

Applied Industrial (AIT)

\$64.15 (As of 08/13/20)

Price Target (6-12 Months): **\$67.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 07/24/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: B

Growth: A

Momentum: A

Summary

Applied Industrial remains focused on improving its product line and providing value-added services to its wide customer base. Also, driving operational excellence and saving on costs remain its priorities. In fourth-quarter fiscal 2020, the company's earnings surpassing estimates by 17.65%, while declined 21.6% year over year on weak sales performance and a decline in margin. For fiscal 2021, it refrained for providing projections due to the pandemic-related uncertainties. Sales in the first quarter are expected to decline 17-18% year over year. Huge debt levels and weak free cash generation can be detrimental in the quarters ahead. In addition, foreign-exchange headwinds might adversely impact its performance. In the past three months, Applied Industrial's shares have underperformed the industry.

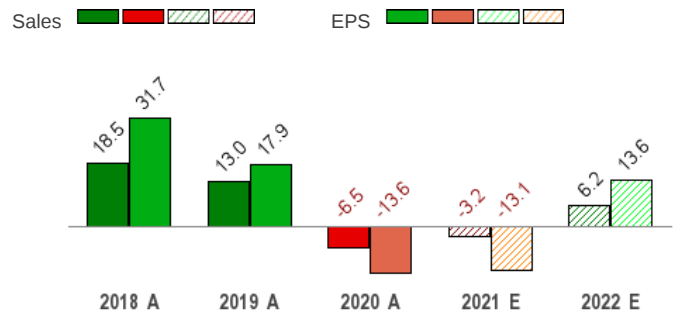
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$70.62 - \$30.66
20 Day Average Volume (sh)	145,929
Market Cap	\$2.5 B
YTD Price Change	-3.8%
Beta	1.35
Dividend / Div Yld	\$1.28 / 2.0%
Industry	Manufacturing - General Industrial
Zacks Industry Rank	Bottom 36% (162 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	17.7%
Last Sales Surprise	-3.5%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	11/04/2020
Earnings ESP	0.0%
P/E TTM	16.8
P/E F1	19.4
PEG F1	1.6
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022					3,335 E
2021					3,141 E
2020	856 A	833 A	831 A	725 A	3,246 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.80 E	\$0.83 E	\$0.96 E	\$1.04 E	\$3.76 E
2021	\$0.59 E	\$0.60 E	\$0.74 E	\$0.85 E	\$3.31 E
2020	\$1.02 A	\$0.97 A	\$1.02 A	\$0.80 A	\$3.81 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 08/13/2020. The reports text is as of 08/14/2020.

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.

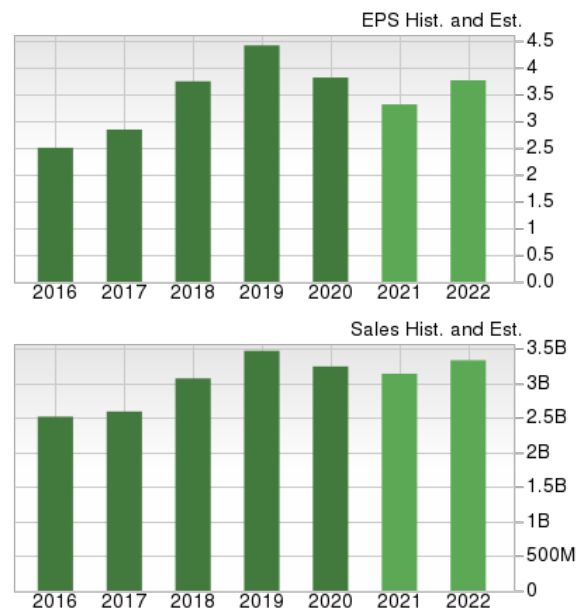
The company is also well known in the market for its engineering, design and systems integration services. Moreover, its inventory management solutions and maintenance training services boost the value of end users in the market. The company, founded in 1923, is currently headquartered in Cleveland, 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** (67.4% of net revenues in the fourth quarter of fiscal 2020) 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** (32.6%) 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:

- ▲ 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. Also, 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. EBITDA margin is anticipated to grow to 11%.
- ▲ Applied Industrial 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 fiscal 2020, it used \$48.9 million to pay out dividends to shareholders, reflecting 3.4% growth from the previous year. It is worth noting here that the company hiked the quarterly dividend rate by 3.2% in January 2020.
- ▲ Over time, Applied Industrial 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. Notably, the automation solutions offered by Olympus Controls are proving beneficial amid the pandemic. In fourth-quarter fiscal 2020, buyouts had a positive impact of 1.5% on the company's sales. For the Fluid Power & Flow Control segment, acquired assets raised sales by 5% year over year.

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.

Reasons To Sell:

- ▼ In the past three months, Applied Industrial's shares have gained 28% compared with the industry's growth of 30.7%. In fourth-quarter fiscal 2020, the company's earnings declined 21.6% year over year on weak sales performance and lower margin. It noted that industry demand has been adversely impacted by the coronavirus outbreak. For fiscal 2021, the company refrained from providing financial projections due to the prevailing pandemic-related uncertainties. For the first quarter, it expects a year-over-year organic sales decline of 17-18%. Organic sales decline of mid-teens is expected for the Fluid Power & Flow Control segment and in high-teens for the Service Center-Based Distribution segment.
- ▼ The company's long-term debt rose 21.3% (CAGR) in the last five fiscal years (2016-2020). The balance at the end of fourth-quarter fiscal 2020 was \$855.1 million, while its net leverage was at 2.3x. This compares favourably with long-term debt of \$864.8 million and net leverage of 2.5x at the end of third-quarter fiscal 2020. Despite this, we find the company's ability to address financial obligations concerning. The company's times interest earned in the first quarter was at 2.5x, down from 3.0x at the end of the third quarter. Its cash and cash equivalents were just \$268.6 million exiting fourth-quarter fiscal 2020, while its net cash from operating activities was \$296.7 million. We believe that high-debt levels and weak abilities to repay debts can prove detrimental to the company's margins and profitability in the quarters ahead. It expects seasonality to hurt its free cash flow generation in the first half of fiscal 2021.
- ▼ 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 fourth-quarter sales by 1%.

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

Last Earnings Report

Applied Industrial Q4 Earnings Top Estimates, Sales Lag

Applied Industrial reported mixed results for fourth-quarter fiscal 2020 (ended Jun 30, 2020), with earnings surpassing estimates by 17.65%. However, sales lagged estimates by 3.48%.

The company's earnings in the fiscal fourth quarter were 80 cents per share, surpassing the Zacks Consensus Estimate of 68 cents. However, quarterly earnings declined 21.6% from the year-ago quarter's figure of \$1.02 on weak sales performance and a decline in margin.

For fiscal 2020, the company's adjusted earnings per share were \$3.81, lower than the year-ago number of \$4.41. However, the bottom line surpassed the Zacks Consensus Estimate of \$3.69.

Quarter Ending 06/2020

Report Date	Aug 12, 2020
Sales Surprise	-3.48%
EPS Surprise	17.65%
Quarterly EPS	0.80
Annual EPS (TTM)	3.81

Revenue Details

In the reported quarter, Applied Industrial's net sales amounted to \$725.1 million, down 17.9% year over year. The results were adversely impacted by an 18.4% fall in organic sales and a 1% impact from forex woes, partially offset by a 1.5% gain from acquired assets.

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, its top line lagged the Zacks Consensus Estimate of \$751.3 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 \$488.6 million, which contributed 67.4% to net revenues in the quarter under review. On a year-over-year basis, the segment's revenues declined 22.3%. Organic sales declined 21.1% and unfavorable movements in foreign currencies had an adverse impact of 1.2%.

Weakness in mining, machinery, oil & gas, transportation, and metals end markets affected the segment's results.

The Fluid Power & Flow Control segment generated revenues of \$236.4 million, contributing 32.6% to net revenues in the reported quarter. The figure decreased 6.8% year over year due to an 11.8% decline in organic sales, partially offset by a 5% gain from acquisitions.

The results suffered from weakness in the flow-control end market as well as a soft demand in off-highway mobile and fluid power industrial applications. Project activity too was down in the quarter. The headwinds were partially offset by an improvement in technology end markets.

For fiscal 2020, the company's net sales were \$3,245.7 million, decreasing 6.5% year over year. However, the top line lagged the Zacks Consensus Estimate of \$3.27 billion.

Margin Profile

In the reported quarter, Applied Industrial's cost of sales declined 17.4% year over year to \$516.8 million. Cost of sales was 71.3% of the quarter's net sales. Gross profit in the quarter decreased 19.1% year over year to \$208.3 million, while gross margin fell 43 basis points (bps) year over year to 28.7%.

Selling, distribution and administrative expenses (including depreciation) decreased 13.8% year over year to \$159.7 million. It represented 22% of net sales in the reported quarter versus 21% in the year-ago quarter. Adjusted earnings before interest, tax, depreciation and amortization (EBITDA) were \$64.8 million, reflecting a year-over-year decline of 26%. Margin decreased 98 bps year over year to 8.9%.

Interest expenses declined 20.6% year over year to \$8.1 million. Adjusted income tax rate in the quarter was 25.2%.

Balance Sheet & Cash Flow

Exiting the fourth quarter of fiscal 2020, Applied Industrial had cash and cash equivalents of \$268.6 million, up 62.3% from \$165.5 million recorded in the last reported quarter. Long-term debt decreased 1.1% sequentially to \$855.1 million.

During the year, the company repaid long-term debts of \$49.6 million, while borrowings (long-term) were \$25 million.

The company generated net cash of \$296.7 million from operating activities in fiscal 2020, reflecting an increase of 64.3% from the previous year. Capital spent on property purchase totaled \$20.1 million compared with \$19 million in the previous year. Free cash flow increased 71.1% year over year to \$276.6 million.

Applied Industrial rewarded shareholders with a dividend payout of \$48.9 million in fiscal 2020. The amount represents growth of 3.4% year over year.

Outlook

In the quarters ahead, the company anticipates gaining from its growth initiatives and cost-control measures. For the first quarter of fiscal 2021 (ending September 2020), it expects organic sales to decline 17-18% on a year-over-year basis.

For fiscal 2021 (ending June 2021), the company did not provide financial projections due to the uncertainties related to 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 Applied Industrial have decreased 3.8% in the year-to-date period and increased 22.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector declined 1.9% and 0.9% in the year-to-date period, respectively. In a year, the Zacks sub-industry grew 14.4%, while the sector increased 17.4%.

The S&P 500 index has increased 4.6% on a year-to-date basis and 18.6% in the past year.

The stock is currently trading at 19.06X forward 12-month earnings per share, which compares to 27.81X for the Zacks sub-industry, 22.3X for the Zacks sector and 22.87X for the S&P 500 Index.

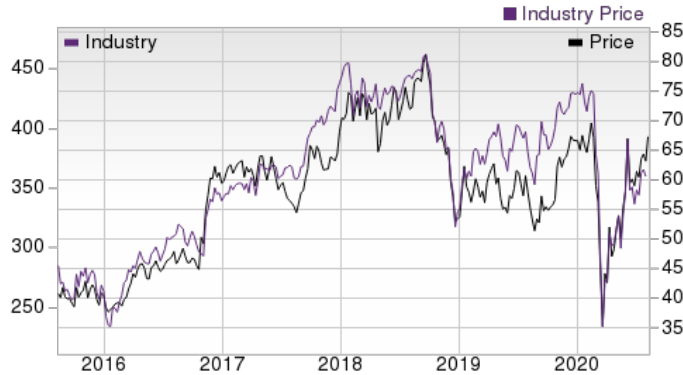
Over the past five years, the stock has traded as high as 24.14X and as low as 7.05X, with a 5-year median of 16.27X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our price target of \$67 reflects 20.01X forward 12-month earnings per share.

The table below shows summary valuation data for AIT.

Valuation Multiples - AIT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	19.06	27.81	22.3	22.87
	5-Year High	24.14	27.81	22.3	22.87
	5-Year Low	7.05	15.6	12.55	15.25
	5-Year Median	16.27	19.7	17.48	17.58
P/S F12M	Current	0.78	3.59	2.99	3.7
	5-Year High	1.04	3.59	2.99	3.7
	5-Year Low	0.35	1.58	1.52	2.53
	5-Year Median	0.72	2.25	2.04	3.05

As of 08/13/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (162 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Fastenal Company (FAST)	Neutral	3
Genuine Parts Company (GPC)	Neutral	3
W.W. Grainger, Inc. (GWW)	Neutral	3
IDEX Corporation (IEX)	Neutral	3
Ingersoll Rand Inc. (IR)	Neutral	3
MSC Industrial Direct Company, Inc. (MSM)	Neutral	3
DXP Enterprises, Inc. (DXPE)	Underperform	4
ParkOhio Holdings Corp. (PKOH)	Underperform	3

Industry Comparison Industry: Manufacturing - General Industrial				Industry Peers		
	AIT	X Industry	S&P 500	DXPE	GPC	GWW
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	4	3	3
VGM Score	A	-	-	D	A	B
Market Cap	2.48 B	1.30 B	23.58 B	365.62 M	13.61 B	18.86 B
# of Analysts	2	3	14	2	3	12
Dividend Yield	2.00%	0.00%	1.68%	0.00%	3.35%	1.74%
Value Score	B	-	-	B	B	B
Cash/Price	0.06	0.10	0.07	0.24	0.07	0.09
EV/EBITDA	9.57	13.34	13.34	5.44	12.61	13.55
PEG Ratio	1.60	3.36	2.99	NA	12.61	2.35
Price/Book (P/B)	2.94	2.02	3.20	1.02	4.74	8.76
Price/Cash Flow (P/CF)	7.19	11.75	12.83	5.74	11.56	15.98
P/E (F1)	19.18	26.89	21.99	32.39	18.91	22.56
Price/Sales (P/S)	0.77	1.25	2.53	0.31	0.75	1.62
Earnings Yield	5.16%	3.13%	4.35%	3.06%	5.29%	4.43%
Debt/Equity	1.01	0.51	0.77	0.62	1.21	1.53
Cash Flow (\$/share)	8.92	2.49	6.94	3.58	8.16	22.04
Growth Score	A	-	-	D	A	A
Hist. EPS Growth (3-5 yrs)	14.14%	10.21%	10.41%	18.18%	5.17%	11.24%
Proj. EPS Growth (F1/F0)	-13.12%	-24.67%	-6.32%	-67.60%	-12.30%	-9.73%
Curr. Cash Flow Growth	28.52%	0.16%	5.20%	-0.72%	10.00%	-1.82%
Hist. Cash Flow Growth (3-5 yrs)	13.96%	7.19%	8.55%	-21.68%	6.64%	2.17%
Current Ratio	2.72	2.06	1.33	2.70	1.22	3.54
Debt/Capital	50.34%	34.34%	44.59%	38.08%	54.83%	60.53%
Net Margin	0.74%	4.34%	10.13%	1.97%	-1.06%	5.34%
Return on Equity	16.69%	10.81%	14.51%	6.62%	21.67%	42.19%
Sales/Assets	1.38	0.75	0.51	1.49	1.27	1.77
Proj. Sales Growth (F1/F0)	-3.24%	-7.62%	-1.43%	-19.74%	-13.16%	1.63%
Momentum Score	A	-	-	F	A	C
Daily Price Chg	-5.38%	-0.44%	-0.44%	-3.25%	-2.59%	-1.05%
1 Week Price Chg	6.56%	4.95%	2.30%	11.61%	2.88%	2.30%
4 Week Price Chg	1.41%	6.33%	4.38%	7.95%	6.45%	5.63%
12 Week Price Chg	17.02%	21.24%	13.59%	35.56%	22.31%	19.17%
52 Week Price Chg	22.14%	0.00%	5.75%	-34.96%	6.20%	32.95%
20 Day Average Volume	145,929	59,201	1,984,154	119,685	698,505	341,170
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	4.98%	2.08%	-35.53%	22.91%	5.24%
(F1) EPS Est 12 week change	2.00%	3.13%	2.66%	-61.40%	25.01%	7.14%
(Q1) EPS Est Mthly Chg	NA%	2.61%	0.94%	-97.30%	37.68%	14.85%

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	B
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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