



Applied Industrial Technologies (AIT)

Updated April 28th, 2023, by Patrick Neuwirth

Key Metrics

Current Price:	\$136	5 Year CAGR Estimate:	10.9%	Market Cap:	\$5.3 B
Fair Value Price:	\$157	5 Year Growth Estimate:	7.0%	Ex-Dividend Date¹:	05/12/23
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.0%	Dividend Payment Date¹:	05/31/23
Dividend Yield:	1.0%	5 Year Price Target	\$221	Years Of Dividend Growth:	15
Dividend Risk Score:	A	Retirement Suitability Score:	C	Rating:	Buy

Overview & Current Events

Applied Industrial Technologies (AIT) is a company that specializes in distributing industrial products to companies across all different industries. The business distributes power transmission products, engineered fluid power components and systems, specialty flow control solutions, advanced automation products, and more through its network of ~400 local service centers across North America, Australia, and New Zealand. The business operates through its two segments, Service Center Based Distribution (67% of 2022 sales) and Engineered Solutions (33% of 2022 sales). The Service Center Based Distribution segment includes revenue from the local service centers, and it includes business from scheduled maintenance and repair of their customers' machinery, equipment, and facilities. The Engineered Solutions segment specializes in selling hydraulic (water pressure) and pneumatic (air/gas pressure) technologies, specialty flow control products, and automation products.

On April 27th, 2023, Applied Industrial Technologies reported third quarter 2023 results for the period ending March 31st, 2023. The company reported adjusted net income of \$93.5 million or \$2.38 in earnings per diluted share for the quarter, which is an increase of 36.3% compared to the same quarter last year. Revenue for the quarter increased 12.2% year-over-year to \$1.1 billion. For the quarter, acquisitions contributed to a 0.7% increase in revenue, however, foreign currency challenges had a negative effect of 0.3%. The company report organic sales growth of 15.0%, a gross margin of 29.4%, up 13 bps versus the prior year of 29.3% and up 33 bps compared to the previous quarter.

Management raised the fiscal year 2023 earnings-per-share guidance range for the second time this year from \$8.10 - \$8.50 to \$8.47 - \$8.60, leading to our estimate for earnings-per-share estimate to \$8.50. Over the intermediate term, the company has goals to grow net sales to over \$5 billion (2022's sales were \$3.8 billion) and expand EBITDA margins to over 15% (2022's EBITDA margin was 10.7%).

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$2.78	\$2.67	\$2.80	\$2.39	\$2.84	\$3.61	\$3.68	\$0.62	\$3.68	\$6.58	\$8.50	\$11.92
DPS	\$0.88	\$0.96	\$1.04	\$1.10	\$1.14	\$1.19	\$1.23	\$1.27	\$1.31	\$1.35	\$1.40	\$1.62
Shares	42	42	40	39	39	39	39	39	39	38	39	40

Over the past 9 years, AIT has seen earnings-per-share grow at an average annualized rate of 10.0%. In 2023, we expect a jump in earnings-per-share based on management's revised earnings-per-share forecast of \$8.10 to \$8.50 for the full year 2023. We forecast that the business will continue to grow earnings-per-share at 7% annually after 2023, which guides our 2028 earnings-per-share estimate of ~\$11.92.

Over the past 9 years, the business has grown its dividend at 4.9% annually, and over the past 5 years, the business has grown its dividend at 3.3% annually. Over the next 5 years, we estimate that the business will grow its dividend at 3% annually, in line with historic dividend growth rates, and somewhat below our estimated earnings-per-share growth rates. As a reminder, AIT has made consecutive dividend payments for 27 years in a row and has increased dividend

¹ Estimated Date.

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payments for 15 consecutive years, so it has a stable history of dividend growth. In January 2023, the company increased its quarterly dividend by 2.9% from \$0.34 to \$0.35 per share.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	15.2	18.4	16.1	17.2	19.7	18.3	17.5	93.5	21.2	14.7	16.0	18.5
Avg. Yld.	1.9%	2.0%	2.3%	2.7%	2.0%	1.8%	1.9%	2.2%	1.7%	1.4%	1.0%	0.7%

During the past decade shares of AIT have traded with an average price-to-earnings ratio of about 25.2 times earnings and today, it stands at 16.0. We are using 18.5 times earnings as a fair value baseline, which is below the 5-year average of 33, implying the potential for a small valuation tailwind. The company's dividend yield is currently 1.0% which is below the average yield over the past decade of 1.8%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

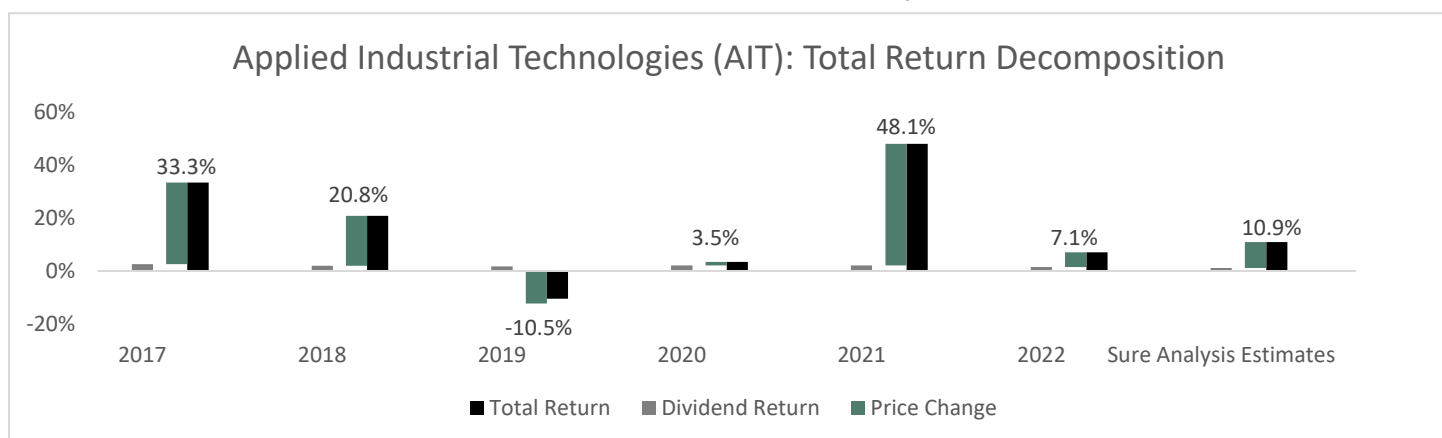
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	32%	36%	37%	46%	40%	33%	33%	205%	36%	21%	16%	14%

AIT has averaged a payout ratio of about 52% over the past 9 years, but this was skewed by 2020's irregular payout ratio of 205%. Excluding 2020, the company has averaged a payout ratio of 35%. We think the business has historically paid a safe dividend based on their earnings, and we expect them to continue to maintain a low payout ratio based on our 2028 estimates. Additionally, the business has a strong balance sheet with ~\$1.5 billion in current assets (including nearly \$180 million in cash & equivalents) compared to total liabilities of under \$1.2 billion. The business has strong liquidity and solvency ratios and ~\$1.4 billion in shareholders' equity. We think the business's strong balance sheet gives the company recession resiliency, and the business may have a competitive advantage because of its specialized products.

Final Thoughts & Recommendation

AIT is a stable business with a strong balance sheet that has recently seen strong growth in sales and earnings-per-share. At today's price, we rate the stock as a Buy because total return prospects come in at 10.9% annually over the next five years driven by an estimated 7% annual earnings-per-share growth, a 3.0% valuation multiple rerating, and a 1.0% dividend yield. Investors might be interested in this company if they are looking at the Industrial sector, or if they like the company's recent increase in earnings-per-share guidance.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	2,462	2,460	2,752	2,519	2,594	3,073	3,473	3,246	3,236	3,811
Gross Profit	683	687	770	707	738	884	1,008	938	936	1,107
Gross Margin	27.7%	27.9%	28.0%	28.1%	28.4%	28.8%	29.0%	28.9%	28.9%	29.0%
SG&A Exp.	507	523	585	553	562	658	742	718	680	749
D&A Exp.	26	28	42	42	40	50	62	63	55	54
Operating Profit	176	164	185	155	175	226	266	220	255	358
Op. Margin	7.2%	6.7%	6.7%	6.1%	6.8%	7.3%	7.7%	6.8%	7.9%	9.4%
Net Profit	118	113	115	30	134	142	144	24	145	257
Net Margin	4.8%	4.6%	4.2%	1.2%	5.2%	4.6%	4.1%	0.7%	4.5%	6.7%
Free Cash Flow	99	90	142	149	148	124	162	277	226	169
Income Tax	60	53	60	49	33	63	50	31	32	72

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	1,059	1,334	1,433	1,312	1,388	2,286	2,332	2,284	2,272	2,453
Cash & Equivalents	73	71	69	60	105	54	108	269	258	184
Acc. Receivable	330	376	376	348	391	549	541	450	516	656
Inventories	281	336	362	338	345	422	448	389	363	450
Goodwill & Int.	198	353	453	394	370	1,083	1,031	884	840	814
Total Liabilities	299	534	691	654	642	1,471	1,435	1,440	1,339	1,303
Accounts Payable	137	172	180	149	181	257	237	186	208	259
Long-Term Debt	---	171	321	328	292	964	958	934	828	689
Total Equity	760	800	741	658	745	815	897	844	933	1,149
LTD/E Ratio	---	0.21	0.43	0.50	0.39	1.18	1.07	1.11	0.89	0.60

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	11.7%	9.4%	8.3%	2.2%	9.9%	7.7%	6.2%	1.0%	6.4%	10.9%
Return on Equity	16.5%	14.5%	15.0%	4.2%	19.1%	18.2%	16.8%	2.8%	16.3%	24.7%
ROIC	16.5%	13.0%	11.4%	2.9%	13.2%	10.1%	7.9%	1.3%	8.2%	14.3%
Shares Out.	42	42	40	39	39	39	39	39	39	39
Revenue/Share	57.88	58.11	66.81	63.84	65.82	78.24	88.68	83.22	82.35	97.45
FCF/Share	2.33	2.12	3.45	3.77	3.75	3.16	4.13	7.09	5.75	4.33

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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