Applied Industrial Technologies (AIT)

Updated August 19th, 2024, by Patrick Neuwirth

Key Metrics

Current Price:	$202	**5 Year CAGR Estimate:**	11.4%	**Market Cap:**	$7.7 B
Fair Value Price:	$192	**5 Year Growth Estimate:**	12.0%	**Ex-Dividend Date[1]:**	11/14/24
% Fair Value:	105%	**5 Year Valuation Multiple Estimate:**	-1.0%	**Dividend Payment Date[1]:**	11/29/24
Dividend Yield:	0.7%	**5 Year Price Target**	$338	**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 (68% of 2024 sales) and Engineered Solutions (32% of 2024 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 15th, 2024, Applied Industrial Technologies reported its fourth quarter and full-year results for the period ending June 30th, 2024. The company reported adjusted net income of $103.5 million, or $2.64 in earnings per diluted share for Q4, which was an increase of 12.6% compared to the same quarter last year. Net sales for the quarter grew marginally by 0.2% year-over-year to $1.2 billion. Acquisitions contributed a 1.5% increase in revenue, while foreign currency exchange had a slight negative effect of 0.1%. In the fourth quarter, Applied Industrial Technologies experienced a 0.7% decrease in revenue for the Service Center-Based Distribution segment, which contributed 68% of net revenues with a total of $791.4 million. The Engineered Solutions segment, contributing 32% of net revenues, saw a 4.6% decrease with total revenues of $369.3 million. Gross profit for the quarter increased to $356.2 million, with the gross margin improving to 30.7%. For the full fiscal year 2024, the company reported net sales of $4.5 billion, an increase of 1.5% compared to the prior year. Full-year net income was $385.8 million, or $9.83 in earnings per diluted share, reflecting an 11.2% increase year-over-year. The company also generated $553.3 million in EBITDA, up 5.5% year-over-year, with an EBITDA margin of 12.4%.

Management has introduced its fiscal year 2025 earnings-per-share guidance, setting a range of $9.20 to $9.95, based on a projected total sales growth of -2.5% to +2.5% and EBITDA margins ranging from 12.1% to 12.3%. This guidance reflects ongoing economic uncertainties, including expectations of continued moderation in industrial activity and a muted sales recovery in the Engineered Solutions segment in the near term. Despite these challenges, management remains optimistic about the company's long-term potential. The company maintains its intermediate-term goals, such as increasing net sales to over $5.5 billion (compared to 2024's sales of $4.5 billion) and expanding EBITDA margins to over 13% (compared to the 12.4% EBITDA margin achieved in 2024).

Growth on a Per-Share Basis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
EPS	$2.80	$2.39	$2.84	$3.61	$3.68	$0.62	$3.68	$6.58	$8.84	$9.83	***$9.60***	***$16.92***
DPS	$1.04	$1.10	$1.14	$1.19	$1.23	$1.27	$1.31	$1.35	$1.40	$1.48	***$1.48***	***$1.72***
Shares	40	39	39	39	39	39	39	38	38	38	***39***	***40***

[1] Estimated date.

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The company has grown earnings by 15.0% per year over the past decade and 73.0% 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 3.1%. In January 2024, the company increased its quarterly dividend by 5.7% to $0.37 from $0.35.

Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/E	16.1	17.2	19.7	18.3	17.5	93.5	21.2	14.7	15.8	21.0	***21.0***	***20.0***
Avg. Yld.	1.9%	2.7%	2.0%	1.8%	1.9%	2.2%	1.7%	1.4%	1.1%	0.7%	***0.7%***	***0.5%***

During the past decade shares of AIT have traded with an average price-to-earnings ratio of about 25.5 times earnings and today, it stands at 21.0. 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 headwind. Excluding the 2020 spike, the company has an average price-to-earnings ratio of 16 since 2015. The company's dividend yield is currently 0.7%, which is below the average yield of 1.9% over the past decade.

Safety, Quality, Competitive Advantage, & Recession Resiliency

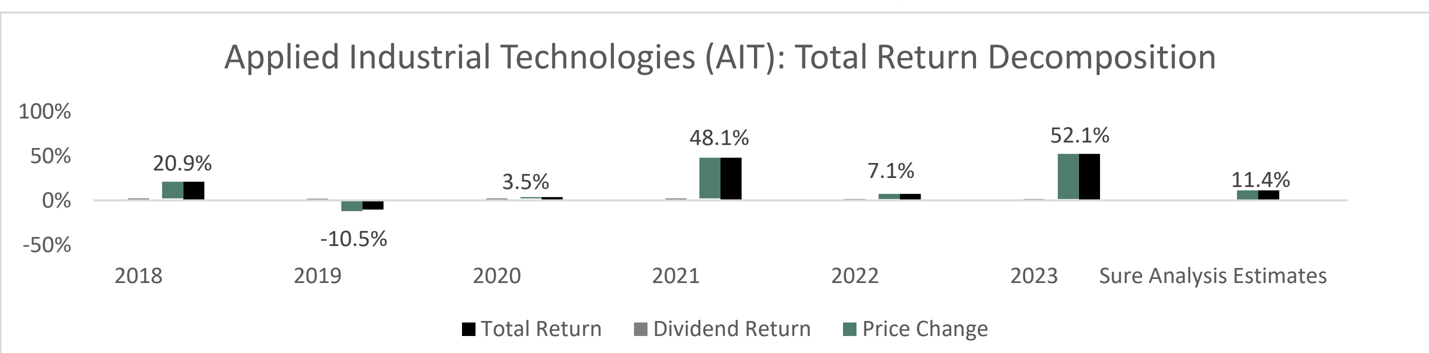
Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Payout	37%	46%	40%	33%	33%	205%	36%	21%	16%	15%	***15%***	***10%***

AIT has averaged a payout ratio of about 48% 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 $461 million in cash & equivalents) compared to total liabilities of under $1.26 billion. The business has strong liquidity and solvency ratios and ~$1.69 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 growth prospects. We estimate total return potential of 11.4% per year for the next five years based on a 12% earnings-per-share growth, a dividend yield of 0.7%, and a valuation headwind. 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.