility, and dividend yield must be applied. The expected life is the average length of time over which the employee groups will exercise their options, which is based on historical experience with similar grants. Expected volatilities are based on the movement of the Company's stock over the most recent historical period equivalent to the expected life of the options. The risk-free interest rate is based on the U.S. Treasury rate over the expected life at the time of grant. The dividend yield is estimated over the expected life based on our current dividend payout, historical dividends paid, and expected future cash dividends. The following table illustrates the assumptions for the options granted in 2007.

	Options Granted April 2007
Weighted-average expected life of option in years	4.9
Weighted-average volatility	31.6%
Risk-free interest rate	4.6%
Expected dividend yield	1.0%
Weighted-average grant date fair value of stock option	\$ 11.36

On April 15, 2008 (subsequent event), the Compensation Committee of our Board of Directors approved the grant under our employee stock option plan, effective at the close of business that day, of options to purchase approximately 300 thousand shares of our common stock at a strike price of \$54 per share. The closing stock price on the date of grant was \$48.70 per share. These options vest and become exercisable over a period of up to eight years. Each option will terminate, to the extent not previously exercised, 13 months after the end of the relevant vesting period.

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FASTENAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

March 31, 2008 and 2007

(Unaudited)

The following table presents a reconciliation of the denominators used in the computation of basic and diluted earnings per share related to our employee stock option plan:

	Three months ended March 31,	
	2008	2007
Basic - weighted shares outstanding	149,121	151,179
Weighted shares assumed upon exercise of stock options		
Diluted - weighted shares outstanding	149,121	151,179

The dilutive impact summarized above relates to periods when the average market price of our stock exceeded the exercise price of the potentially dilutive option securities then outstanding.

(3) Comprehensive Income

Comprehensive income and the components of other comprehensive income were as follows:

	Three months ended March 31,	
	2008	2007
Net earnings	\$ 68,094	54,033
Translation adjustment	(1,269)	1,052
Change in marketable securities	(27)	(77)
Total comprehensive income	\$ 66,798	55,008

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

March 31, 2008 and 2007

(Unaudited)

(4) Unrealized Investment Gains and Losses

The following tables show the fair value and the gross unrealized gains and losses of our investments. This information is aggregated by the investment category and maturity of the investment.

Description	March 31, 2008		Non-Current		Total	
	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)
State and municipal bonds	\$ 158		1,924	(27)	2,082	(27)
Certificates of deposit or money market	49				49	
Total	\$ 207		1,924	(27)	\$ 2,131	(27)

Description	March 31, 2007		Non-Current		Total	
	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)	Fair value	Unrealized gain (loss)
Federal mortgage backed security	\$ 9,924	(77)			\$ 9,924	(77)
State and municipal bonds			2,769		2,769	
Total	\$ 9,924	(77)	2,769		\$ 12,693	(77)

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FASTENAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

March 31, 2008 and 2007

(Unaudited)

As was disclosed in our 2007 annual report to shareholders, we classify these securities as available-for-sale. Available-for-sale securities are recorded at fair value based on current market value. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings, but are included in comprehensive income, and are reported as a separate component of stockholders' equity until realized.

The unrealized losses on our investments at the end of the periods were caused by interest rate increases. Because the decline in market value is attributable to changes in interest rates and not credit quality and because we have the ability and intent to hold these investments until recovery of the fair value, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at March 31, 2008 and 2007.

(5) Operating Leases with Guarantees

We lease certain pick-up trucks under operating leases. These leases typically have a 72-month term and include an early buy out clause we generally exercise, thereby giving the leases an effective term of 15-20 months. Certain operating leases for vehicles contain residual value guarantee provisions, which could 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 at lease expiration, of the leases that contain residual value guarantees, is approximately \$12,623 at March 31, 2008. We believe the likelihood of funding the guarantee obligation under any provision of the operating lease agreements is remote, except for a \$2,613 loss on disposal reserve provided at March 31, 2008.

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FASTENAL COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

March 31, 2008 and 2007

(Unaudited)

(6) Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48). This interpretation, which we adopted on January 1, 2007, clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Implementation of FIN No. 48 on January 1, 2007 resulted in no adjustment to our recorded liability for unrecognized tax benefits. Included in this liability is an immaterial amount for interest and penalties, both of which we classify as a component of income tax expense.

During the three months ended March 31, 2008, there were no changes to the total gross unrecognized tax benefits of \$5,143.

Fastenal, or one of its subsidiaries, 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 2005, in the case of United States Federal and non-United States examinations, and 2002 in the case of state and local examinations.

(7) Subsequent Event

On April 15, 2008, the Compensation Committee of our Board of Directors approved the grant, effective at the close of business that day, of options to purchase approximately 300 thousand shares of our common stock at a strike price of \$54 per share. This grant was discussed in footnote (2) Stockholders' Equity and Stock-Based Compensation.

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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 that have affected our financial position and operating results during the periods included in the accompanying consolidated financial statements. (Dollar amounts are in thousands except for per share amounts and where otherwise noted.)

The following discussion refers to the term daily sales. Daily sales are defined as net sales for a period of time divided by the number of business days in that period of time.