Applied Industrial Technologies (AIT)

Updated August 15th, 2023, by Patrick Neuwirth

Key Metrics

Current Price:	$155	**5 Year CAGR Estimate:**	14.6%	**Market Cap:**	$6.0 B
Fair Value Price:	$169	**5 Year Growth Estimate:**	12.0%	**Ex-Dividend Date[1]:**	11/14/23
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	1.8%	**Dividend Payment Date[1]:**	11/30/23
Dividend Yield:	0.9%	**5 Year Price Target**	$298	**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 2023 sales) and Engineered Solutions (33% of 2023 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 August 10th, 2023, Applied Industrial Technologies reported fourth quarter 2023 results for the period ending June 30th, 2023. The company reported adjusted net income of $92.2 million, or $2.35 in earnings per diluted share, for the quarter, which is an increase of 16.1% compared to the same quarter last year. Revenue for the quarter increased 9.1% year-over-year to $1.2 billion. For the quarter, acquisitions contributed to a 0.7% increase in revenue, however, foreign currency challenges had a negative effect of 0.2%. Cost of sales increased 8.6% to $819.5 million. Gross profit grew 10.4% year-over-year to $338.6 million, while the gross margin increased 35 basis points to 29.2%. For the full fiscal year, the company reported sales of $4.4 billion or an increase of 15.8% compared with the prior year and net income was $346.7 million, or $8.84 per share.

Management has issued a fiscal year 2024 earnings-per-share guidance range of $8.80 to $9.50, based on a sales growth projection of 0% to 4% and EBITDA margins ranging from 11.9% to 12.1%. In the intermediate term, the company aims to achieve goals, such as increasing net sales to over $5.5 billion (compared to 2023's sales of $4.4 billion) and expanding EBITDA margins to over 13% (compared to 11.9% EBITDA margin in 2023).

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$2.67	$2.80	$2.39	$2.84	$3.61	$3.68	$0.62	$3.68	$6.58	$8.84	***$9.15***	***$16.13***
DPS	$0.96	$1.04	$1.10	$1.14	$1.19	$1.23	$1.27	$1.31	$1.35	$1.40	***$1.40***	***$1.62***
Shares	42	40	39	39	39	39	39	39	38	38	***39***	***40***

The company has grown earnings by 14.2% per year over the past decade and 20% over the past five years. We expect earnings to increase by 12% per year for the next five years. AIT has made consecutive dividend payments for 27 years in a row and has increased dividend payments for 15 consecutive years, so it has a stable history of dividend growth. Over the last five years, the average annual dividend growth rate is 2.6%. In January 2023, the company increased its quarterly dividend by 2.9% to $0.35 from $0.34.

[1] Estimated Date.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Current	2029
Avg. P/E	18.4	16.1	17.2	19.7	18.3	17.5	93.5	21.2	14.7	15.8	***16.9***	***18.5***
Avg. Yld.	1.9%	2.3%	2.7%	2.0%	1.8%	1.9%	2.2%	1.7%	1.4%	1.1%	***0.9%***	***0.5%***

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 16.9. 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 valuation tailwind. Excluding the 2020 spike, the company has averaged price-to-earnings ratio of 16. The company's dividend yield is currently 0.9% which is below the average yield of 1.8% over the past decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

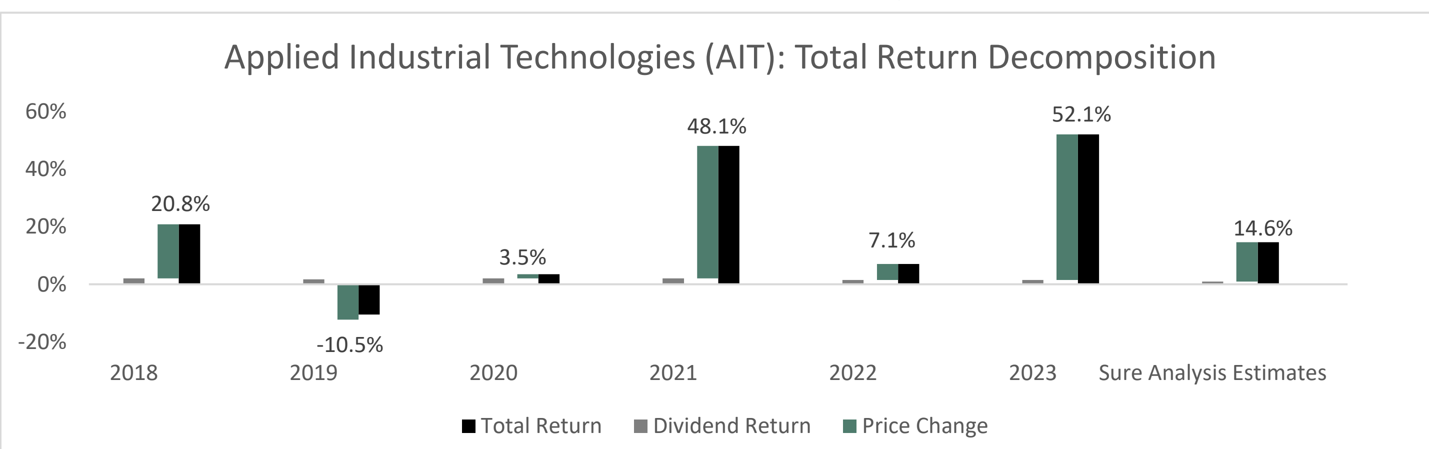
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Current	2029
Payout	32%	36%	37%	46%	40%	33%	33%	205%	36%	21%	***15%***	***10%***

AIT has averaged a payout ratio of about 52% over the past decade, 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 2029 estimates. Additionally, the business has a strong balance sheet with ~$2.7 billion in current assets (including nearly $344 million in cash & equivalents) compared to total liabilities of under $1.3 billion. Long-term debt was $596.9 million, down 8% from fiscal 2022 end. The business has strong liquidity and solvency ratios and ~$1.5 billion in shareholders' equity. We believe the business's strong balance sheet gives the company recession resiliency, and the business may have a competitive advantage because of its specialized products. Its strategic geographic presence and strong network further enables the company to serve various industries effectively.

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. 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. We estimate total return potential of 14.6% per year for the next five years based on a 12% earnings-per-share growth, a dividend yield of 0.9%, and a valuation tailwind. Shares earn a buy rating.

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.