



Applied Industrial Technologies (AIT)

Updated April 28th, 2024, by Patrick Neuwirth

Key Metrics

Current Price:	\$181	5 Year CAGR Estimate:	14.0%	Market Cap:	\$7.0 B
Fair Value Price:	\$193	5 Year Growth Estimate:	12.0%	Ex-Dividend Date¹:	05/14/24
% Fair Value:	94%	5 Year Valuation Multiple Estimate:	1.3%	Dividend Payment Date¹:	05/31/24
Dividend Yield:	0.8%	5 Year Price Target	\$340	Years Of Dividend Growth:	16
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 April 25th, 2024, Applied Industrial Technologies reported its third quarter 2024 results for the period ending March 31st, 2024. The company reported adjusted net income of \$97.2 million, or \$2.48 in earnings per diluted share, which was an increase of 0.4% compared to the same quarter last year. Net sales for the quarter grew 1.3% year-over-year to \$1.1 billion. Acquisitions contributed a 1.2% increase in revenue, and foreign currency exchange had a positive effect of 0.2%. In the third quarter, Applied Industrial Technologies experienced a 3.6% increase in revenue for the Service Center-Based Distribution segment, which contributed 67.7% of net revenues with a total of \$789.4 million. In contrast, the Engineered Solutions segment (formerly Fluid Power & Flow Control segment), contributing 32.3% of net revenues, saw a 3.6% decrease with total revenues of \$357.0 million. Gross profit for the quarter increased to \$338.2 million, and the gross margin remained stable.

Management has updated its fiscal year 2024 earnings-per-share guidance range of \$9.55 to \$9.70 (\$9.35 to \$9.70 previously), based on a sales growth projection of 1.5% to 2.5% and EBITDA margins ranging from 12.0% to 12.1% (12.0% to 12.3% previously). The guidance includes the effects of ongoing moderation in underlying industrial activity and muted sales growth recovery in Engineered Solutions segment near term. 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). Furthermore, the company announced the acquisition of Grupo Kopar to expand its automation platform in Mexico, enhancing its capabilities in high-value robotics, machine vision, and IoT applications, and adding approximately 200 new associates, with the deal expected to close soon.

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	\$9.65	\$17.01
DPS	\$0.96	\$1.04	\$1.10	\$1.14	\$1.19	\$1.23	\$1.27	\$1.31	\$1.35	\$1.40	\$1.48	\$1.72
Shares	42	40	39	39	39	39	39	39	38	38	39	40

¹ Estimated date.

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The company has grown earnings by 14.2% per year over the past decade and 21.3% 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 16 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 2024, the company increased its quarterly dividend by 5.7% to \$0.37 from \$0.35.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	18.4	16.1	17.2	19.7	18.3	17.5	93.5	21.2	14.7	15.8	18.8	20.0
Avg. Yld.	1.9%	2.3%	2.7%	2.0%	1.8%	1.9%	2.2%	1.7%	1.4%	1.1%	0.8%	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 18.8. We are using 20.0 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 an average price-to-earnings ratio of 16. The company's dividend yield is currently 0.8%, which is below the average yield of 1.9% over the past decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

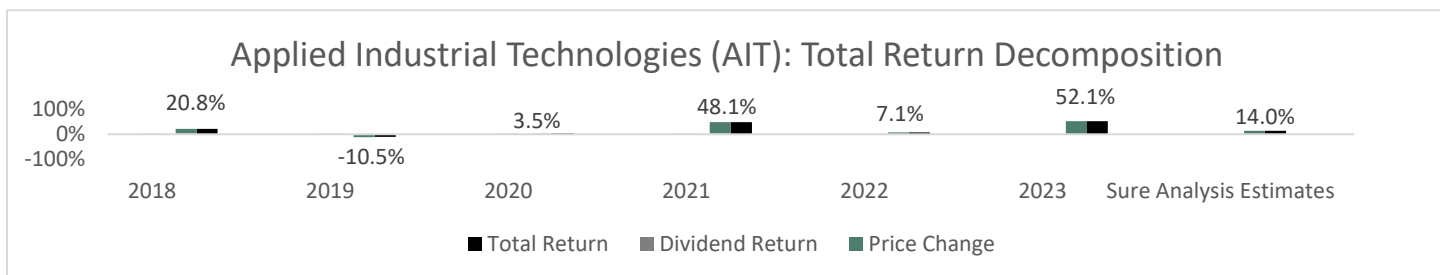
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	36%	37%	46%	40%	33%	33%	205%	36%	21%	16%	15%	10%

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%. Historically, the company has had 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 ~\$1.77 billion in current assets (including nearly \$456 million in cash & equivalents) compared to total liabilities of under \$1.19 billion. The business has strong liquidity and solvency ratios and ~\$1.67 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 good 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 14.0% per year for the next five years based on a 12% earnings-per-share growth, a dividend yield of 0.8%, and a valuation tailwind. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	2,460	2,752	2,519	2,594	3,073	3,473	3,246	3,236	3,811	4,413
Gross Profit	687	770	707	738	884	1,008	938	936	1,107	1,287
Gross Margin	27.9%	28.0%	28.1%	28.4%	28.8%	29.0%	28.9%	28.9%	29.0%	29.2%
SG&A Exp.	523	585	553	562	658	742	718	680	749	815
D&A Exp.	28	42	42	40	50	62	63	55	54	53
Operating Profit	164	185	155	175	226	266	220	255	358	472
Op. Margin	6.7%	6.7%	6.1%	6.8%	7.3%	7.7%	6.8%	7.9%	9.4%	10.7%
Net Profit	113	115	30	134	142	144	24	145	257	347
Net Margin	4.6%	4.2%	1.2%	5.2%	4.6%	4.1%	0.7%	4.5%	6.7%	7.9%
Free Cash Flow	90	142	149	148	124	162	277	226	169	317
Income Tax	53	60	49	33	63	50	31	32	72	103

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,334	1,433	1,312	1,388	2,286	2,332	2,284	2,272	2,453	2,743
Cash & Equivalents	71	69	60	105	54	108	269	258	184	344
Acc. Receivable	376	376	348	391	549	541	450	516	656	708
Inventories	336	362	338	345	422	448	389	363	450	501
Goodwill & Int.	353	453	394	370	1,083	1,031	884	840	814	814
Total Liabilities	534	691	654	642	1,471	1,435	1,440	1,339	1,303	1,285
Accounts Payable	172	180	149	181	257	237	186	208	259	302
Long-Term Debt	171	321	328	292	964	958	934	828	689	622
Total Equity	800	741	658	745	815	897	844	933	1,149	1,458
LTD/E Ratio	0.21	0.43	0.50	0.39	1.18	1.07	1.11	0.89	0.60	0.43

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	9.4%	8.3%	2.2%	9.9%	7.7%	6.2%	1.0%	6.4%	10.9%	13.4%
Return on Equity	14.5%	15.0%	4.2%	19.1%	18.2%	16.8%	2.8%	16.3%	24.7%	26.6%
ROIC	13.0%	11.4%	2.9%	13.2%	10.1%	7.9%	1.3%	8.2%	14.3%	17.7%
Shares Out.	42	40	39	39	39	39	39	39	39	39
Revenue/Share	58.11	66.81	63.84	65.82	78.24	88.68	83.22	82.35	97.45	112.51
FCF/Share	2.12	3.45	3.77	3.75	3.16	4.13	7.09	5.75	4.33	8.10

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

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