

PODCAST TRANSCRIPT

Talking Research

On the Road: Fastenal's frugal formula

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Katie Boyce: Hello and welcome to *Talking Research*, a podcast from Walter Scott. I'm Katie Boyce, an investment writer at the firm.

Fastenal founder Bob Kierlin, who died in February this year, was the CEO who didn't believe in extravagance. He hated waste so much that he once sent a bill to one of his store managers for leaving a light on. Much of the furniture at the industrial supplier's headquarters was second hand, and, even when he was CEO, Kierlin didn't have a company car or a secretary. So, when Fastenal started to put vending machines into factories, it wasn't a gimmick. It made sense. Instead of snacks, these machines dispense screws, bolts, drill parts and safety goggles, but only when needed, tracking each and every item. This meant no overstock and, crucially, no waste. What began as a cost-saving idea, dreamed up by Kierlin in 1967, turned Fastenal into the \$44 billion business it is today. His obsession with cost cutting didn't only shape the company's culture, it reinvented how industries manage their supplies, one vending machine at a time.

On a recent research trip to the US, Investment Analyst Doctor Oriana Beaumont and Investment Manager Max Skorniakov visited Fastenal in Winona, Minnesota. And I'm delighted to be joined by Oriana today. By way of introduction, Oriana interned at Walter Scott in the summer of 2023, and she joined us permanently in September of that year. Oriana, welcome.

Oriana Beaumont: Hi, Katie. Thanks for having me.

KB: Before we get started, a reminder that the podcast is intended for investment professionals only and should not be construed as investment advice or a recommendation. Any stock examples discussed are given in the context of the theme being explored, and the views expressed are those of the presenters at the time of the recording.

So Oriana, as mentioned, you're just back from the US. Tariffs are the only talking point in town at the moment. What did you hear from the companies when you were there?

OB: Yes, tariffs are all over the place at the moment. I think maybe it's helpful to say that we were in the US at the beginning of March. So, at that time, Tariff Tuesday was the big talking point. You hadn't yet had 'liberation day' and tariffs coming into effect that we have today.

KB: We should note that this is being recorded on the 9th of April.

OB: Yes. So it's a busy time and you're seeing that as well in the markets. So, we met with 22 companies, and it was really useful to be able to ask each of those companies, what impact do you think tariffs are going to have on your business? Most of them didn't know because it's a changing environment.

KB: And at that stage nobody knew.

OB: No one knew what was to come. Absolutely. So if I had to just say one sentence on tariffs today, I would say that companies are really hesitant to act, to invest because nobody knows how long these tariffs are going to be around for. Are they going to be around for four years, one year, one month or even come into effect? That's been the big question.

KB: What have you, in the Research team, been doing of late?

OB: Yeah, so we've upped the intensity of research meetings. Now post liberation day, we are debating and discussing every single stock in the portfolio, seeing how it's positioned and where exposures might be. We're also conducting mini projects. I'm doing one on pharma and medtech. But you've got other ones going on as well, sort of a domestic

champions play and thinking about the resilience of consumers, so not just the first-order impacts but also second-order impacts. There's also the excitement of the stock-picking opportunities too. We maintain watch lists – companies that we've assessed and looked at but maybe the valuations have been too rich in the past. So it's quite an interesting buying opportunity on the flip side too.

KB: And going back to your trip, where exactly were you in the States?

OB: So during the busy two weeks we visited six cities. So they were Orlando, Miami, New York, Moline, Chicago and Minneapolis, really all over the place.

KB: And what kind of companies were you meeting?

OB: A whole range. So really from pharma and medtech to aerospace, financial services and industrial companies too. I think we had a lot of really good meetings. I won't say everything's great. There's one that stands out that was maybe less good than the others but the good ones were great because we really took the time to consider who we wanted to meet there and asked for additional tours and really made the investment cases come to life and off the screen. I think that was the value of going and doing the trip itself.

KB: And which companies would you highlight?

OB: So I think Fastenal was a really great day. That was a whole capital markets day. You mentioned it in the introduction. The company has really been on a transformation. They've transformed themselves from being a supplier and retailer to being more of a strategic supply-chain partner to their customers.

KB: What does that mean?

OB: Great question. So I think about this in three buckets. The first one would be that they've halved their branch network from over 2,400 stores back in 2013 to less than 1,200 today, yet still maintain their footprint of over 90% of their stores being within half an hour of their customers. It's been very effective for them. The second one is that they've expanded the focus on the larger accounts. These are customers who are spending over \$50,000 a month. And lastly, the company is really focusing with their employees on role specialisation so that they execute more effectively.

KB: In the introduction, I mentioned the kind of cost-conscious nature of the founder. Did that still come across when you met with the company?

OB: Absolutely. It was a really no-frills investor day. So I've been to a couple of investor days now and they try and give you a branded water bottle or a branded notebook, and there was none of that. At Fastenal's investor day, we sat down to listen to the presentations and, on the table in front of you, there was a plastic button. And if you push this plastic button, it would light up red for a few seconds. And that was it. So we were all pretty confused and sort of turning and interacting with each other, saying, why is there this plastic button on the desk? Later, during the day, it came to light that this button was actually a demonstration of how customers can communicate to Fastenal without Fastenal sending any employees to a customer site when they need to replace a pallet of products.

KB: So these buttons are in place in a customer's factory.

OB: These buttons are in a customer's factory on a specific bucket of nuts or bolts. So if you say that you're running low in this particular type of bolt, you'll press the button, that will send a signal to Fastenal that you need a new pallet of this product to just seamlessly arrive.

KB: So it's a development of the original vending machines that were referred to earlier?

OB: Yes. And also, I think quite an easy, no-frills approach, too.

KB: You talked about the transformation from the branches to the strategic partnerships. Did you visit a branch? Could you tell us a bit about that?

OB: Yeah. So at the end of the capital markets day, we went to a nearby branch that had previously been a retail location. So it was on the outskirts of town. If I was to have visited it, say, five years ago, I'd have walked in and it would have been very much a DIY sort of store. I could have gone in and spent \$30, use 20 minutes of an employee's time, and I'd have seen low-level shelving, very spacious shopping environment essentially. Going in today, it's not open to the public. They are effectively a warehouse that supports large customers on-site operations. And, in order to do this effectively, out of that one branch that we visited,

they're supporting three customers. So they've gone from this sort of spacious shopping approach to taking the roof off the same building – physically taking the roof off – they've added a few metres in height, put the roof back on, and they've now got racks very high where they store products, to then deliver it to site when it's needed. So it's a very different shift. And I think it's that drive that they're trying to get to that I mentioned earlier of expanding into larger customers.

KB: Fastenal is clearly a great example of a domestic-focused business. What about some of the other industrial companies that you met with?

OB: Yes. So we met with a really interesting one, actually, John Deere, who are an innovative market leader in agricultural machinery with their iconic green and yellow tractors and combines. We visited them in Moline. That was the only thing we saw in Moline.

KB: Moline being?

OB: Moline is about three hours to the west of Chicago, and we travelled there, actually from New York. We had to connect, because it's such a small airport, in Atlanta. Max and I were not sitting next to each other. We were sitting very much next to your typical Midwestern American who lives in Moline. And the chap I was sitting next to, he was saying that his son works at John Deere. I got off the plane chatting to Max and the person he was chatting to also was working at John Deere. Very much that is what's in the area that is serving the community. Absolutely.

KB: And perhaps you tell us about the tour. Did you get a ride on a tractor?

OB: We did get a ride on a tractor. I would like to say we got to ride on one of the huge tractors that were on the production lines that we saw, but actually we went around the factory on a mini John Deere tractor because it was a huge factory. I think one of the interesting things that I hadn't thought about before, how do you paint a John Deere tractor, and how do you make it last a long time? So we saw these huge dip tanks all lined up with the parts coming in on a large conveyor. They got dunked into one tank and over into the next one. So that's everything from a pretreatment to an electric coat to applying zinc phosphate, so these products don't rust and last a long time.

KB: Presumably this kit is expensive and so customers would hope it would last a long time?

OB: Absolutely. So most farmers don't buy equipment new because a tractor can cost somewhere north of \$1m. Most buy them second or third-hand because they have a useful life of well over 10 years.

KB: And you've talked about the innovation at John Deere. Perhaps you could talk about that a bit more?

OB: Yes. I think precision agriculture is a really innovative piece of the story here.

KB: Which is?

OB: Yes, well, precision agriculture – that's trying to make the right decision on a plant by plant level. So, for John Deere, they have this See & Spray technology where there's cameras on the tractors and combines that are scanning the field, looking at it on a plant by plant level. Farmers, they know their fields. I'm not trying to dispute that. They know where the soil is wetter but, actually, how can you manage the field better on a plant level so you can get the maximum yields.

KB: And presumably spend less on fertilisers or whatever the product is?

OB: Absolutely. So, something that they're doing today is that they're scanning to only spray weeds in the field. So you spray the weed with herbicide, rather than a blanket coverage, that's raising the yields that they're getting. However, in the future what they want to do is assess plant health, so that means looking at a plant with a camera, making a split-second decision using AI. Does a plant look like it's maybe a bit deficient in nitrogen? If so, I will spray that individual plant with a bit of fertiliser. Then that then saves farmers a lot of their input costs too, because fertiliser is very expensive.

KB: I wondered how long it would take for AI to get a mention. I presume it came up in some of your meetings?

OB: It came up in a lot of meetings, actually. I would say, almost like the tariff question, we asked it in every meeting. I think the good or the funny thing about John Deere, and the bit that I quite liked speaking to the company, is that today there's more computing power on a John Deere combine

than there was in the first space shuttle. Just a bit of perspective as to how fast technology is moving.

KB: What about in terms of other companies? What did you hear from them?

OB: So I'd say quite a good juxtaposition, there is Moody's, a very different company. They are very well known in the global finance landscape. Thinking about the company is really split into two buckets. You've got the credit ratings portion of the business where they are the global leader. And you've also got an analytics segment where they provide data and solutions to try and help companies make better and faster decisions.

KB: And where does the AI element come into this?

OB: So, after speaking with the CEO, we got a product demonstration of their first generative-AI offering for the analytics portion of the business, which is called Research Assistant.

KB: And what does that Research Assistant do?

OB: So it's really taking a lot of information and analysing it and presenting it in a succinct format for the user. Very user-friendly, lots of charts and graphs to make it very visual. And, as a result, that's saving users around 30 to 40% of the time, which Moody's can therefore charge.

KB: And, being in the financial services sector, presumably it's heavily regulated. Does that cause any issues?

OB: Yes, more so I would say on the credit ratings portion of the business, where they would have to jump through a lot of hoops in order to pass through the regulations.

KB: All those discussions sound really interesting and really positive but were there any disappointing discussions?

OB: There's one that would stand out, and I think that also highlights the value of being on the road and seeing these companies in person. Looking at the company in the office and on a screen, it was coming across as a really great company. We arrived there and went up in the lift. There was no one there, the lights were off. You had the person who we had the meeting with but, other than that, it was dead. We were walking through, turning on the

lights to find a meeting room to have the meeting. Then we sat down and he was answering our questions, but at the same time he was also on his phone, which I presume he was also answering emails at the same time. And it's not really the level of engagement that you'd want to have with a company. And also, I guess it speaks to that cultural element as well. You think, where is everyone? Are you speaking and communicating effectively?

KB: I guess one dud meeting out of 22 is not too bad.

OB: No, it's pretty good.

KB: Thank you, Oriana. That's been a great overview of your trip. It sounded like a busy couple of weeks.

OB: Absolutely.

KB: I should also mention, for those of the audience who don't know you, you came to Walter Scott having qualified as a medical doctor. Why the change of career?

OB: Yes, it's quite the change. I'd say there were several factors that led into that decision. Medicine in the UK is a six-year degree that's split into three years preclinical, which is lecture based, very textbook heavy and then the last three years, which is clinical. And that means rotating around a lot of specialties, really doing the job and getting hands-on learning. For that second portion, I did that between 2020 and 2023 in London, and maybe you've picked up there on the dates that that was unfortunately over Covid.

KB: It must have been tough.

OB: Yes. I spent a lot of time in the end in ICU, especially in 2020, so I think that did taint my experience there. But, also, I felt very much like a number in a system. And I don't think it mattered as well how much or how good I was at my job or how good I was at that particular piece of care, which is quite sad. But you were a number and filling that rota space. And I took a step back and I thought, what do I want my career to look like? And I thought, actually, I kind of want something a bit better than that when I can show people what I'm capable of.

The thing that I liked about medicine was lifelong learning. And if I was to have continued down the medicine path, I loved surgery and anatomy. I really liked the hands-on nature there, so I would have

probably had gone down the surgery path. But you end up specialising and becoming so niche in one type of surgery. For example, you might be really good at a knee replacement, or you might be completely specialised in the shoulder area. And whilst that's great for patient outcomes, it really wasn't the reason I went into medicine.

KB: And what do you think that medical background brings to your role here at Walter Scott?

OB: So I think it's a really transferable degree. When I was at med school, you put the patient at the centre of everything that you did. Here you transfer that, and now the client is at the centre of everything that we do. The mantra that I had in med school, that you get through the NHS, is this "see one, do one, teach one" attitude. So you're really getting stuck in and getting hands on. And I try to apply that here as well, so with our discussions, throwing in opinions but also pitching stocks too and allowing myself to be curious.

KB: And your medical experience even came in handy, I believe, on the journey back from the US this time? Perhaps you could share that.

OB: So I'd just gone to sleep for about maybe 15, 20 minutes, and then you got a Tannoy over the plane saying, is there a medical professional or a doctor on board, please? My colleague Max hadn't

yet gone to sleep. I was waking up, but he was up like a shot and was going "Orianna, are you off to help?" And I went, "yes, yes, I'm off, Max, I'm quickly just getting myself together".

KB: Crucially, Oriana, I think all listeners want to know is was it a happy ending?

OB: Yes it was. They got off the plane alive. But we did end up making an unscheduled stop in Iceland because there's not much you can do when you're flying over the Atlantic.

KB: Good news. Well, it's very reassuring for all of us to know we have a doctor in the house in Charlotte Square.

Thank you, Oriana, for your time today. Given the current uncertainty, it's been really useful to hear from you on all of this. To our audience, thank you very much for listening today. If you'd like to hear about another trip, Oriana's colleagues, Alan and Connor, recently visited [South Korea](#). The country may have been in the headlines for its political turmoil, but they were there to learn more about its world-leading memory semiconductor industry. If you'd like to read more about this trip, please go to the insights page of our website walterscott.com/insights.

Thank you very much again. Goodbye.

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STOCK EXAMPLES

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