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Jun 11, 2020

Applied Industrial (AIT)

$64.94 (As of 06/10/20)

Price Target (6-12 Months): **$68.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/26/20) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**1-Strong Buy**
	Zacks Style Scores:	VGM:A
	Value: A | Growth: A | Momentum: A	

Summary

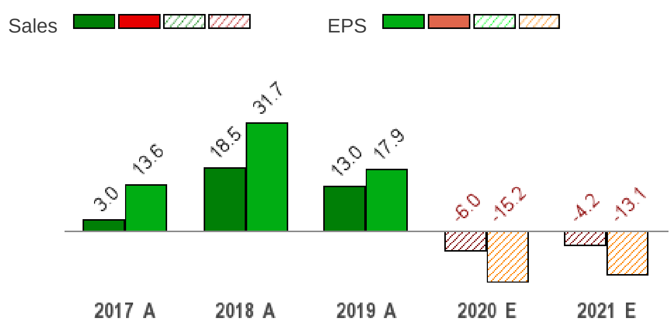
In the past three months, Applied Industrial's shares have outperformed the industry. The company remains focused on improving its product line and value-added services, driving operational excellence, and saving costs. These actions along with shareholder-friendly policies (dividend hike of 3.2% was announced in January 2020) and buyouts might aid in the quarters ahead. In the past 60 days, its earnings estimates have increased for fiscal 2020 and fiscal 2021. However, the company is wary about the challenges related to the coronavirus outbreak and suspended its financial projections for fiscal 2020. In addition to the pandemic-related headwinds, the company faces risks from high debts and unfavorable movements in foreign currencies.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$70.62 - $30.66**
20 Day Average Volume (sh)	**202,738**
Market Cap	**$2.5 B**
YTD Price Change	**-2.6%**
Beta	**1.38**
Dividend / Div Yld	**$1.28 / 2.0%**
Industry	**Manufacturing - General Industrial**
Zacks Industry Rank	**Bottom 26% (187 out of 252)**
Last EPS Surprise	**2.0%**
Last Sales Surprise	**-2.7%**
EPS F1 Est- 4 week change	**1.1%**
Expected Report Date	**08/12/2020**
Earnings ESP	**-6.2%**
P/E TTM	**16.1**
P/E F1	**17.4**
PEG F1	**1.5**
P/S TTM	**0.7**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021					3,127 E
2020	856 A	833 A	831 A	745 E	3,266 E
2019	865 A	840 A	885 A	883 A	3,473 A

EPS Estimates

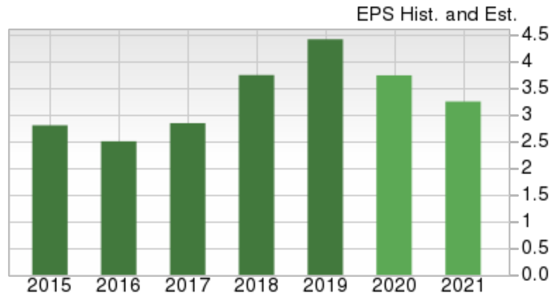
	Q1	Q2	Q3	Q4	Annual*
2021					$3.25 E
2020	$1.02 A	$0.97 A	$1.02 A	$0.73 E	$3.74 E
2019	$1.24 A	$0.99 A	$1.16 A	$1.02 A	$4.41 A

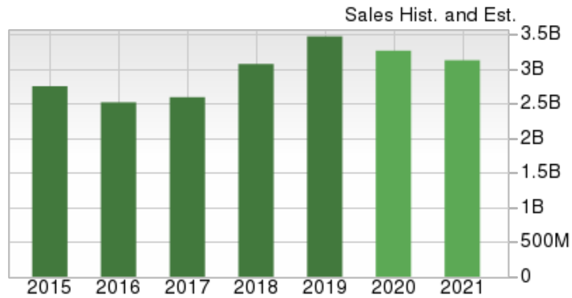
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/10/2020. The reports text is as of 06/11/2020.

Overview

Applied Industrial Technologies, Inc. is a distributor of value-added industrial products — including engineered fluid power components, bearings, specialty flow control solutions, power transmission products and miscellaneous industrial supplies. These products are mainly sold to original equipment manufacturers (OEM) and maintenance, repair, and operations (MRO) customers in Australia, North America, Singapore and New Zealand.





The company is also well known in the market for its engineering, design and systems integration services. Moreover, its inventory management solutions and maintenance training services boost the value of end users in the market. The company, founded in 1923, is currently headquartered in Cleveland, OH.

Applied Industrial reports revenues under two business segments — Service Center-Based Distribution, and Fluid Power & Flow Control. A brief discussion on the segments is provided below:

- **Service Center-Based Distribution** (69.1% of net revenues in the third quarter of fiscal 2020): The segment offers different types of industrial products majorly through service centers in New Zealand, Australia and North America.

  This segment also provides services in the oil and gas industry as well as includes operations of fabricated rubber shops (regional) and rubber service field crews. Service offerings of Applied Maintenance Supplies & Solutions come under the ambit of this segment.

- **Fluid Power & Flow Control** (30.9%): The segment includes specialized regional companies that offer fluid power components, assembling and designing of fluid power systems, and provides equipment repairing services. These products and services are traded to the end-users directly in the absence of any service centers. In addition, the segment engages in the integration of flow control system, pump repair and others.

Reasons To Buy:

- In the past three months, shares of Applied Industrial have increased 53.5% compared with the industry's growth of 24.7%. The company remains committed to rewarding shareholders handsomely through dividend payments. From fiscal 2017 to 2019, the company's dividend payments grew from $1.14 per share to $1.22. In the first three quarters of fiscal 2020, it used $36.4 million to pay out dividends to shareholders, reflecting 3.3% growth from the year-ago period. Also, the company's board of directors hiked the quarterly dividend rate by 3.2% in January 2020.

Focus on value-added services, cost-saving initiatives, gains from acquired assets and shareholder-friendly policies are likely to work well for Applied Industrial, going forward.

- Applied Industrial noted that workers' safety, cash generation, satisfaction of customers and maintaining a reliable supply chain are its priorities in the present difficult environment. Also, it has initiated certain cost-control measures — including pay reductions, lowering discretionary spending, staff adjustments and others — to mitigate some financial pressures. In the past 60 days, the company's earnings estimates have increased by 3.6% for fiscal 2020 and by 8.7% for fiscal 2021.

- Over the long term, Applied Industrial will continue focusing on improving the product line, value-added services, initiatives to drive operational excellence and cost-saving initiatives. It intends to generate revenues of more than $4.5 billion in the long term, with organic sales growth in mid-single digits. EBITDA margin is anticipated to grow to 11%. Acquired assets are likely to contribute $100 million annually. Over time, the company added multiple assets to its portfolio. In this regard, buyouts of Sentinel Fluid Controls (in March 2017), FCX Performance (in January 2018) and Fluid Power Sales (in November 2018) are worth mentioning. Further, Applied Industrial acquired MilRoc Distribution and Woodward Steel in March 2019, while added Olympus Controls to its portfolio in August 2019. In third-quarter fiscal 2020, buyouts had a positive impact of 1.9% on the company's sales. On a segmental basis, acquired assets raised sales of the Fluid Power & Flow Control segment by 5% and that of the Service Center-Based Distribution segment by 0.7%.

Reasons To Sell:

- In third-quarter fiscal 2020, Applied Industrial's earnings declined 12.1% year over year on weak sales performance and lower margin. The company noted that industry demand has been adversely impacted by the coronavirus outbreak. For fiscal 2020, the company withdrew its previously provided projections due to the pandemic-related uncertainties.

- The company's long-term debt rose 46.9% (CAGR) in the last three fiscal years (2017-2019). The balance at the end of third-quarter fiscal 2020 was $864.8 million, while its total- debt to total-capital was at 53.2% (versus 49.6% at the end of the fiscal second quarter). Though the debt balance reflects sequential decline of 1.1%, it is the company's abilities to repay financial obligations (reflected in times interest earned) that is concerning. At third-quarter end, the company's times interest earned was 3x, down from 5.7x in the fiscal second quarter and 9.4x of the industry. We believe that high-debt levels can prove detrimental to the company's margins and profitability in the quarters ahead.

- With operations across multiple continents, Applied Industrial's performance is exposed to the adverse impacts of macroeconomic cycles in the United States and international markets as well as unfavorable foreign currency movements. Forex woes had adversely impacted third-quarter sales by 0.2%.

End-market challenges caused by the coronavirus outbreak are expected to impact Applied Industrial's performance in the near term. Also, huge debts and forex woes might play spoilsports.

Last Earnings Report

Applied Industrial Q3 Earnings Top Estimates, View Weak

Quarter Ending	03/2020
Report Date	**Apr 30, 2020**
Sales Surprise	**-2.65%**
EPS Surprise	**2.00%**
Quarterly EPS	**1.02**
Annual EPS (TTM)	**4.03**

Applied Industrial reported better-than-expected results for third-quarter fiscal 2020 (ended Mar 31, 2020), with earnings surpassing estimates by 2%. However, sales lagged estimates by 2.6%.

The company's earnings in the fiscal third quarter were $1.02 per share, surpassing the Zacks Consensus Estimate of $1.00. However, quarterly earnings declined 12.1% from the year-ago quarter's figure of $1.16 on weak sales performance and a decline in margin.

Revenue Details

In the reported quarter, Applied Industrial's net sales amounted to $830.8 million, down 6.2% year over year. The results were adversely impacted by a 9.5% fall in organic sales and 0.2% impact from forex woes, partially offset by 1.9% gain from acquired assets and 1.6% extra day-related benefit.

The company noted that it continues to serve many industries in the present uncertain environment. However, industrial demand suffered in the quarter due to the pandemic.

Also, the company's top line lagged the Zacks Consensus Estimate of $853.4 million.

The company reports revenues under two market segments. A brief discussion of the quarterly results is provided below:

Service Center-Based Distribution's revenues totaled $574.4 million, which contributed 69.1% to net revenues in the quarter under review. On a year-over-year basis, the segment's revenues declined 8.9%. Organic sales declined 10.9% and unfavorable movements in foreign currencies had adverse impact of 0.3%. This was partially offset by 1.6% gain from selling days and 0.7% benefit from acquisitions.

Weakness in mining, machinery, oil & gas, transportation, and metals end markets affected the segment's results. Internationally, business was weak in Mexico and Canada.

The **Fluid Power & Flow Control** segment generated revenues of $256.4 million, contributing 30.9% to net revenues in the reported quarter. The figure increased 0.5% year over year, driven by 5% gain from acquisitions and 1.6% gain from selling days, partially offset by a 6% decline in organic sales.

Organic sales suffered from weak OEM activities in industrial markets and softness in the flow control market. Project activity was also weak in the quarter.

Margin Profile

In the reported quarter, Applied Industrial's cost of sales declined 5.7% year over year to $594 million. Cost of sales was 71.5% of the quarter's net sales. Adjusted gross profit in the quarter decreased 6.1% year over year to $240.7 million, while adjusted gross margin rose 10 basis points (bps) year over year to 29%.

Selling, distribution and administrative expenses (including depreciation) decreased 3% year over year to $183.7 million. It represented 22.1% of net sales in the reported quarter versus 21.4% in the year-ago quarter. Adjusted earnings before interest, tax, depreciation and amortization (EBITDA) were $75.9 million, reflecting a year-over-year decline of 10.3%. Margin decreased 50 bps year over year to 9.1%.

Interest expenses declined 11.5% year over year to $8.8 million. Adjusted income tax rate in the quarter was 23.3% versus 24.4% in the year-ago quarter.

Balance Sheet & Cash Flow

Exiting the third quarter of fiscal 2020, Applied Industrial had cash and cash equivalents of $165.5 million, up 29.2% from $128.1 million recorded in the last reported quarter. Long-term debt decreased 1.1% sequentially to $864.8 million.

During the first nine months of fiscal 2020, long-term debt repaid totaled $39.8 million, while borrowings (long-term) were $25 million.

The company generated net cash of $169.6 million from operating activities in the first three quarters of fiscal 2020, up 119.8% from $77.2 million generated in the year-ago period. Capital spent on property purchase totaled $16.2 million compared with $11.7 million in the previous year's first three quarters. Free cash flow was $153.4 million compared with $65.5 million in the year-ago comparable period.

Applied Industrial rewarded shareholders with a dividend payout of $36.4 million in the first three quarters of fiscal 2020. The amount represents growth of 3.3% year over year.

Outlook

Applied Industrial noted that worker's safety, cash generation, satisfaction of customers and maintaining a reliable supply chain are its priorities. Also, certain cost-control measures — including pay reductions, lowering discretionary spending, staff adjustments and others — have been taken to mitigate some financial pressures.

However, industry demand has been adversely impacted by the coronavirus outbreak (with an organic sales decline in April).

The company suspended its projections for fiscal 2020 (ending June 2020) due to the uncertainties caused by the pandemic.

Recent News

Dividend

On **May 29, 2020**, Applied Industrial paid a quarterly cash dividend of 32 cents per share to shareholders of record as of May 15.

Valuation

Shares of Applied Industrial have decreased 2.7% in the year-to-date period and increased 13.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector declined 10% and 7.5% in the year-to-date period, respectively. In a year, the Zacks sub-industry and the sector declined 1.2% and 0.4%, respectively.

The S&P 500 Index has moved down 0.5% year to date and increased 11.3% in the past year.

The stock is currently trading at 19.87X forward 12-month earnings per share, which compares to 28.35X for the Zacks sub-industry, 23.25X for the Zacks sector and 23.18X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 24.14X and as low as 7.05X, with a 5-year median of 15.84X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our price target of $68 reflects 20.86X forward 12-month earnings per share.

The table below shows summary valuation data for AIT.

Valuation Multiples - AIT

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	19.87	28.35	23.25	23.18
	5-Year High	24.14	28.35	23.25	23.18
	5-Year Low	7.05	15.6	12.55	15.23
	5-Year Median	15.84	19.48	16.66	17.49
EV/EBITDA F12M	Current	12.38	18.89	20.66	14.17
	5-Year High	12.99	18.89	20.66	14.17
	5-Year Low	6.47	8.2	10.6	9.01
	5-Year Median	9.8	11.12	14.15	10.94
EV/Sales F12M	Current	1.08	3.94	3.4	3.38
	5-Year High	1.32	3.94	3.4	3.51
	5-Year Low	0.62	1.81	1.76	2.28
	5-Year Median	0.89	2.6	2.32	2.82

As of 06/10/2020

Industry Analysis **Zacks Industry Rank:** Bottom 26% (187 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
DXP Enterprises, Inc. **(DXPE)**	Neutral	3
Fastenal Company **(FAST)**	Neutral	3
W.W. Grainger, Inc. **(GWW)**	Neutral	3
IDEX Corporation **(IEX)**	Neutral	3
Ingersoll Rand Inc. **(IR)**	Neutral	2
MSC Industrial Direct Company, Inc. **(MSM)**	Neutral	2
ParkOhio Holdings Corp. **(PKOH)**	Neutral	3
Genuine Parts Company **(GPC)**	Underperform	3

Industry Comparison Industry: Manufacturing - General Industrial

Industry Peers

	AIT	X Industry	S&P 500	DXPE	GPC	GWW
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	1	-	-	3	3	3
VGM Score	A	-	-	C	B	A
Market Cap	2.51 B	1.22 B	22.63 B	365.16 M	12.77 B	17.16 B
# of Analysts	2	3	14	2	6	11
Dividend Yield	1.97%	0.00%	1.87%	0.00%	3.57%	1.80%
Value Score	A	-	-	B	B	B
Cash/Price	0.06	0.09	0.06	0.08	0.03	0.09
EV/EBITDA	9.69	12.11	12.91	6.60	12.47	12.50
PEG Ratio	1.45	3.41	3.07	NA	14.91	2.31
Price/Book (P/B)	3.03	1.74	3.09	1.04	3.76	8.45
Price/Cash Flow (P/CF)	9.33	10.01	12.15	5.75	10.85	14.56
P/E (F1)	17.41	27.84	22.10	20.92	22.36	21.99
Price/Sales (P/S)	0.74	1.18	2.40	0.29	0.66	1.47
Earnings Yield	5.74%	3.30%	4.30%	4.81%	4.47%	4.55%
Debt/Equity	1.04	0.50	0.76	0.80	1.03	1.63
Cash Flow ($/share)	6.96	2.49	7.01	3.58	8.16	22.04
Growth Score	A	-	-	D	C	A
Hist. EPS Growth (3-5 yrs)	14.14%	11.57%	10.87%	11.80%	5.53%	10.63%
Proj. EPS Growth (F1/F0)	-15.31%	-34.06%	-10.71%	-49.74%	-30.43%	-15.59%
Curr. Cash Flow Growth	35.35%	5.37%	5.46%	-0.72%	10.00%	-1.82%
Hist. Cash Flow Growth (3-5 yrs)	13.96%	5.59%	8.55%	-21.68%	6.64%	2.17%
Current Ratio	2.60	2.19	1.29	2.79	1.21	3.28
Debt/Capital	51.01%	33.61%	44.75%	44.53%	50.77%	61.94%
Net Margin	0.99%	4.65%	10.54%	2.74%	3.11%	6.56%
Return on Equity	17.40%	11.37%	16.08%	10.06%	21.54%	45.00%
Sales/Assets	1.44	0.76	0.55	1.59	1.32	1.86
Proj. Sales Growth (F1/F0)	-5.97%	-9.37%	-2.59%	-9.50%	-8.17%	-1.93%
Momentum Score	A	-	-	D	B	A
Daily Price Chg	-2.78%	-1.59%	-1.68%	-12.28%	-3.44%	-1.68%
1 Week Price Chg	15.43%	10.45%	7.51%	38.46%	10.63%	4.27%
4 Week Price Chg	33.18%	22.83%	16.99%	73.59%	25.32%	17.50%
12 Week Price Chg	102.75%	40.78%	37.11%	84.14%	33.40%	36.03%
52 Week Price Chg	13.69%	-12.39%	0.02%	-39.72%	-13.60%	16.66%
20 Day Average Volume	202,738	88,186	2,620,901	159,848	838,545	328,951
(F1) EPS Est 1 week change	1.08%	0.00%	0.00%	0.00%	0.55%	1.01%
(F1) EPS Est 4 week change	1.08%	0.00%	0.00%	-40.12%	-0.84%	0.18%
(F1) EPS Est 12 week change	-13.14%	-34.72%	-15.86%	-55.02%	-32.47%	-21.25%
(Q1) EPS Est Mthly Chg	5.84%	0.00%	0.00%	0.00%	2.70%	3.64%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	A
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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