The Industrial Distribution Industry

Fastenal (FAST), W.W. Grainger (GWW), MSC Industrial Direct (MSM) and United Stationers (USTR)

Date Presented: March 5, 2014

CHOOSING AN INDUSTRY

- My clubs base the study on a stock of interest that has been brought to the club’s attention. For this study, FASTENAL was the trigger.
- We could use a company in the industrial sector
- We make no effort to pick “the best” industry.
- We make certain it is understood by all that we might not like any stocks in the industry.

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A small group went through each company, looking for characteristics that fit “the model” of UP, STRAIGHT and PARALLEL.

That narrowed the list to seven companies. We then examined the remaining seven, focusing on Section 2 of the SSG. That reduced the group to four companies.

The Industry Classification System:
- Each classification system is different
- Each classification system is dynamic
- Each system overlaps the others but none match exactly to names of industries or companies assigned to an industry
- You can decide, finally, whether to include or exclude a company.

Why We Liked This Industry

**Our Hypothesis**
- The economy is recovering
- Manufacturing is expanding
- This expansion is not uniform
- Middlemen that provide many industrial products at competitive prices will do well
- The Industrial Sector has not recovered as quickly as some other sectors … some catch-up might be in order
Fastenal (FAST)
Charles Bard

Fastenal
Founded in 1967
2,620 North American Stores and 32 International
14 Distribution Centers in US, Canada and Mexico
Sells Industrial and Construction Supplies in 11 product categories
95% of sales are products manufactured by others

Growth Through Customer Service

FAST SolutionsSM (industrial vending)
Benefits Customers
Benefits Fastenal

Company Statistics & Quarterly Results

<table>
<thead>
<tr>
<th>Company</th>
<th>Fastenal Company</th>
<th>Date</th>
<th>2/28/2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepared by</td>
<td>Bard</td>
<td>Data</td>
<td>BI Stock Data</td>
</tr>
<tr>
<td>Where traded</td>
<td>NAS Industry, Industrial Distribution</td>
<td>Capitalization -- Outstanding Amounts</td>
<td>Reference</td>
</tr>
<tr>
<td>Preferred ($M)</td>
<td>0.0</td>
<td>% Insiders</td>
<td>% Institution</td>
</tr>
<tr>
<td>Common (M Shares)</td>
<td>296.8</td>
<td>9.0</td>
<td>86.1</td>
</tr>
<tr>
<td>Debt ($M)</td>
<td>0.0</td>
<td>% to Tot Cap</td>
<td>% Pot Dil</td>
</tr>
<tr>
<td>FY2013 Quarter Ending (1/13)</td>
<td>Sales ($M)</td>
<td>Earnings Per Share</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Least (Quarter)</td>
<td>813.6</td>
<td>0.33</td>
</tr>
<tr>
<td></td>
<td>Year Ago Quarter</td>
<td>757.2</td>
<td>0.33</td>
</tr>
<tr>
<td></td>
<td>Percentage Change</td>
<td>7.5%</td>
<td>0.3%</td>
</tr>
</tbody>
</table>
The Industrial Distribution Industry

Visual Analysis

Reality Check

Sales
- Value Line 5.0 B
- S&P expects 14% in 2014

EPS Growth
- Value Line 15% to $2.75
- NASDAQ Growth to $2.43
- Zacks, Yahoo & MSN 16% EPS Growth implies $3.17

Final Growth Predictions

Pre-Tax Profit, ROE & Debt

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March 5, 2014
The Industrial Distribution Industry

ONLINE STOCK STUDY SERIES

P/E History

<table>
<thead>
<tr>
<th>Year</th>
<th>High</th>
<th>Low</th>
<th>Earnings</th>
<th>Price Earnings Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>21.1</td>
<td>12.9</td>
<td>0.92</td>
<td>34.0</td>
</tr>
<tr>
<td>2010</td>
<td>30.2</td>
<td>20.5</td>
<td>0.90</td>
<td>33.6</td>
</tr>
<tr>
<td>2011</td>
<td>44.4</td>
<td>28.8</td>
<td>1.21</td>
<td>36.7</td>
</tr>
<tr>
<td>2012</td>
<td>55.1</td>
<td>37.8</td>
<td>1.42</td>
<td>38.9</td>
</tr>
<tr>
<td>2013</td>
<td>53.4</td>
<td>43.8</td>
<td>1.51</td>
<td>35.4</td>
</tr>
<tr>
<td>AVERAGE</td>
<td>28.7</td>
<td>23.8</td>
<td>1.51</td>
<td>35.7</td>
</tr>
</tbody>
</table>

CURRENT/TTM - AVERAGE PRICE EARNINGS RATIO 30.2

ONLINE STOCK STUDY SERIES

Dividends

<table>
<thead>
<tr>
<th>Low This Year</th>
<th>42.50</th>
</tr>
</thead>
</table>

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Potential High and Low Price

A HIGH PRICE - NEXT 5 YEARS
Avg. High P/E 33.00
B LOW PRICE - NEXT 5 YEARS
(A) Avg. Low P/E 24.00
(B) Low Price of Last 5 Years 28.7
(C) Recent Market Low Price 37.61
(D) Price Dividend Will Support Present Dividend = 1.000
(High Yield) = 1.60%
(E) Selected Forecasted Low Price $ 56.6

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Zoning

C ZONING: using 25% - 35% - 35%
Forecasted High Price 80.2
Minus Forecasted Low Price 36.2
= 44.0
Range = 20% of Range = 11.0
Buy Zone = 36.2
Hold Zone = 47.2
Sell Zone = 69.2
Present Market Price = 47.19
Buy Zone is in the

D UPSIDE DOWNSIDE RATIO (POTENTIAL GAIN VS. RISK OR LOSS)

<table>
<thead>
<tr>
<th>Present Market Price</th>
<th>47.19</th>
</tr>
</thead>
</table>

E PRICE TARGET (Note: This shows the potential market price appreciation over the next five years in simple interest terms.)

<table>
<thead>
<tr>
<th>Present Market Price</th>
<th>47.19</th>
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W. W. Grainger (GWW)
Susan Maciolek

Grainger is an established MRO leader

- Founded in Chicago, 1927
- Distributor of maintenance, repair and operations (MRO) products; industry leader
- 2013 revenues of $9.4 billion; with 89% of sales in the U.S. and Canada

The MRO market remains fragmented

North American MRO Market – $145 Billion

Source: Global Insight
The Industrial Distribution Industry

2018 North American network

Today, penetration is best with large customers

Large

75% of sales

Medium

21% of sales

< 1%

Market Share

15%

Company of Needs

Small

4% of sales

Two operating models to fuel global scale advantage

Customer size

Large

Multichannel

High service, high touch model with sales coverage to foster offer to individual customer needs and constraints

Grainger model

Medium

Online

Low-touch, single price offer without significant investment in solutions, services or customization

Small

- U.S. market size: $72B
- 27M business locations

- Medium

- U.S. market size: $37B
- 1.5M business locations

- Small

- U.S. market size: $48B
- 25M business locations

eCommerce accelerates growth

- $3B in 2013 eCommerce sales

- Channel daily sales up 15%

eCommerce as a % of total company sales

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**W.W. Grainger shares edged lower:** since our last report, down about 5%. This move looks consistent with the pace of growth so far in 2013, but some thought is required to understand how the company has been able to grow in a difficult environment. This has been fueled by sales in the lower end of the market, which has been supportive due to higher commodity prices. Grainger has managed to grow at a rate of about 5% per year in recent years, which is below its historical growth rate. The company is expected to continue growing at a rate of about 5% per year in the near future, with potential upside if conditions improve. Grainger is well-positioned to benefit from any improvement in the economy, and investors should keep an eye on the company's performance as it moves into the new year.

**Is this a quality company?**

- **Growth:** 6.8%
- **Quality:** 83%
- **Value:** 71%
- **Investor Rating:** C
- **Market Capitalization:** $21.8 billion
- **Price:** $271.25
- **Earnings:** $18.00
- **P/E Ratio:** 14.1
- **Price/Earnings Growth Ratio:** 1.2
- **ROE:** 23.2%
- **Dividend Yield:** 0.3%
- **Beta:** 0.8

**Does management pass the test?**

- **Growth:** 6.8%
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**Fundamental Company Data**

- **Sales:** $6.04
- **Earnings:** $1.27
- **P/E Ratio:** 14.1
- **Price/Earnings Growth Ratio:** 1.2
- **ROE:** 23.2%
- **Dividend Yield:** 0.3%
- **Beta:** 0.8

**Total Return**

- **Total Return:** 6.8%
- **Price Return:** 6.8%
- **Dividend:** 0.3%

**Valuation**

- **Price/Earnings Growth Ratio:** 1.2
- **Price/Book:** 1.7
- **Price/Sales:** 4.4
- **Price/Free Cash Flow:** 8.9
- **Price/Net Income:** 11.2
- **Price/Current Liabilities:** 5.8

**Investor Returns**

- **5-Year Annualized Return:** 6.8%
- **10-Year Annualized Return:** 6.8%

**Conclusion**

W.W. Grainger is a well-managed company with a strong track record of growth and profitability. The company has a solid balance sheet and a strong dividend policy. Grainger is well-positioned to continue growing at a rate of about 5% per year in the near future, with potential upside if conditions improve. Grainger is a quality company with a proven track record of growth and profitability. The company is well-positioned to continue growing at a rate of about 5% per year in the near future, with potential upside if conditions improve. Grainger is well-positioned to continue growing at a rate of about 5% per year in the near future, with potential upside if conditions improve.
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Value Line Estimates

ANNUAL RATES Past Past Est’d '10-'12 of change (per sh) 10 Yrs. 5 Yrs. to '16-'18 Sales 8.5% 10.5% 8.5% "Cash Flow" 13.0% 13.5% 11.0% Earnings 14.5% 15.0% 13.0% Dividends 14.0% 18.0% 8.5% Book Value 8.5% 8.5% 16.0%
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MSC Industrial Direct (MSM)
Mary Ann Rentsch

MSC Industrial Direct Co., INC (MSM) … It’s products…
- One of largest industrial distributors
- Repairs
- Maintenance
- Industrial Supplies

MSC Industrial Direct Co., INC (MSM) … Business…
- Internet (e-commerce)
- “Big Book” (catalogue)
  - 900,000 items to choose from!
  - Weekly, monthly, quarterly updates…
- Vending machines
- SKU’s—over 600,000 products are stocked.
- Same-day shipping and 24-hour delivery

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MSC Industrial Direct Co., INC (MSM) ...capital investments

- 5 Customer fulfillment centers
  - 4 in USA
  - 1 UK
- 106 branch offices
  - 104 USA
  - 1 Canada
  - 1 Mexico
- Building new headquarters & new distribution center

MSC Industrial Direct Co., INC (MSM) ...A little history...

- Founded by Sid Jacobson 1941 in NY...
- 2006 Acquired J&L Systems, expanding service to metalworking customers
- 2011 Sid’s grandson Erik Gershwind became president and CEO
- 2013 Acquired Barnes Distribution North America (inventory management with Canadian footprint and largest acquisition to date)

MSC Industrial Direct Co., INC (MSM) ...The graph shows...

MSC Industrial Direct Co., INC (MSM) ...Management

<table>
<thead>
<tr>
<th>Year</th>
<th>EPS</th>
<th>ROE</th>
<th>P/E</th>
<th>Debt/Equity</th>
<th>P/Sales</th>
</tr>
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<tbody>
<tr>
<td>2004</td>
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<td>2005</td>
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<td>2011</td>
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<td>2012</td>
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<td>2013</td>
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<td>5Y Avg</td>
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Sid is CEO

Erik is CEO
MSC Industrial Direct Co., INC (MSM) — Growth estimates

- Sales are $2548M — a mid-sized company
  - Reasonable expectation is 8-12% growth

- Historically, 9.7% sales growth; 12.3% earnings growth

- Expert (BI, YAHOO, Value Line) estimates:
  - Sales growth between 6.4% and 11%
  - Earnings growth between 12.5% to 14%

I’ll choose … 10% Sales and earnings growth

- Gives me projected sales in 2018 of $3958M

- Gives me projected EPS in 2018 of $6.08, compared to Value Line’s estimated EPS of $6.75 (2016-2018)

MSC Industrial Direct Co., INC (MSM) — High Price estimate

<table>
<thead>
<tr>
<th>Year</th>
<th>High Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>26.9</td>
</tr>
<tr>
<td>2010</td>
<td>24.3</td>
</tr>
<tr>
<td>2011</td>
<td>22.9</td>
</tr>
<tr>
<td>2012</td>
<td>20.5</td>
</tr>
<tr>
<td>2013</td>
<td>23.3</td>
</tr>
<tr>
<td>Average</td>
<td>23.6</td>
</tr>
</tbody>
</table>
MSC Industrial Direct Co., INC (MSM) ... Price ranges...

C. ZONING using 25%-50%-25% (click to toggle)
Forecasted High Price: $133.8 Minus Forecasted Low Price: $55.7 = 78.1 Range. 25% of Range: $19.5
Buy Zone: 56.7 to 75.2
Hold Zone: 75.2 to 114.2
Sell Zone: 114.2 to 133.8

Present Stock Price of $88.33 is in the HOLD Zone.

MSC Industrial Direct Co., INC (MSM) ... 5-yr potential

A. PRESENT YIELD
Present Value of Dividend = $1.32
Present Price $55.30
Yield = 2.4%

B. AVERAGE YIELD - USING FORECAST HIGH P/E
Average Dividend $1.32
Calculated Price of Return 20.00
Average Yield 6.6%

C. COMPOUND ANNUAL RETURN - USING FORECAST HIGH P/E
Annual Appreciation 9.4%
Average Yield 6.6%
Annuual Rate of Return 10.6%

MSC Industrial Direct Co., INC (MSM) ... 5-yr potential

United Stationers – Ticker Symbol: USTR

United Stationers (USTR) Pat Donnelly

Leading Wholesale Distributor of Business Products

Online Training Team

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Strong Business Fundamentals

- Leadership position in large, structurally attractive markets
- Distinctive competitive advantage in logistics and marketing services
- Unique growth platforms positioned to take advantage of current trends
- Driving margin enhancement with focused initiatives
- Strong cash flow generation with track record of returning cash to investors
- Strong balance sheet and resilient business model

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Markets We Serve

- Industril
- Office Furniture
- Technology Products

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Three Core Categories

Sales Mix: Q1 2013

- INDUSTRIAL 11%
- OFFICE PRODUCTS 62%
- JANITORIAL AND BREAKROOM 27%
- Office Supplies 6%
- Technology Products 30%

ONLINE STOCK STUDY SERIES

Distribution Infrastructure Delivers Service Excellence

- National distribution network
- 69 distribution centers
- Approximately 15.8 million sq. ft. of warehouse space
- Over $700 million inventory investment
- Predisominantly pre-sold orders
- 97% line fill rates
- Trading office in Hong Kong to facilitate product sourcing overseas

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Channel Breadth and Broad Offering Drives Cross-Selling

Over 130,000 Products in Stock
230,000 Different Products Shipped Annually

Operating Cash Flows

Acquisitions

Net Capital Spending

Stock Repurchases

Capital Allocation (2002-2012)
In millions

Operating Cash Flows

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Rationale:

Within the last 10 years the High PE range has approached 20 several times. Looking at the Low PEs for the same period, a realistic low PE appears to be around 8.
The Industrial Distribution Industry

My Results

- Calculated forecast high price of $69.5 and an estimated low price of $24.6 during the 5 year period
- At the current price, the calculated upside / downside ratio is 1.5 to 1
- This places the stock’s current price in the HOLD zone
- With these judgments the PAR is 4.8% and the CATR is 11.4%

Considering the size of this company these are not unexpected rates of return

*Your judgments may provide different results

Questions?

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cbard@email.toast.net
smaciolek@gmail.com
mah145092005@yahoo.com
PatTheInvestor@gmail.com

Thank You!

Upcoming Stock Study:
Company: To-Be-Announced
Suzi Artzberger
Director of Information Technology, BetterInvesting
April 2, 2014 - 8:00pm Eastern Time

We will use the Stock Comparison Guide module located in our Toolkit 6 program to compare these four stocks.