

APPLIED INDUSTRIAL TECHNOLOGIES INC
Form 10-Q
November 08, 2013
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended SEPTEMBER 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number 1-2299

APPLIED INDUSTRIAL TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Ohio	34-0117420
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

One Applied Plaza, Cleveland, Ohio	44115
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (216) 426-4000
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
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Non-accelerated filer	<input type="checkbox"/>	(Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

There were 42,164,870 (no par value) shares of common stock outstanding on October 15, 2013.

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PART I: FINANCIAL INFORMATION

ITEM I: FINANCIAL STATEMENTS

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended	
	September 30,	
	2013	2012
Net Sales	\$605,305	\$610,519
Cost of Sales	435,510	445,986
Gross Profit	169,795	164,533
Selling, Distribution and Administrative, including depreciation	130,256	120,215
Operating Income	39,539	44,318
Interest Expense, net	61	25
Other (Income) Expense, net	(1,091) (459
Income Before Income Taxes	40,569	44,752
Income Tax Expense	13,725	15,220
Net Income	\$26,844	\$29,532
Net Income Per Share - Basic	\$0.64	\$0.70
Net Income Per Share - Diluted	\$0.63	\$0.70
Cash dividends per common share	\$0.23	\$0.21
Weighted average common shares outstanding for basic computation	42,157	41,966
Dilutive effect of potential common shares	480	511
Weighted average common shares outstanding for diluted computation	42,637	42,477
See notes to condensed consolidated financial statements.		

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
 CONDENSED STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
 (Unaudited)
 (In thousands)

	Three Months Ended September 30,	
	2013	2012
Net income per the condensed statements of consolidated income	\$26,844	\$29,532
Other comprehensive income (loss), before tax:		
Foreign currency translation adjustments	550	9,001
Postemployment benefits:		
Reclassification of actuarial losses and prior service cost into SD&A expense and included in net periodic pension costs	95	218
Unrealized gain (loss) on investment securities available for sale	34	23
Total of other comprehensive income (loss), before tax	679	9,242
Income tax expense related to items of other comprehensive income	48	94
Other comprehensive income (loss), net of tax	631	9,148
Comprehensive income, net of tax	\$27,475	\$38,680

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)

	September 30, 2013	June 30, 2013
ASSETS		
Current assets		
Cash and cash equivalents	\$76,877	\$73,164
Accounts receivable, less allowances of \$7,582 and \$7,737	320,281	329,880
Inventories	302,404	281,417
Other current assets	34,174	52,819
Total current assets	733,736	737,280
Property, less accumulated depreciation of \$160,592 and \$157,506	81,149	83,243
Intangibles, net	87,961	91,267
Goodwill	106,973	106,849
Deferred tax assets	20,568	21,026
Other assets	19,702	19,041
TOTAL ASSETS	\$1,050,089	\$1,058,706
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$131,195	\$136,575
Compensation and related benefits	45,373	63,899
Other current liabilities	49,007	45,426
Total current liabilities	225,575	245,900
Postemployment benefits	25,340	30,919
Other liabilities	24,552	22,272
TOTAL LIABILITIES	275,467	299,091
Shareholders' Equity		
Preferred stock—no par value; 2,500 shares authorized; none issued or outstanding	—	—
Common stock—no par value; 80,000 shares authorized; 54,213 shares issued	10,000	10,000
Additional paid-in capital	154,492	153,893
Income retained for use in the business	841,448	824,362
Treasury shares—at cost (12,031 and 12,044 shares)	(228,528)	(225,219)
Accumulated other comprehensive income (loss)	(2,790)	(3,421)
TOTAL SHAREHOLDERS' EQUITY	774,622	759,615
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,050,089	\$1,058,706
See notes to condensed consolidated financial statements.		

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended September 30,	
	2013	2012
Cash Flows from Operating Activities		
Net income	\$26,844	\$29,532
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property	3,431	3,022
Amortization of intangibles	3,249	3,055
Unrealized foreign exchange transactions gain	(291)	(286)
Amortization of stock options and appreciation rights	636	809
Loss (gain) on sale of property	35	(117)
Other share-based compensation expense	754	1,035
Changes in assets and liabilities, net of acquisitions	(18,014)	(13,456)
Other, net	312	353
Net Cash provided by Operating Activities	16,956	23,947
Cash Flows from Investing Activities		
Property purchases	(1,571)	(3,892)
Proceeds from property sales	183	243
Net cash paid for acquisition of businesses, net of cash acquired	—	(35,409)
Net Cash used in Investing Activities	(1,388)	(39,058)
Cash Flows from Financing Activities		
Purchases of treasury shares	(3,001)	—
Dividends paid	(9,746)	(8,867)
Excess tax benefits from share-based compensation	1,516	1,168
Acquisition holdback payments	(606)	(760)
Exercise of stock options and appreciation rights	—	36
Net Cash used in Financing Activities	(11,837)	(8,423)
Effect of Exchange Rate Changes on Cash	(18)	1,765
Increase (Decrease) in Cash and Cash Equivalents	3,713	(21,769)
Cash and Cash Equivalents at Beginning of Period	73,164	78,442
Cash and Cash Equivalents at End of Period	\$76,877	\$56,673

See notes to condensed consolidated financial statements.

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share amounts) (Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position of Applied Industrial Technologies, Inc. (the “Company”, or “Applied”) as of September 30, 2013, and the results of its operations for the three month periods ended September 30, 2013 and 2012 and its cash flows for the three months ended September 30, 2013 and 2012, have been included. The condensed consolidated balance sheet as of June 30, 2013 has been derived from the audited consolidated financial statements at that date. This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended June 30, 2013.

Operating results for the three month period ended September 30, 2013 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending June 30, 2014.

Change in Accounting Principle - Alignment of Canadian Subsidiary Reporting

Effective July 1, 2013, the Company aligned the consolidation of the Company’s Canadian subsidiary in the consolidated financial statements which previously included results on a one month reporting lag. The Company believes that this change in accounting principle is preferable as it provides contemporaneous reporting within our consolidated financial statements. In accordance with applicable accounting literature, the elimination of a one month reporting lag of a subsidiary is treated as a change in accounting principle and requires retrospective application. The Company has determined that the effect of this change is not material to the financial statements for all periods presented and therefore, the Company has not presented retrospective application of this change. The net impact of the lag elimination of \$1.2 million of income for the month of June 2013 has been included within “Other (Income) Expense, net” on the Statement of Consolidated Income for the first quarter of fiscal 2014. The three months ended September 30, 2013 reflect the same results, had the financial statements been retrospectively adjusted, with the exception of net income which would have decreased \$1.2 million. Net sales, operating income and net income for the three months ended September 30, 2012, would have decreased by \$1.5 million, \$0.8 million and \$0.8 million respectively had the financial statements been retrospectively adjusted.

Inventory

The Company uses the last-in, first-out (LIFO) method of valuing U.S. inventories. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and costs and are subject to the final year-end LIFO inventory determination.

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(Amounts in thousands, except per share amounts) (Unaudited)

2. GOODWILL AND INTANGIBLES

The changes in the carrying amount of goodwill for the three month period ended September 30, 2013 are as follows:

	Service Center Based Distribution	Fluid Power Businesses	Total
Balance at July 1, 2013	\$105,920	\$929	\$106,849
Goodwill acquired during the period	—	—	—
Other, primarily currency translation	124	—	124
Balance at September 30, 2013	\$106,044	\$929	\$106,973

At September 30, 2013, accumulated goodwill impairment losses subsequent to fiscal year 2002, totaled \$36,605 and related to the Fluid Power Businesses segment.

The Company's intangible assets resulting from business combinations are amortized over their estimated period of benefit and consist of the following:

September 30, 2013	Amount	Accumulated Amortization	Net Book Value
Finite-Lived Intangibles:			
Customer relationships	\$101,009	\$41,146	\$59,863
Trade names	26,436	8,987	17,449
Vendor relationships	15,352	5,684	9,668
Non-competition agreements	3,290	2,309	981
Total Intangibles	\$146,087	\$58,126	\$87,961
June 30, 2013	Amount	Accumulated Amortization	Net Book Value
Finite-Lived Intangibles:			
Customer relationships	\$100,854	\$38,844	\$62,010
Trade names	26,690	8,643	18,047
Vendor relationships	15,433	5,443	9,990
Non-competition agreements	4,743	3,523	1,220
Total Intangibles	\$147,720	\$56,453	\$91,267

Amounts include the impact of foreign currency translation. Fully amortized amounts are written off.

Estimated future amortization expense by fiscal year (based on the Company's intangible assets as of September 30, 2013) is as follows: \$9,700 for the remainder of 2014, \$11,400 for 2015, \$10,300 for 2016, \$9,600 for 2017, \$8,400 for 2018 and \$7,500 for 2019.

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(Amounts in thousands, except per share amounts) (Unaudited)

3. FAIR VALUE MEASUREMENTS

Marketable securities measured at fair value at September 30, 2013 and June 30, 2013 totaled \$10,906 and \$10,483, respectively. These marketable securities are held in a rabbi trust for a non-qualified deferred compensation plan. The marketable securities are included in other assets on the condensed consolidated balance sheets and their fair values were derived using quoted market prices (Level 1 in the fair value hierarchy).

4. SHAREHOLDERS' EQUITY

Accumulated Other Comprehensive Income (Loss)

Changes in the accumulated other comprehensive income (loss) for the three months ended September 30, 2013, is comprised of the following:

	Foreign currency translation adjustment	Unrealized gain (loss) on securities available for sale	Postemployment benefits	Total Accumulated other comprehensive income (loss)
Balance at July 1, 2013	\$360	\$(52) \$(3,729) \$(3,421
Other comprehensive income (loss)	550	23		573
Amounts reclassified from accumulated other comprehensive income (loss)			58	58
Net current-period other comprehensive income (loss), net of taxes	550	23	58	631
Balance at September 30, 2013	\$910	\$(29) \$(3,671) \$(2,790

Other Comprehensive Income (Loss)

Details of other comprehensive income (loss) are as follows:

	Three Months Ended September 30,					
	2013			2012		
	Pre-Tax Amount	Tax Expense (Benefit)	Net Amount	Pre-Tax Amount	Tax Expense (Benefit)	Net Amount
Foreign currency translation adjustments	\$550	\$—	\$550	\$9,001	\$—	\$9,001
Postemployment benefits:						
Reclassification of actuarial losses and prior service cost into SD&A expense and included in net periodic pension costs	95	37	58	218	85	133
Unrealized gain (loss) on investment securities available for sale	34	11	23	23	9	14
Other comprehensive income (loss)	\$679	\$48	\$631	\$9,242	\$94	\$9,148

Antidilutive Common Stock Equivalents

In the three month periods ended September 30, 2013 and 2012, stock options and stock appreciation rights related to the acquisition of 272 and 221 shares of common stock, respectively, were not included in the computation of diluted earnings per share for the periods then ended as they were anti-dilutive.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except per share amounts) (Unaudited)

5. BENEFIT PLANS

The following table provides summary disclosures of the net periodic postemployment costs recognized for the Company's postemployment benefit plans:

Three Months Ended September 30,	Pension Benefits		Retiree Health Care Benefits	
	2013	2012	2013	2012
Components of net periodic cost:				
Service cost	\$19	\$19	\$12	\$20
Interest cost	295	315	35	47
Expected return on plan assets	(104) (101)	
Recognized net actuarial loss (gain)	153	184	(9) (13
Amortization of prior service cost	20	21	(68) 27
Net periodic cost	\$383	\$438	\$(30) \$81

The Company contributed \$5,108 to its pension benefit plans and \$50 to its retiree health care plans in the three months ended September 30, 2013. Expected contributions for the remainder of fiscal 2014 are \$1,600 for the pension benefit plans to fund scheduled retirement payments and \$200 for retiree health care plans.

6. SEGMENT AND GEOGRAPHIC INFORMATION

The accounting policies of the Company's reportable segments are generally the same as those used to prepare the condensed consolidated financial statements. Sales primarily from the Fluid Power Businesses segment to the Service Center Based Distribution segment of \$5,533 and \$3,735, in the three months ended September 30, 2013 and 2012, respectively, have been eliminated in the Segment Financial Information tables below.

Three Months Ended	Service Center Based Distribution	Fluid Power Businesses	Total
September 30, 2013			
Net sales	\$492,072	\$113,233	\$605,305
Operating income for reportable segments	28,372	9,457	37,829
Assets used in business	841,770	208,319	1,050,089
Depreciation and amortization of property	2,999	432	3,431
Capital expenditures	1,394	177	1,571
September 30, 2012			
Net sales	\$497,826	\$112,693	\$610,519
Operating income for reportable segments	33,720	10,536	44,256
Assets used in business	787,028	214,739	1,001,767
Depreciation and amortization of property	2,564		