LETTER TO SHAREHOLDERS

A Good Year for the Blue Team

Our 50th year was a good year for Fastenal, a year for our customers and employees to experience improving success, a year for our suppliers to participate in this success, and a year for our shareholders to enjoy a return on their investment.

It was also a year to remind us about the nature of Fastenal. We believe in people. We believe we can accomplish anything if everyone in the organization pursues a common goal. And we believe we can accomplish our goals faster if we unleash the vast human potential within the organization.

We have a common goal; it's *Growth Through Customer Service*. We also have a means to unleash our potential; it's called challenging each other, providing great training, and operating with a decentralized decision-making mindset.

What a difference a couple of years can make.

At the end of 2015, our customers were experiencing a weak economy and we were struggling for growth. We closed out the year with a daily sales contraction of about 2% during the fourth quarter. In 2016, we worked extremely hard, but it often felt like we were running in place.

We found our footing as we stepped into 2017. We also started to 'Think Big,' and we rekindled our belief in our ability to grow faster. For the year, we grew our sales around 11% and grew our pre-tax earnings around 11% – a return to double digits on both fronts. We are proud of this accomplishment.

Here is a quick recap of 2017. In the first quarter we grew both sales and pre-tax earnings around 6%, a welcome improvement. Our momentum continued in the second quarter as we grew our sales around 11% and our pre-tax earnings around 13%. We were excited to create some leverage in the business. (For this purpose, we define leverage as pre-tax earnings growing faster than sales.)

In the third quarter we grew both our sales and pre-tax earnings around 12%. That was less satisfying than the second quarter. We understand our growth drivers, and we understand that our primary growth drivers carry a lower gross profit margin contribution. This challenges our gross profit margins as our sales mix changes. Our complementary challenge is simply to manage our operating expenses as this sales mix change progresses.

These aren't new comments, but they're worth repeating. Our lack of leverage in the third quarter did raise some concerns for us. We believe we should be able to leverage 12% revenue growth. That said, there are a couple of items worth noting about the quarter. First, there was one less business day (63 days in 2017 versus 64 days in 2016). One less day means about $18 million less in sales; however, certain expenses are linked to the month, not the day, and they don't drop when we lose a business day. Examples include base payroll dollars, benefits, vehicle payments, insurance, and occupancy. This hurts our gross profit percentage as freight utilization suffers. It also hurts our operating expense percentage as facility and people utilization suffers.

The second item centers on people costs and on our aggressive ramp-up related to our Onsite rollout. Late in 2016, we modified our branch manager compensation formula. This change, when combined with an added element to reward for Onsite revenue growth, added to our expense growth. We have also been aggressively adding resources to vet and implement new Onsite locations. We view this as a great long-term investment, but it did create some added expenses in the near term. These two items will also impact subsequent quarters.

This brings us to the fourth quarter, when we grew our sales about 15%. Given the relatively strong gross profit margin performance in the fourth quarter of 2016, we did not expect to leverage our pre-tax earnings; however, we did expect pre-tax earnings to grow within two or three percentage points of sales growth. We fell just shy of this and grew our pre-tax earnings about 11%. We moved a bit too slowly on challenging our gross profit margins. As president and CEO, that's on me. With that said, I'm glad we continued to invest in our future. This will serve us well in 2018.

You might have noticed the discussion above was focused on sales growth and pre-tax earnings growth. The recent income tax changes in the United States had a meaningful impact on our fourth quarter net earnings – our tax expense dropped and our net earnings grew faster. By focusing our discussion on pre-tax results, we were able to provide you with a more 'straightforward' discussion. (We like straightforward.)

You may be wondering why a tax law signed in 2017 and effective in 2018 would impact our net earnings in the fourth quarter of 2017. This relates to the tax liabilities we had previously recorded on our financial statements for deferred taxes. To make a long story short, these liabilities (which will come due in future years) were recorded using the old income tax rates but will be paid using the new income tax rates. The accounting rules stipulate that we recognize this impact in the quarter the tax law is signed, hence our recognition in the fourth quarter of 2017.

We also expect that the recent income tax changes will continue to have a meaningful impact on our results. This impact is magnified by the global mix of our business, which remains 'U.S.-centric' despite our continued international expansion. From an historical perspective, we didn't start to expand our global footprint until we entered Canada in the mid-1990s. Because of this, our business in the United States enjoyed a 30-year 'head start' and continues to generate over 85% of our sales and profits. As a result, our income tax expense is primarily driven by U.S. income tax rates, which historically have been high relative to the rest of the world. To put this in perspective, the average effective income tax rate of the companies included in the S&P 500 has been around 27% in recent years. By contrast, our rate has been closer to 37%.

Our customers have historically been limited by four things – the vibrancy and size of their economy, the ability to fund growth, the ability to develop their talent, and the ability to develop ideas to serve their market. These four limitations impact Fastenal too. With a stronger economy and lower tax burden, our task in 2018 will center on the last two items – developing talent and generating ideas.

Year 51 is here for Fastenal. Let's continue to build our traditions, starting with a simple approach - *Think Big!*

Fastenal began in November 1967, and as was mentioned earlier, we celebrated 50 years in business during 2017. A lesser known milestone also occurred: We celebrated 30 years as a public company (since August 1987). Many have benefitted from our decision to go public, including our employees, who have an opportunity to take ownership in the company they're working so hard to grow.

Milestones are too often about celebrating the past. Our 2017 milestones gave us an opportunity to reflect on the enduring strength of our culture and core beliefs. We believe in people, we believe in decentralized decision-making, we promote from within, we provide great business solutions for customers, and we believe in the future.

Speaking of the future, we believe we have the ability to grow for years to come. We think this statement is important. We also believe this can be *profitable* growth. Here are some thoughts on our business.

First, we foster strong customer relationships by providing products and services through multiple channels. These channels include our traditional branch network, our Onsite network, our vending network, our FMI (Fastenal Managed Inventory, or bin stock) network, and our distribution network outside of North America. Most of our customers buy from us through multiple channels. In fact, if you add up customers with multiple-channel purchases, it's approximately 90% of our revenues. We have to perform at a high level every day, but because our customer relationships are so durable, the economy and our ability to expand business relationships really drive our results. The 10% of our revenue that is single-channel primarily includes smaller customers and 'cash customers' (non-account retail sales). These customers tend to buy from us through the traditional branch network. Fortunately, our growth with these last two groups of customers continues to experience growth as well.

Second, we believe we have a durable and vibrant business model. Our durability derives from our frugality. This allows us to be profitable where others aren't and to try things others can't. We're vibrant in that we learn from each other, and can identify and replicate best practices quickly across the company.

Third, the market is really big. After 50 years in business, we believe our market share is just a small sliver of the potential opportunity.

Some insight into several of our channels:

Let's talk industrial vending. It helps us grow faster, it's profitable, and we continue to improve (although we still have a lot of opportunity for improvement). We ended 2017 with about 86,000 vending devices deployed. Roughly 71,000 of these devices primarily vend Fastenal-supplied products, and the remaining 15,000 devices are primarily used to check out and return customer-owned assets (tools, scanners, gauges, etc.) We believe we are 12 to 18 months from having 100,000 total devices deployed.*

Let's talk Onsite. An Onsite business is a discrete business unit serving a large customer location. We often describe it as a 'branch' within a customer's facility, but it can also be a customer-dedicated location within a lower-cost facility near the customer, or a customer-dedicated location within an overflow space in the back of an existing branch. Our Onsite model has become a bigger growth driver in recent years. At the end of 2014, we had roughly 200 Onsite locations. Today, we have over 600, and we believe we are 12 to 18 months from having 1,000 Onsite businesses.*

On November 6, 2017, 65 long-tenured Fastenal employees traveled to Times Square to ring the Nasdaq opening bell. The event was a celebration of two major milestones for our company in 2017: 50 years in business and 30 years on the Nasdaq Stock Market.

We often speak about national accounts and government accounts. These aren't channels; they're customer types. What makes them different is we utilize a non-branch sales force to cultivate and grow these relationships (although local branch and Onsite personnel provide most of the delivery and stocking services). We have a great sales team, and they are operating at a very high level. These two customer groups represent just over 50% of our revenue and contribute nearly 70% of our growth.

Our 50-year-old business evolves.

We have some core beliefs, and these beliefs typically manifest in our strategy. We believe our marketplace can be under-served by traditional distribution; therefore, we live by a *Growth Through Customer Service* motto. We believe proximity to our customer is a key ingredient to service; therefore, we operate a very frugal business ethic to stretch our ability to operate smaller distribution locations close to our customer. Finally, we know the needs of our customers, the nature of our competitive landscape, and the location of our marketplace change every day; therefore, we need to evolve and understand our marketplace to provide success for our customers, our employees, our suppliers, and our shareholders.

Here are two perspectives – one on our evolution over the last 15 years focused on time, the other on marketplace differences.

Time – In the five-year period from 2003 to 2007 we opened around 1,000 branch locations and we closed/consolidated seven. The number of Onsite businesses increased from around 75 to 130, and the number of deployed vending devices went from very few to still very few.

In the five-year period from 2008 to 2012 we opened around 550 branch locations and we closed/consolidated around 65. The number of Onsite businesses increased from around 130 to 160, and the number of deployed vending devices went from very few to around 21,000.

In the five-year period from 2013 to 2017 we opened approximately 175 branch locations; however, we closed/consolidated around 450. The number of Onsite businesses increased from around 160 to over 600, and the number of deployed vending devices went from around 21,000 to around 86,000. This evolution positions us to provide a greater service from an ever closer proximity.

Markets – We operate in individual marketplaces (cities) ranging from large to small. We think of it as three distinct markets.

Large markets: In the United States, there are approximately 100 Major MSAs (defined as Metropolitan Statistical Areas with a population over 500,000 people). The Large MSA markets represent just over half of our revenues, just over half of our branch locations, and just over half of our Onsite locations.

Smaller Markets: In the United States, we track approximately 170 Small MSAs (defined as Metropolitan Statistical Areas with a population under 500,000 people). Our home office is located in one of these Small MSAs, an area that includes La Crosse, Wisconsin and Winona, Minnesota. The Small MSA markets represent just over 15% of our revenues, around 15% of our branch locations, and just over 15% of our Onsite locations.

Markets ignored by others: For lack of a better term, we refer to the rest as our 'Non-MSA' markets (primarily smaller towns and rural areas). The Non-MSA markets represent about a third of our revenues, about a third of our branch locations, and about a third of our Onsite locations.

I personally find this information really exciting because our business model is successful in various channels (branch, Onsite, vending, FMI, etc.), in various economies (United States, Canada, Mexico, and overseas), and in a range of market sizes, from major cities to small towns. It all adds up to a lot of great opportunities for members of the Blue Team to be successful serving customers.

Finally, some thoughts on our obligations:

After two years in this role, I try to be honest about the quality and type of leadership I provide. The Blue Team deserves great leadership every day. If you flip to the inside back cover of this report, you will see a group of talented, dedicated, and diverse leaders. If you look deeper into the organization, you will see an incredible depth of talent and potential – we are fortunate.

When thinking about my obligation to our team, several thoughts come to mind: (1) to communicate, (2) to listen, and (3) to challenge the team to Think Big!

When thinking about the obligations of every Fastenal employee to each other, again several thoughts come to mind: (1) be willing to learn and change, (2) be willing to help each other succeed, and (3) be willing to challenge each other to Think Big!

And finally, a few overriding obligations for everyone at Fastenal: (1) Create opportunities for your customers and for your employees every day. (2) Think Big! This means - have a plan, stretch yourself, and vet your business plan with those around you (your team, your peers, your mentor or leader). (3) Make wise decisions.

Thank you for your belief in Fastenal, and thank you for being a shareholder. We will endeavor to make wise decisions every day as we embark on our next 50 years of *Growth Through Customer Service*.

Sincerely,

Dan

DANIEL L. FLORNESS
President and Chief Executive Officer

** We don't have a crystal ball. This is neither a prediction nor a target; it's our stated belief in the future.*