Fastenal Company, Q1 2025 Earnings Call, Apr 11, 2025

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Operator

Greetings, and welcome to the Fastenal Q1 2025 Earnings Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It's now my pleasure to turn the call over to your host of Fastenal. Please go ahead.

Unknown Executive

Welcome to the Fastenal Company 2025 First Quarter Earnings Conference Call. This call will be hosted by Daniel Florness, our Chief Executive Officer; Jeff Watts, our President and Chief Sales Officer; and Holden Lewis, our Chief Financial Officer. The call will last for up to 1 hour, and we'll start with a general overview of our quarterly results and operations, with the remainder of the time being open for questions and answers.

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As a reminder, today's conference call may include statements regarding the company's future plans and prospects. These statements are based on our current expectations, and we undertake no duty to update them.

It is important to note that the company's actual results may differ materially from these anticipated. Factors that could cause actual results to differ from anticipated results are contained in the company's latest earnings release and periodic filings with the Securities and Exchange Commission, and we encourage you to review those factors carefully.

I would now like to turn the call over to Mr. Dan Florness.

Daniel Florness

Good morning, everybody, and thank you for joining us for our Q1 earnings call. As you can see from the -- flip book on Page 3, Bob Kierlin, our founder passed away on

February 10. He was 85 years of age. I just thought I'd open with a few thoughts on Bob, if you'd indulge me.

So Bob was born in June of 1939 in Winona, Minnesota. It's town about 25,000 people in Southeastern Minnesota on the banks of the -- Western banks of the Mississippi River. His first memory as a child was the World War II victory parade going across the Interstate Bridge coming into Winona.

In his victory, it said Bob's Compass was a true north -- Bob's Compass had a true north with a belief in people, free minds and free markets. And he indiscriminately respected others, seeing the best in everyone without desiring reciprocation himself. I had the good fortune, I knew Bob for just over 30 years. I met him in the second quarter of 1994. And I had a number of across-the-country road trips. Bob preferred to travel by van and visit Fastenal locations. And I remember my first trip with him. We left on a Sunday morning at about 7:00. We drove to Denver, visited some locations, with some investors. We drove to Salt Lake City. We drove to Vegas. We drove to L.A., San Francisco, Rock Springs, Wyoming and made a way back to Winona on Friday evening.

In that, I learned how well read Bob was. And one thing I've observed over the years is there was not a day that Bob Kierlin does not read the Wall Street Journal from cover to cover. And I thought it appropriate based on my travels with him that in his obituary, it said Bob's sense of humor was kindled from old MAD magazines, Bob and Ray comedy shows, which I might be older than most of the folks at Fastenal. So I'm not sure what that is. Steve Martin and Bob Newhart, I do know the latter two, and I do know the MAD magazine reference.

The -- about 60 years ago, Bob convinced 4 friends to invest in a vending company, selling nuts and bolts. The idea didn't work. And he -- but he -- after calling on customers, understanding what they needed as far as helping their supply chain needs with fasteners, he went with plan B. And that's the organization you know today and that the investing public first became aware of in 1987 when we went public.

40 years after our start in around 2007, 2008 time frame, we revisited Bob's vending idea. Today, about 25% of our revenue goes through vending machine. And we've added a lot of other technologies to that since. And if you look at our broadly defined FMI or Fastenal Managed Inventory, which is really point-of-use technologies that we've deployed. Over 43% of our revenue today goes through some type of technology platform.

And there's been a number of articles written on Bob over the years and recently. I remember the first one after a trip I've done with Bob. He was regarded as frugal, the cheapest CEO in America. The fact that he shares hotel rooms with other Fastenal employees when he travels. All my trips with Bob, I shared hotel room. And he wore your suits. And they painted somewhat of a character about Bob. But I think in many ways, they missed the point.

And so what our flip book includes is an excerpt from a book Bob wrote in the late 1990s, titled the Power of Fastenal people. And he talked about philosophy and leadership within the organization. And he had 10 rules about leadership he had coined over the years. And I'm sharing that with our folks on the call today, whether that be shareholders, analysts, employees of Fastenal, others. In hopes that more of society can capture some of the ideas that Bob shared with us. I was very blessed to have met Bob, as I said 30 years ago. Like many others at Fastenal, he changed the course of my life.

The -- for me, the ones that stand out, particularly when I think of Bob is the first rule about challenge rather than control, treating everyone as your equal, see the unique humanness in all persons, let people learn and we've tweaked that a little bit to challenge people to learn and ask them to consider changing when they learn something new. And then finally, remember how little you know. We have a lot of tenure within Fastenal. A lot of people choose to spend -- start their career young with Fastenal and spend their career here. Whether you've been here 5 years or 30 years, you always have things to learn. And Bob carried that mantra through his entire life, and he will be sorely missed.

I was personally blessed in that a couple of weeks before he passed away, I had a nice visit with Bob. And we served on the board of another organization together, and we had a conversation afterwards. And he is sorely missed in the organization and in the community at large. Thanks, Bob.

Flipping to Page 4. Some thoughts on the quarter. The -- from a quarterly perspective, our sales grew about 3.5%. We had one less day, so our daily growth grew about 5%. The marketplace we operate at is still sluggish. I deem what's happening in our growth as mostly self-help things that we're doing from an execution standpoint, and there's an element of comps in there, too. But it's mostly self-help. And I make that comment when I look at the sequential patterns of our business. Because that's about how we're executing new customer relationships we're creating and expansion of existing customer relationships that we're creating. We're executing at a very high level.

And when I think of -- we made a lot of changes 2, 2.5 years ago within the organization. As we came through COVID, we had drifted apart a little bit. And we weren't as focused on a common goal as we should have been. As travel resumed, we saw signs of that, and we made leadership changes in our sales side of the organization. And everybody has been in their roles now a couple of years, and you're really seeing it gel, and it's shining through in our numbers.

The quarter is a little odd to look at if you think about it from a monthly perspective, but don't be misled by that either. January was a bit understated because of weather. And March is a bit overstated because of the timing of Easter. I don't know if Holden will agree to my number here, but I estimate about 2%, 2.5% of the growth in March. It's a bit about Good Friday being in April. And -- but regardless of that, even if you adjust for the weather in January and you adjust for the Easter timing in March, the sequential pattern is quite strong and it's strong in all of our geographies, which is really good to see. And again, I deem that to be about what Fastenal is doing and engaging with the marketplace, rather than what the marketplace is asking us to help with because of their business patterns because it's still sluggish.

The -- as is typical of April, we held our customer expo. A few of us actually traveled back yesterday. The expo was on -- finished on Wednesday evening and flew back on Thursday morning. We had similar to what we witnessed in 2024, record attendance by customers at the event. It -- last year surprised us a bit because coming out of COVID, the first 2 years in '22 and '23 that we had to show, it was a very subdued event because a lot of organizations either weren't traveling yet or they were doing limited traveling, and it was still difficult to travel internationally that we weren't getting international folks. And so folks weren't coming from Canada or up from Mexico for the event.

This year, I can tell you firsthand that we had a record number of attendees from our business unit in Mexico because I had the opportunity to speak to a large group that was gathered. And it was exciting to see the types of questions they were asking about and the way they were approaching the relationship.

The other thing -- I'll probably touched on this a couple times through my commentary. It was a unique week because in talking to various groups, the one thing there wasn't a lot of discussion on was tariffs. That's not to say it didn't come up. But the way we address the conversation in every group I talked to, it was a few sessions we had where it was a Q&A and Bill Drazkowski was the moderator. He led off with a question on tariffs, and he pointed at me each time. And what I really impressed upon our customers is the way a supply chain partner approaches any kind of chaos. I shared some stories about the lead up to COVID, the vetting of suppliers that we did for safety products before the world got weird and how that put us in a position to be a better supply chain partner. The tactical decisions we made to go out and buy inventory to get ahead of the onslaught of everybody else.

Because of the strength of our balance sheet and our financial resources, a lot of that attributed to things we do, but really the foundation that Bob Kierlin laid many years ago and priorities in an organization and what you do with cash. But what I can tell you is we shared with them the tactics we're taking right now in some cases, fattening our balance sheet a little bit to -- it doesn't solve any issue other than it gives you time to have options. Talked about products we're bringing directly into Canada and Mexico that we would have brought through the United States before because some of the new tariffs are not eligible for duty drawback. And while it might be more expensive to bring it directly into that market from a logistics perspective, it's a lot less expensive than a tariff that gets layered on top of maybe a tariff going into Canada or Mexico as well. So we're being very thoughtful about that because about 15% of our revenue is in Canada or Mexico.

From the standpoint of the U.S. in all markets, we talked a lot about how we've changed our sourcing patterns in the last 5 years on diversifying where we're sourcing from to provide a better supply chain. But we also talked about the fact that when we diversify our sourcing practices, we don't just play whack-a-mole and try to avoid a problem. We try to improve the supply chain in every step we take. And we try to be relevant to the new manufacturing partners we joined with regardless of where they're located.

In that we're a top 1, 2, 3, 4, 5 customer with that manufacturer because if you're a significant customer to a manufacturer and they get tight on capacity, or they need to expand their capacity. They're going to help their largest partners first when they're prioritizing their efforts and the fact that they know we have financial resources to match with dollars, what our commitments are. We often get in line ahead of everybody else, and that serves our customers in the marketplace really well.

We've added a bunch of customer site information to our disclosures this quarter, 3 year's worth of history. We had a recent Investor Day where we talked about it. We touched on it in our January earnings call to really give better visibility to some of the strategies we have deployed and are deploying to broaden the size of our market opportunity.

When I think of stepping into this role a decade ago, one of the points I've made to the -- to our Board was coming from my old role, I had the advantage of I've studied the numbers of Fastenal for years, and I had a lot of conversation with our regional leaders over the years. So I understood maybe better how they thought about things, where they discovered success. There was a few people for me that stood out that have been very successful in their business. When I think of our business in Minnesota and Wisconsin, I took a lot of stuff out of that playbook. When I think about our regional leaders, the 2 Millers, Randy, who led our business down in Indianapolis and Casey, who led our business down in what we referred to the Southeast Central at the time, which was Kentucky and Tennessee.

Our team in Mexico, our team in international more broadly. Jeff Watts at the time, had a lot of discussions to really understand their tactics for growing because they had consistently discovered the success, maybe sometimes on others had it. Bob Hopper's another one on that list where I touched with and he covered our Florida market, incredible success and you learn and you ask people, how are you doing it? And what I shared with the Board is our most successful regions have a great key account program. If you put me in this role, I'm going to drive the business towards where they're discovering success because I think it broadens the market for Fastenal, but we have to lower our cost structure to go after that kind of business. And I'm pleased to say we've done that. And you see the success that shines through in some of those customer site information statistics.

Finally, on Page 4, we inched up our dividend from $0.43 to $0.44. And -- it's a dumb reason. I'll give you a little historical perspective. In 2003, our sales -- total sales, we needed 10.5% growth to break $1 billion that year. We came in at 9.9%, and we reported $995 million in sales. That was cool, but $1 billion plus would have been neither. But we can't change our sales. We can influence it by our activities, but we can't change it, at least not legally.

In 2018, our operating income came -- we needed 13.4% growth to break $1 billion that year. We only got 13.3%. We came in at $999.2 million of operating income. We can't change that one either. Holden did get a dirty look from me, but we can't change that one, but we can change our dividend. So in the first quarter, we paid out $246 million, and I looked at Holden and I said, we bumped that up $0.01. If our Board goes along with it and we continue this dividend through the year, we'll break $1 billion in regular dividend for the first time. It's dumb reason, sorry about that.

Flipping to Page 5. FMI, we continue to execute at a high level there. Given the comment I just made a lot dividend, I'd feel a lot better if we had 130,000 devices, not 129,996, but I'm going to round it and say we have 130,000 devices deployed in 25 countries. Our device count grew 12.5%. When you look at our safety sales growth of almost 10% in March. That's about execution in FMI and our vending more generally, but FMI more broadly.

Going down the page, digital footprint, 61% of total sales versus 59% and 54% 1 and 2 years ago. Our goal remains in October, 66% to 68% of sales is going through digital footprint. And that's what we're working towards. And then again, the customer site, data success in our $10,000-plus sites. And what that means is this is a customer, it's a building, it's a campus where we provide more than $10,000 a month in product and services.

A subset of that is what we call on-site like customer sites. So that's where we do more than $50,000 a month with that customer. That group grew 7%. So that's about executing and engaging with customers at a high level. There's one category that you'll see that doesn't shine so strongly, and that's our under $5000. And it's really our under $2,000, a subset of that. And if you're on our e-commerce team right now or if you're in IT or if you're in supply chain, you're getting a lot of pressure and dirty looks from Dan right now because we need to get better at the e-commerce side.

We solved the problem with that group not by adding resources and sales teams to go after $500 and $800 a month customers. We want those customers. That marketplace has chosen to buy more in the online channels, and that accelerated during COVID. We're not great at that piece of the business. We're great at a lot of things. That's not on the list, but we can be. And the reason that matters is when you look at -- through some of the customer site data, I believe a great eCommerce platform enhances our ability to be successful in all groups because I believe there's probably a 20% lift.

And this is just -- this is the belief. This is not based on any data. I believe there's -- there can be a 20% lift in every category, if we have a great e-commerce strategy because there's random MRO spend, we don't necessarily get even when we have a great relationship with the customer because some department in that organization might find it easier to order somewhere else. We need to get better at that.

I'll shut up now and flip it over to Holden.

Holden Lewis

All right. Thanks, Dan, and good morning, everyone. Before digging into the results for what will be my final call, I did want to mention a few things. First, to Dan, who nearly 9 years ago, based on the response of many of the people on this call, took a chance on a relatively unorthodox hire. It's been an unbelievable experience working with a great leader, and I sure have enjoyed being your partner in this.

To the entire Blue Team, I know I got this opportunity in part because of my outsider's perspective, but at the same time, you all challenged me to earn your trust and respect and you deserve that. I've tried to do that for 9 years, but it wouldn't have been possible if not for your passion for learning, teaching and collaboration, that's the foundation of our culture. So I've surely enjoyed being your CFO, and I couldn't ask for 24,000 better friends.

And to our investors, you probably don't realize how often I've actually used your observations, perspectives and questions in my own work here. And for that, I thank you. I hope I've been able to provide a deep and differentiated view into our business. I could go on. But if I do, I suspect the music will start, so why don't I just jump into Slide 6.

Sales in the first quarter of 2025 were up 3.4% with daily sales up 5%. That's our strongest daily sales rate since the second quarter of 2023. Feedback from regional leadership continues to reflect sluggish end market demand despite generally favorable outlooks. Customer tone did seem to shift from the steady improvement we've seen since the election to plateauing as trade policy created some caution.

Notwithstanding this uncertainty, we did not discern any meaningful pre-buying ahead of tariffs. In the absence of much external health, the improvement in our DSR reflects 2 other variables. First, even as the market has stabilized, our comparisons have gotten easier, particularly in the cyclical parts of our business. This factor helped produce our first quarter of growth for fasteners since the first quarter of 2023, and acceleration in manufacturing end markets.

Second, contributions from our strong contract signings over the past 2 years continues to build. We continue to experience a healthy pace and mix of signings in the first quarter of 2025 and our count of national, regional and government contracts has grown at a double-digit rate for 12 consecutive months.

Now the monthly cadence during the quarter warrants some discussion. I feel like Dan covered much of that. So I agree with his numbers about the impact of Good Friday having fallen in March of last year. What I will say is the quarterly daily sales rate growth is a fair representation of our performance, and we did see acceleration through the period. It was a solid self-help driven result in a soft market. But even so, as you interpret our results, please take stock of the discrete factors that affected each period.

The pricing outlook also warrants some discussion. Year-to-date, significant tariffs have been applied to products from China as well as steel, including derivative products like fasteners on a global basis. We continue our long-term trend on diversifying our supply chain where possible questioning the size and timing of our suppliers pricing actions, and we have added some inventory to our own balance sheet.

That said, supply chains have gotten more expensive and a part of our response over time will be incremental pricing. We have been proactively engaging with our customers for several months. And in April, we took our first actions, which we believe will contribute 3% to 4% of price in the second quarter of 2025 with the potential for that to double in the second half of 2025, depending on the pace and execution of our actions.

We have taken no actions on the deferred portion of their reciprocal tariffs but may need to should those ultimately go into force. We are encouraged by the easier comparisons, the improved sentiment and particularly our internal momentum. That said, we have limited visibility and share our customers' uncertainty over how current trade policy may impact demand over the course of 2025.

However, Fastenal has historically been able to win market share during periods of disruption on the strength of our nimble sales force, our frugal and adaptive culture and the weight of the technologies and global supply chain resources we can apply to finding solutions to customer challenges. That is our expectation in the current environment.

Now to Slide 7. Operating margin in the first quarter of 2025 was 20.1%, down 50 basis points year-to-year. We had one less selling day in the period versus the first quarter of 2024, which is worth roughly $31.5 million in sales. Had the first quarter of 2024 and 2025 had the same number of selling days, we would likely have leveraged SG&A and our operating margin would have been down a more measured 10 to 20 basis points.

Gross margin in the first quarter of 2025 was 45.1%, down 40 bps from the year ago period. Product and customer mix was the usual contributor. We also saw higher costs from third-party freight providers and higher hub vehicle lease costs, both coming against relatively flat freight revenue. The price cost was neutral in the period. We anticipate easier gross margin comparisons in the latter half of the year though our effectiveness in managing price cost and the degree of macro improvement will influence this scenario.

SG&A was 25% of sales in the first quarter of 2025, up from 24.9% from the year ago period. As described above, we believe we would have leveraged in the period had the current and year ago quarters had the same number of selling days. All major cost categories either leverage or deleverage very modestly with none standing out. We continue to manage cost effectively. Total SG&A expenses were up 3.6% year-to-year consistent with what has been a stable 2% to 4% rate of increase over the last 9 quarters. We continue to invest in key areas of our business to support growth while managing other costs more tightly to reflect the sluggish business conditions. Putting it all together, we reported first quarter 2025 EPS of $0.52, flat with the first quarter of 2024.

Now turning to Slide 8. We generated $262 million in operating cash in the first quarter of 2025 or 88% of net income. This is a lower conversion rate than we might typically achieve in the first quarter, reflecting our current investment working capital. Otherwise, we remain comfortable with the cash generation of our model and continue to carry a conservatively capitalized balance sheet with quarter-end debt being 5.1% of total capital.

Accounts receivable were up 5.4%, reflecting sales growth, relatively faster growth to larger customers that tend to carry longer terms and an uptick in quarter end deferred payments from our customers. Inventories were up 11.9%, not different than the preceding quarter. We have increased inventory as part of our effort to improve product availability in our in-market locations and improve picking efficiencies in our hubs. We have added stock to support customer growth, including expected incremental growth in the warehousing space, and we accelerated some inventory scheduled for future delivery into current periods ahead of potential tariffs. Inventory growth may remain elevated in 2025 as we continue to navigate tariffs and has more inflation builds in inventory.

Accounts payable were up 23.9%, reflecting the increase in inventories and the timing of payments associated with certain capital projects. Net capital spending in the first quarter of 2025 was $53.8 million, up from $48.3 million in the first quarter of 2024. This increase is consistent with our expectations for the full year where we anticipate capital spending in a range of $265 million to $285 million, up from $214 million in 2024. This increase is from higher FMI device spending in anticipation of higher signings, higher IT spend, which includes projects aimed at developing additional digital capabilities, and distribution center outlays to reflect spending on our Utah and Atlanta hubs and automated picking additions across our hub network.

With that, operator, we'll turn it over to begin the Q&A.

Operator

[Operator Instructions] Our first question is coming from David Manthey from Baird.

David Manthey

Holden, thanks for everything and best of luck.

Holden Lewis

Thank you.

David Manthey

Your customers may not be talking about tariffs, but that's all we talk about here on Wall Street, so I'll start there. If you could just, Dan, maybe talk about the 145%. I don't know how realistic that is, but if that type of tariff is actually implemented even for a short period of time, are your customer contracts set to absorb the timing and magnitude of that kind of increase? And just any other thoughts you have around if that should transpire?

Daniel Florness

Yes. So you're talking about specifically the China non-steel tariff. Because for us, because the China steel is -- with all the recent noise is total of 70%, but 45% of that is new. And -- but going to your question, do our contracts have the capability to adjust pricing? Yes.

The question you have to look at is what optionality do you have as far as alternative sourcing? Because if we move steel-based product out of China, there's the 25% Section 232 that's on steel and metal products essentially, but it changes quite dramatic because you don't have the other duties that have been put in place, both back in 2018 and earlier this year. So it becomes an optionality.

And so most of our discussions with customers is frankly on optionality and things we're doing. And -- but our contracts do allow for that. You have -- then you have to ask yourself what demand gets destroyed. But keep in mind, for most of our customers, every dollar they spend with us, they're probably spending $10 somewhere else whether that be products, if it's in an OEM setting product or directly sourcing. So you have to look at it and say what business has become not economical, when you have that type of steel-based tariffs. From a non-steel where the actual total duty is 170%, of which 145% is new with all the pieces that have been added in. Again, same fact pattern. But there are, in many cases, some optionality again for how you can direct the spend depending on the willingness of the customer and the availability of alternatives.

The other wild card and the piece that we have no control over is a lot of products that we source are branded products that are coming from suppliers in country that are having product manufactured with their name on it somewhere else in the planet. And the question is what their ability is to change sourcing and to manage through it. But Dave, getting back to your question, yes, we do have the ability to raise prices.

Holden Lewis

And probably the only other thing I would probably add to that is the ability includes not only the contract terms. But frankly, I think at the customer expo, a lot of the discussion was about visibility, clarity, certainty. And the fact that we have direct sourcing capabilities gives us the degree of knowledge about what's happening sort of in the source markets that a lot of our competitors frankly might be buying from master distributors may not have the same visibility. The pricing review tool that we developed in 2018 in response to that round of tariffs provides a tremendous amount of granularity to our customers. And so when you're starting off and your opening conversation is very detailed about the why's and the what's and the where's. You never say this is an easy conversation. And the order of magnitude is somewhat -- something we haven't navigated before. But we start off in a much stronger position because of the capabilities we've created to communicate effectively.

Daniel Florness

But Dave, you know where a lot of the conversations went with customers was actually to tactics that we're taking because we're very transparent with our customer of things we're doing and have done because we've been modifying our sourcing teams quite dramatically over the last 5 years. If you go back to 2019, the year before COVID hit and right after the tariffs, if I look at other sourcing we have in Asia, for example, our teams outside of China are 10x larger today sourcing teams.

Now that's working off a pretty small base than they were in 2019, because we wanted to -- the way you move faster as you get closer to the manufacturer. But a lot of discussions with customers, and I know we're taking this question in a lot of tangents in our answer. But hopefully, it's answering maybe some other questions that might be out there is sharing those tactics with our customers because in some cases, they're searching for answers too. Because they have to solve the other $9 of spend for every dollar they have with Fastenal where they're sourcing directly. And in some cases we might help them find some manufacturing capability. That's what a supply chain partner does. And I believe we're poised to be more successful in this type of environment, just like we were during COVID and the reemergence of the global economy after COVID because we sourced in so many places, and we know our customers on a first name basis locally and a lot of that sourcing is done locally too.

Holden Lewis

And perhaps the last piece of that, I would say, talking to Bill Drazkowski, who heads up national accounts. He said that where the dialogue went at the show was much more about show me the math so I can understand what's happening and then don't shut me down. And that seemed to be the mindset of our partners and customers at the show around this..

Operator

Next question is coming from Stephen Volkmann from Jefferies.

Stephen Volkmann

I guess I'll ask the next one here. How do you -- I mean the magnitude of these increases is pretty unprecedented. Do you try to sort of smooth this out for your customers? Or does it just become very...

Daniel Florness

Hello. I hope we're still here. Stephen, can you hear us?

Stephen Volkmann

Yes, you are, yes. Please proceed.

Daniel Florness

The question cut off there. That's why I was wondering. The -- as Holden mentioned, we do so much direct sourcing because of our scale of operation. It gives us much more visibility to communicate with our customer and transparency. And we do have some buffers in that we have some inventory, so it allows you to step into things in a different way because we don't want to -- our goal here isn't to profit on the inventory on the shelves. Our goal profit because of tariffs, inventory on the shelf. Let me rephrase that.

Our goal is with that natural hedge, how can we use that to our customers' advantage as we manage through this and it gives us time for some optionality on certain products. In some cases, that when the tariff situation is changing daily, in fact, we -- this was every week, starting February 10, Kevin Fitzgerald and our team that provides communication to the field and guidance to the field. We've been putting out an updated video. In fact, it was just a new one that came out this morning because it's been a moving target. And even during the course of our conversations, numbers are moving around, because the week started and ended in 2 different places. There's no way to cushion 145% tariffs. There's no math that you can make that work.

The question is what optionality do you have because on non-steel product, if we source it out of Taiwan, the math changes from 145% of new tariff 10%. And -- or if we source it in other places in Asia or other places around the world, then the number goes to

10%, but it might be 30% more expensive or more depending on their ability to produce it and to produce it in a chaotic environment where there's a lot of change going on. And so -- but there is no silver bullet that will cause something where you have a tariff that was declared on Wednesday or Thursday -- Wednesday, I guess it was, that's 145%. That's just math.

Holden Lewis

But we do try to align the timing of the costing hitting our COGS in terms of thinking about how we're going to affect pricing. So when you talk about smoothing it, we try to align with where the market is. The one thing I would point out, though, I think everyone is aware that we have turns of about 2.5x. As it relates to this matter, once something actually hits the U.S. shores, our turns are obviously much faster with all of our products, right? And so in the case of tariffs, when those go in, it's really only a couple of few months before the costing is beginning to catch up with the P&L. And so that's why when you think about the cadence of tariff conversations are really heavy in February and March, and we took our first steps in April, even though we have a very long supply chain with 2.5 turns, that was because tariffs begin to hit much faster than generalized inflation. And so to Dan's point, we aren't timing this to pull margin in ahead of costing. It's just tariffs move through the P&L a little quicker.

Operator

Next question is coming from Ryan Cooke from Wolfe Research.

Ryan Cooke

Maybe we could spend some time on SG&A. I know you called out some elevated freight expense again within that other category that was up double digits. Can you maybe just quantify that impact in the quarter and share how we should think about things trending for the rest of the year? And I guess just more broadly, it does sound like you expect to be leveraging SG&A in the remaining quarters given you would have been there without the loss of a selling day in 1Q. So just making sure, is that the correct way to be interpreting your outlook?

Holden Lewis

Yes. On the phrase, the nature of the freight was different this quarter than it was last quarter. Last quarter, we had some expedited shipments that we paid for.

Daniel Florness

So that's in cost of goods.

Holden Lewis

Right?

Daniel Florness

You're talking freight and SG&A, you're talking more vehicles -- vehicles.

Holden Lewis

Got it. Sorry. I was anticipating a different question. Yes. On the SG&A, so we are cycling through our fleet of pickups. And that pace has accelerated in the last, call it, 6, 12 months, and that's because one of the sort of after glows of the pandemic was -- it took a while for the vehicle supply chain to catch up. And we had several years where we were probably not cycling as quickly as you normally would, during which those things were inflating. And so we'd be -- that is continuing to move through.

I think as you get into the second and fourth quarter, in particular, the comps do start getting somewhat easier and so I do think you have that working in your favor on the SG&A. But to your broader point, look, I've always argued that when we grow at a mid-single-digit rate, we should be able to defend the margin. And I think this quarter, if we hadn't lost the day compared to last quarter or the year ago quarter, we would have grown it at 5%, and that's what our DSR was at. And at that level, we were pretty close to sustaining our operating margin and would have leveraged SG&A. And so I think the answer to the question is it depends on what you think demand is going to do. If you think that we're going to grow or continue to grow at a mid or better than mid-single-digit rate, then I would expect that we should be able to leverage SG&A at that level, particularly with the way that we're managing our costs today. So -- but volume always has a say in that.

Daniel Florness

The only thing I'll add to that is -- and I think it was Dave Manthey that coined this a number of years ago. We talked about the shock absorbers in our system, and that is, we use a meaningful amount of incentive compensation in our structure. And one of the messages I had for our leadership earlier this morning was as we're moving into the second quarter here. We did a nice job of managing expenses. Our sales growth has picked up. We expect that to continue as we move into second and third quarter. And there will be some reloading of bonus numbers because you can read our proxy, and you can see it was pretty ugly for a few of us, and that's not unique to the folks that are in proxy, that's throughout the organization. Folks saw a meaningful cut in their incentive comp in '23 and '24.

And there will be some reloading of that. But that's predicated on the fact that our gross profit dollars and our pre-tax dollars are growing and driving that. And so optically, you'd see your operating expenses growing a little bit faster. The incentive comp within labor growing a bit faster, but it's because the operating earnings are growing faster. That makes sense.

Holden Lewis

That's why we always talked about an incremental margin to be in that 20%, 25% range because you do have that shock absorber effect that works on both. Works when volume is expanding as well as when it's slower.

Ryan Cooke

Great. Holden, that's all very clear. And I guess if we can just spend a quick moment on the customer sites and thank you for the additional disclosures you've given there. I guess -- maybe just how do you think about the disaggregation between manufacturing versus the nonmanufacturing locations? Should we think of the pruning opportunity as maybe more substantial on the non-manufacturing side, given those look to be a little bit heavier mix of this low spend customers? Or anything you could share on just how you think about the two differences there? And maybe if there's any significant margin differentials to think about?

Holden Lewis

Well, I'm not sure there's a difference between manufacturing and nonmanufacturing as much as there is a difference between the services that are utilized. The reality is what we sell are supply chain solutions using a high touch model and a lot of technology. And we need customers that have the scale to take advantage of that, and are willing to sort of pay for the savings and advantages that we can bring to them. Whether that's a customer in manufacturing, non-manufacturing, to some degree, is somewhat agnostic to us. .

When you look at the bucket information and you look at what's happened to the total customer sites and that less than $5,000 group, the reason that's acting the way it's acting is in part because we've closed branches. That process has obviously stabilized, but the reason we've lost customers is because we closed branches. The other part is because a customer that does $500 a month with us doesn't use a lot of the tools that we can bring to bear for customer supply chains, whereas a customer that spends $10,000 or more months with us, they typically are using multiple of our solutions, right? And so when we think about manufacturing and nonmanufacturing, I don't think there's as much of a distinction there as much as there's a distinction between the size and the opportunity that exists with the customer in either of those spaces.

Daniel Florness

One thing I'll add to that is on the non -- the manufacturing, obviously, is a more cyclical customer base to certain degree. The nonmanufacturing includes some customer segments that we've seen -- enjoyed success with that aren't manufacturers. And they're businesses that are involved in warehousing and distribution, typically supporting e-commerce models. They might be organizations that are involved in data centers. They might be organizations. I've talked previously about some of the success we've enjoyed with on-site going through the COVID period.

For example, and I mentioned Bob Hopper earlier. I go down and visit Bob once a year. He usually doesn't let me come to Florida in winter, I have to come in the summer. But hotels are cheaper. But when I come down to visit, invariably, I'm going to a K-12 school district, where we have on-site, or I'm going to a boat manufacturer, 1 of the 2.

And so there's roughly 600 -- 4-year state colleges, 2-year technical colleges, K-12 school districts with more than 20,000 students in the United States alone. You take that number to 10,000-plus students that 600 goes to over 1,300.

Prior to COVID, we had fewer than 5 on sites with higher Ed for K-12. Coming out of COVID, it had grown 25. Of that 600 number, I don't know this for a fact, but we're probably sitting there with about 5% of them right now. And those are -- those would be in that bucket, and that's where we found success because that group of customers found we were special during COVID because we can get them stuff other people couldn't get. And it opened up their eyes to the potential of some of the FMI devices, the resources we can bring to their supply chain. And I'm pleased to say, in the last few years, we've had on-site customers that are in the final 4 of the best [indiscernible], and we're rooting them on. And we had one this year as well. So -- but it's a case of -- that's one of the reasons to break that out, but that group is less cyclical given what they do. Whereas in the manufacturing, the only pieces that are less cyclical is where we have customers in manufacturing that are more in food production, because people always eat might change what they eat, but they always eat.

Operator

The next question is coming from Thomas Moll from Stephens.

Thomas Moll

I wanted to follow back -- follow up on a comment. I think this was from you, Holden. Just on the pricing actions that were taken in April. You quantified maybe 3 to 4 points year-over-year uplift in the second quarter that could potentially double in the second half, if I heard that correctly. Is the driver there just the staggered dates of implementation for these increases? And is that just tied to the pricing and costing alignment you referenced earlier? Or is there something else going on here?

Holden Lewis

Staggered timing as well as just the timing it takes to sort of implement have conversations. Our model starts with discussions with customers, right? It's not just sort of flipping a switch on a website. And so those conversations can take their own varying paces, particularly when 70% of your business is in the contract realm.

Daniel Florness

I touched on a few things. That's heavily centered on fastener product because that 25% tariff that came in on steel-based products, once it was clarified it was derivative products as well, which includes threaded fasteners because there's a high steel content there. And so we'll start [indiscernible], sorry. But -- part of that is having conversations with our customers and understanding what inventory we have to support them and some of the timings that can come into play. And so that creates some saving effect, particularly on the OEM side of fasteners, and that's about 2/3 of our fastener sales.

Thomas Moll

And I wanted to follow up with a question on gross margin. Holden, I believe it was last quarter, you said that there was a shot for flat in 2025, maybe a slight decline. Any update on that outlook? It sounds like maybe not just give some of the price cost commentary and how you think you can defend margin percentage there, but I just wanted want to ask if there is anything else you wanted to offer?

Daniel Florness

No. Let me take that one.

Holden Lewis

It would be my guess. I look forward to hearing what you have to say.

Daniel Florness

This is a philosophical thing. And historically, we've defended gross profit percentage. And in fact, I had a conversation with a few of our directors yesterday on just this fact. And when -- if you look back to 2018 time frame, we largely defended our gross margin percentage. It was a little chaotic because we didn't have the tools we have today. And the degradation you did see in gross profit over time was the earlier mentioned hard front to attack on growing our $50,000-plus customers and there was a mix shift that was going on both in customer mix and product mix, and those were competing with gross profit percentage. .

But we largely defended the percentage. And -- but we have to be very thoughtful about what it means for our customer. And our bigger challenge to our customer right now is what optionality we can create in their business because depending gross profit percentage in an arena where you're talking 125 -- I mean whatever hell number you throw out. There, you're really working with your customer to manage their supply chain and you're doing right by everybody. That includes employees, customers, suppliers because we're pushing back on suppliers pretty darn hard too and our shareholders.

And you're finding what the right mix is, and you're also trying to figure out, is this a -- is this a forever thing? Or is this something that's going to be announced on Wednesday and canceled on Friday? And what -- what steps are you going to you take? You're not going to stick your head in the sand than it's not happening because that's naive -- that's foolish. But you're not going to jump out the window either. You're going to find some place in between and make great supply chain decisions for your customers. And -- but -- our goal has always been to manage gross profit percentage through scenarios.

Our goal -- our real goal long term is to grow relationships and find -- discover more customers that find the Fastenal supply chain model to be special. And then with existing customers once established, to grow our footprint with them and be special for more things. And that's an incredibly trusting relationship. And we're going to do right by all 4 constituencies I talked about, and all 4 are going to get pushed as we go through this: suppliers, customers, shareholders and employees. And I think with that kind of mix, I think our shareholders do really well, investing in Fastenal over time because we have our head in the right place. And we keep our eye on -- despite this quarter and beefing up our inventory to do a number of things strategically, we keep our eye pretty well on our cash flow operation, too.

I see we're at 5 minutes on the hour, we can take one more -- if it's a quick question. But in case we run out of time, I do want to reciprocate and say to Holden, thanks for the last 9 years, you brought a very unique insight to the Fastenal organization. I always used to get home and my wife would ask me, "Hey, how were the questions today and/or some of the follow-up questions." And I'd always share a handful of names who asked some folks that would have some really, really good questions. Holden is always on that list. And so he will be missed at Fastenal. But if there's one more question, we'll take it.

Operator

Our final question today is coming from Chris Snyder from Morgan Stanley.

Christopher Snyder

I just wanted to maybe ask you, Dan, about fastener supply chains. They're very heavily tied to Asia. When we look at other industrial categories, we did see more of a shift to Mexico over the last 5 years that hasn't really happened in fasteners. So just are there contract manufacturers in Mexico that could kind of take on some of this production? If not, any views as to why? Because when we think about a fastener, the majority of the COGS are transportation and metal. So I would think that producing domestically even in the U.S., couldn't make sense for that category. So just wondering if you had any thoughts on that? And then what that could mean for Fastenal, if the supply chain is getting shorter?

Daniel Florness

Yes. I don't have a great answer for you other than there are sources of product in North America, and we source product out of Canada. And -- but there are sources of product -- of fastener product in North America. We took a really hard look ourselves over a multi-year period of taking some of our working capital and redirecting that into fixed capital and saying, can we take some of the dollars we have on the balance sheet because we have a long supply chain and build our own capability. And we did a lot of -- and the U.S. has some things. North America has some really key things going for it long term.

And the most critical one that I can think of is there's no place on the planet -- industrial place on the planet that has a more reliable long-term source of stable cost energy than North America. Whether we choose to use it or not, that's a different question. But there is nobody with the capability, industrialized area that has that capability. And so it does create a unique advantage. The problem was there's such scale in Asia with fastener production with steel production and by extension fastener production, such scale that's been created because automotive took fastener manufacturing to Japan and South Korea post World War II in the 50s and 60s, long before we even existed. And so there's such scale over there.

Part of the issue you have in North America and this comment include Mexico. There isn't the same scale that's been developed as far as competitive fasteners. And obviously, this changes the math.

And the real question is, does the marketplace, do the producers of fasteners believe the investment is justified because you hear on all the talking, CNBC in the morning about certainty and all this kind of junk. There is no certainty in the world. There never has been. But if it's government mandated, that's a really weird thing for certainty because if the economics work because there's a 50% tariff or a 25% tariff or a 75% tariff. And that tariff can go away in a day as easy as it can be created in today.

Are you going to make that investment in Mexico for scale manufacturing? You may or may not. My guess is you probably won't, unless you have comfort that you can put $0.5 billion into a plant, and that 25% piece will be there for the next 15 years, 20 years. You're not going to do it if you think it could disappear in 2. And that's the challenge. But we have not found scale manufacturing capabilities to satisfy our needs in North America.

Operator

We reached end of our question and I'd like to turn the floor back over for any further or closing comments.

Daniel Florness

I already slipped in my comment on Holden. And as always, thank you for participating in our call today. And in future quarters, between Jeff, Cheryl and Dan will try to step into the void that Holden will create. So be patient with us. Thank you.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.