

APPLIED INDUSTRIAL TECHNOLOGIES INC

Form 10-Q

May 01, 2008

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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 MARCH 31, 2008

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Check One:

Large accelerated filer: Accelerated filer: Non-accelerated filer: Smaller reporting company:

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Shares of common stock outstanding on April 15, 2008

42,295,684

(No par value)

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
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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 March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net Sales	\$ 530,156	\$ 521,129	\$ 1,559,711	\$ 1,486,084
Cost of Sales	385,656	380,557	1,133,664	1,080,227
	144,500	140,572	426,047	405,857
Selling, Distribution and Administrative, including Depreciation	106,815	106,467	311,878	309,446
Operating Income	37,685	34,105	114,169	96,411
Interest Expense, net	241	749	516	2,006
Other Expense (Income), net	162	(308)	553	(1,097)
Income Before Income Taxes	37,282	33,664	113,100	95,502
Income Taxes	13,687	11,967	42,081	34,120
Net Income	\$ 23,595	\$ 21,697	\$ 71,019	\$ 61,382
Net Income Per Share Basic	\$ 0.55	\$ 0.50	\$ 1.65	\$ 1.40
Net Income Per Share Diluted	\$ 0.55	\$ 0.49	\$ 1.62	\$ 1.37
Cash dividends per common share	\$ 0.15	\$ 0.12	\$ 0.45	\$ 0.36
Weighted average common shares outstanding for basic computation	42,558	43,616	42,963	43,810
Dilutive effect of stock options and awards	701	798	788	875
Weighted average common shares outstanding for diluted computation	43,259	44,414	43,751	44,685

See notes to condensed consolidated financial statements.

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollar amounts in thousands)

	March 31, 2008	June 30, 2007
ASSETS		
Current assets		
Cash and cash equivalents	\$ 70,580	\$ 119,665
Accounts receivable, less allowances of \$6,390 and \$6,134	244,863	248,698
Inventories	219,265	199,886
Other current assets	34,407	32,284
Total current assets	569,115	600,533
Property, less accumulated depreciation of \$124,801 and \$119,006	65,158	67,788
Goodwill	61,760	57,550
Other assets	56,634	51,498
TOTAL ASSETS	\$ 752,667	\$ 777,369
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	\$ 85,928	\$ 97,166
Long-term debt payable within one year		50,395
Compensation and related benefits	53,292	59,536
Other accrued liabilities	32,579	27,913
Total current liabilities	171,799	235,010
Long-term debt	25,000	25,000
Postemployment benefits	38,377	36,552
Other liabilities	34,712	29,824
TOTAL LIABILITIES	269,888	326,386
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	131,848	127,569
Income retained for use in the business	525,601	473,899
Treasury shares at cost, 11,940 and 11,097 shares	(190,763)	(159,803)
Accumulated other comprehensive income (loss)	6,093	(682)
TOTAL SHAREHOLDERS EQUITY	482,779	450,983
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 752,667	\$ 777,369

See notes to condensed consolidated financial statements.

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

	Nine Months Ended March 31,	
	2008	2007
Cash Flows from Operating Activities		
Net income	\$ 71,019	\$ 61,382
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,081	10,208
Share-based compensation and amortization of intangibles	3,849	3,889
Gain on sale of property	(1,192)	(349)
Treasury shares contributed to employee benefit and deferred compensation plans	683	1,778
Changes in operating assets and liabilities, net of acquisitions	(22,117)	(43,561)
Other net	627	(1,692)
 Net Cash provided by Operating Activities	 61,950	 31,655
 Cash Flows from Investing Activities		
Property purchases	(6,108)	(8,125)
Proceeds from property sales	1,881	999
Net cash paid for acquisition of businesses	(11,128)	
Other	(78)	(229)
 Net Cash used in Investing Activities	 (15,433)	 (7,355)
 Cash Flows from Financing Activities		
Long-term debt repayment	(50,000)	
Purchases of treasury shares	(33,224)	(33,988)
Dividends paid	(19,382)	(15,799)
Excess tax benefits from share-based compensation	3,153	2,714
Exercise of stock options	1,458	2,323
 Net Cash used in Financing Activities	 (97,995)	 (44,750)
 Effect of exchange rate changes on cash	 2,393	 (960)
 Decrease in cash and cash equivalents	 (49,085)	 (21,410)
Cash and cash equivalents at beginning of period	119,665	106,428
 Cash and Cash Equivalents at End of Period	 \$ 70,580	 \$ 85,018

See notes to condensed consolidated financial statements.

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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 for interim financial information and with the instructions to Form 10-Q and Regulation S-X. The Condensed Consolidated Balance Sheet as of June 30, 2007 has been derived from the audited consolidated financial statements at that date. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States 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) as of March 31, 2008, and the results of operations and cash flows for the three and nine month periods ended March 31, 2008 and 2007, have been included. 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, 2007.

Operating results for the three and nine month periods ended March 31, 2008 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending June 30, 2008.

Cost of sales for interim financial statements are computed using estimated gross profit percentages, which are adjusted throughout the year, based upon available information. Adjustments to actual cost are made based on periodic physical inventories and the effect of year-end inventory quantities on LIFO costs.

During the periods presented, the following common stock equivalents were outstanding but excluded from the diluted earnings per share computation as their effect was antidilutive:

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2008	2007	2008	2007
Weighted average antidilutive common stock equivalents	242	499	229	443

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

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

2. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements , (SFAS 157). This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States, and expands disclosures about fair value measurements. The provisions of SFAS 157 apply under other accounting pronouncements that require or permit fair value measurements; it does not expand the use of fair value in any new circumstances. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007. At the February 6, 2008 FASB meeting, they agreed to defer for one year the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). The impact of SFAS 157 on the Company s consolidated financial statements has not been determined.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities , (SFAS 159). This statement permits companies to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The impact on the Company s consolidated financial statements has not been determined.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations , (SFAS 141(R)), which replaces SFAS 141. SFAS 141(R) requires most assets acquired and liabilities assumed in a business combination, contingent consideration, and certain acquired contingencies to be measured at their fair values as of the date of acquisition. SFAS 141(R) also requires that acquisition related costs and restructuring costs be recognized separately from the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008 and will be effective for business combinations entered into after July 1, 2009.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 , (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. It requires enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts) (Unaudited)

3. SEGMENT INFORMATION

The accounting policies of the Company's reportable segments are the same as those used to prepare the condensed consolidated financial statements. Sales between the service center based distribution and the fluid power businesses segments are not significant.

Segment Financial Information:

	Service Center Based Distribution	Fluid Power Businesses	Total
Three Months Ended March 31, 2008			
Net sales	\$ 472,487	\$ 57,669	\$ 530,156
Operating income	32,176	4,474	36,650
Depreciation	2,663	338	3,002
Capital expenditures	2,247	112	2,359
Three Months Ended March 31, 2007			
Net sales	\$ 469,115	\$ 52,014	\$ 521,129
Operating income	33,749	3,163	36,912
Depreciation	3,266	335	3,601
Capital expenditures	2,402	366	2,768

Reconciliation from the segment operating profit to the condensed consolidated balances is as follows:

	Three Months Ended March 31,	
	2008	2007
Operating income for reportable segments	\$ 36,650	\$ 36,912
Adjustments for:		
Intangible amortization	436	136
Corporate and other (income) expense, net (a)	(1,471)	2,671
Total operating income	37,685	34,105
Interest expense, net	241	749
Other expense (income), net	162	(308)
Income before income taxes	\$ 37,282	\$ 33,664

(a) The change in corporate and other expense, net is due to various changes in the levels and

amounts of
expenses being
allocated to the
segments. The
expenses being
allocated
include
miscellaneous
corporate
charges for
working capital,
logistics support
and other items.

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except per share amounts) (Unaudited)

	Service Center Based Distribution	Fluid Power Businesses	Total
Nine Months Ended March 31, 2008			
Net sales	\$ 1,397,567	\$ 162,144	\$ 1,559,711
Operating income	92,389	12,040	104,429
Assets used in business	668,106	84,561	752,667
Depreciation	8,079	1,002	9,081
Capital expenditures	5,738	370	6,108
Nine Months Ended March 31, 2007			
Net sales	\$ 1,334,258	\$ 151,826	\$ 1,486,084
Operating income	89,629	9,527	99,156
Assets used in business	677,987	63,015	741,002
Depreciation	9,194	1,014	10,208
Capital expenditures	7,230	895	8,125

Reconciliation from the segment operating profit to the condensed consolidated balances is as follows:

	Nine Months Ended March 31,	
	2008	2007
Operating income for reportable segments	\$ 104,429	\$ 99,156
Adjustments for:		
Intangible amortization	1,127	414
Corporate and other (income) expense, net (a)	(10,867)	2,331
Total operating income	114,169	96,411
Interest expense, net	516	2,006
Other expense (income), net	553	(1,097)
Income before income taxes	\$ 113,100	\$ 95,502

- (a) The change in corporate and other expense, net is due to various changes in the levels and amounts of expenses being allocated to the segments. The expenses being allocated include miscellaneous corporate charges for working capital, logistics support and other items.

Net sales by geographic location are as follows:

Three Months Ended March 31,		Nine Months Ended March 31,	
2008	2007	2008	2007

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Geographic Location:

United States	\$ 471,410	\$ 467,132	\$ 1,377,346	\$ 1,314,555
Canada	51,327	48,623	163,032	153,726
Other	7,419	5,374	19,333	17,803
Total	\$ 530,156	\$ 521,129	\$ 1,559,711	\$ 1,486,084

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

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

4. COMPREHENSIVE INCOME

The components of comprehensive income are as follows:

	Three Months Ended	
	March 31,	
	2008	2007
Net income	\$ 23,595	\$ 21,697
Other comprehensive income (loss):		
Unrealized gain (loss) on cash flow hedge, net of income tax of \$660 and \$(280)	1,027	(435)
Foreign currency translation adjustment, net of income tax of \$173 and \$(219)	1,482	(1,311)
Unrealized gain on investment securities available for sale, net of income tax of \$26 and \$18	43	26
Total comprehensive income	\$ 26,147	\$ 19,977
	Nine Months Ended	
	March 31,	
	2008	2007
Net income	\$ 71,019	\$ 61,382
Other comprehensive income (loss):		
Unrealized gain (loss) on cash flow hedge, net of income tax of \$715 and \$(206)	1,112	(321)
Foreign currency translation adjustment, net of income tax of \$938 and \$(631)	5,647	(2,746)
Unrealized gain on investment securities available for sale, net of income tax of \$9 and \$28	16	45
Total comprehensive income	\$ 77,794	\$ 58,360

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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 benefit costs recognized for the Company's postemployment benefit plans:

Three Months Ended March 31,	Pension Benefits		Other Benefits	
	2008	2007	2008	2007
Components of net periodic benefit cost:				
Service cost	\$ 523	\$ 410	\$ 18	\$ 14
Interest cost	603	502	67	56
Expected return on plan assets	(117)	(104)		
Recognized net actuarial loss (gain)	240	207	(28)	(28)
Amortization of prior service cost	159	150	30	12
Net periodic pension cost	\$ 1,408	\$ 1,165	\$ 87	\$ 54