

APPLIED INDUSTRIAL TECHNOLOGIES INC  
Form 10-Q  
May 02, 2012  
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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended MARCH 31, 2012

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

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

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

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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  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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

There were 42,197,088 (no par value) shares of common stock outstanding on April 13, 2012.



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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 |           | Nine Months Ended |             |
|--|--------------------|-----------|-------------------|-------------|
|  | March 31,          |           | March 31,         |             |
|  | 2012               | 2011      | 2012              | 2011        |
| Net Sales  | \$605,461          | \$565,970 | \$1,755,432       | \$1,622,988 |
| Cost of Sales  | 437,848            | 409,404   | 1,273,646         | 1,179,021   |
| Gross Profit   | 167,613            | 156,566   | 481,786           | 443,967     |
| Selling, Distribution and Administrative, including depreciation   | 125,594            | 118,365   | 363,165           | 337,819     |
| Operating Income   | 42,019             | 38,201    | 118,621           | 106,148     |
| Interest Expense, net  | 54                 | 52        | 111               | 1,634       |
| Other (Income) Expense, net  | (1,887             | ) (2,645  | ) 823             | (3,409      |
| Income Before Income Taxes   | 43,852             | 40,794    | 117,687           | 107,923     |
| Income Tax Expense   | 14,434             | 14,258    | 40,952            | 39,439      |
| Net Income   | \$29,418           | \$26,536  | \$76,735          | \$68,484    |
| Net Income Per Share - Basic                                       | \$0.70             | \$0.63    | \$1.82            | \$1.61      |
| Net Income Per Share - Diluted                                     | \$0.69             | \$0.61    | \$1.79            | \$1.58      |
| Cash dividends per common share                                    | \$0.21             | \$0.17    | \$0.59            | \$0.51      |
| Weighted average common shares outstanding for basic computation   | 42,109             | 42,446    | 42,157            | 42,409      |
| Dilutive effect of potential common shares                         | 670                | 893       | 681               | 845         |
| Weighted average common shares outstanding for diluted computation | 42,779             | 43,339    | 42,838            | 43,254      |

See notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS(Unaudited)  
(In thousands)

|   | March 31,<br>2012 | June 30,<br>2011 |
|---|-------------------|------------------|
| <b>ASSETS</b>   |                   |                  |
| Current assets  |                   |                  |
| Cash and cash equivalents   | \$79,408          | \$91,092         |
| Accounts receivable, less allowances of \$8,570 and \$7,016                       | 307,660           | 290,751          |
| Inventories   | 230,035           | 204,066          |
| Other current assets  | 31,897            | 33,005           |
| Total current assets  | 649,000           | 618,914          |
| Property, less accumulated depreciation of \$147,944 and \$143,930                | 78,464            | 69,014           |
| Intangibles, net  | 88,768            | 89,551           |
| Goodwill  | 84,690            | 76,981           |
| Deferred tax assets   | 34,752            | 43,447           |
| Other assets  | 18,662            | 17,024           |
| <b>TOTAL ASSETS</b>   | <b>\$954,336</b>  | <b>\$914,931</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                       |                   |                  |
| Current liabilities   |                   |                  |
| Accounts payable  | \$124,614         | \$108,509        |
| Compensation and related benefits   | 56,234            | 65,413           |
| Other current liabilities   | 44,847            | 40,766           |
| Total current liabilities   | 225,695           | 214,688          |
| Postemployment benefits   | 35,274            | 47,730           |
| Other liabilities   | 21,158            | 18,950           |
| <b>TOTAL LIABILITIES</b>  | <b>282,127</b>    | <b>281,368</b>   |
| 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  | 149,943           | 148,307          |
| Income retained for use in the business   | 720,202           | 668,421          |
| Treasury shares—at cost (12,017 and 11,611 shares)                                | (215,394)         | (198,224)        |
| Accumulated other comprehensive income  | 7,458             | 5,059            |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>   | <b>672,209</b>    | <b>633,563</b>   |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                 | <b>\$954,336</b>  | <b>\$914,931</b> |
| See notes to condensed consolidated financial statements.                         |                   |                  |

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CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(Unaudited)

(In thousands)

|   | Nine Months Ended |           |
|---|-------------------|-----------|
|   | March 31,         |           |
|   | 2012              | 2011      |
| Cash Flows from Operating Activities  |                   |           |
| Net income  | \$76,735          | \$68,484  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |           |
| Depreciation and amortization of property   | 8,388             | 8,466     |
| Amortization of intangibles   | 8,455             | 8,468     |
| Amortization of stock options and appreciation rights                             | 1,810             | 2,169     |
| Gain on sale of property  | (626)             | (687)     |
| Other share-based compensation expense  | 3,470             | 3,103     |
| Changes in assets and liabilities, net of acquisitions                            | (39,625)          | (29,275)  |
| Other, net  | 3,364             | 3,254     |
| Net Cash provided by Operating Activities   | 61,971            | 63,982    |
| Cash Flows from Investing Activities  |                   |           |
| Property purchases  | (18,295)          | (16,446)  |
| Proceeds from property sales  | 1,209             | 1,079     |
| Net cash paid for acquisition of businesses, net of cash acquired                 | (14,297)          | (27,739)  |
| Other   |                   | 1,722     |
| Net Cash used in Investing Activities   | (31,383)          | (41,384)  |
| Cash Flows from Financing Activities  |                   |           |
| Repayments under revolving credit facility  |                   | (50,000)  |
| Long-term debt repayment  |                   | (25,000)  |
| Settlements of cross-currency swap agreements                                     |                   | (12,752)  |
| Purchases of treasury shares  | (18,990)          | (4,491)   |
| Dividends paid  | (24,939)          | (21,649)  |
| Excess tax benefits from share-based compensation                                 | 2,263             | 1,250     |
| Exercise of stock options and appreciation rights                                 | 324               | 477       |
| Net Cash used in Financing Activities   | (41,342)          | (112,165) |
| Effect of Exchange Rate Changes on Cash   | (930)             | 2,349     |
| Decrease in cash and cash equivalents   | (11,684)          | (87,218)  |
| Cash and cash equivalents at beginning of period                                  | 91,092            | 175,777   |
| Cash and Cash Equivalents at End of Period  | \$79,408          | \$88,559  |

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 March 31, 2012, and the results of its operations for the three and nine month periods ended March 31, 2012 and 2011 and its cash flows for the nine months ended March 31, 2012 and 2011, have been included. The condensed consolidated balance sheet as of June 30, 2011 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, 2011.

Operating results for the three and nine month periods ended March 31, 2012 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending June 30, 2012.

### 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.

During the three and nine month periods ended March 31, 2011, the Company recorded overall LIFO benefits of \$356 and \$2,480, respectively, and the LIFO reserves were reduced by the same amounts. No comparable benefits were recorded in the three and nine month periods ended March 31, 2012.

## 2. BUSINESS COMBINATIONS

During the nine month period ended March 31, 2012, the Company acquired three Canadian distributors to complement and extend its business over a broader geographic area. In August 2011, the Company acquired Chaines-Plus, a distributor of bearings, power transmission and related products. In February 2012, the Company acquired Solutions Industrielles Chicoutimi, which provides bearings, power transmission products and repair services and Spécialités Industrielles Harvey, which distributes bearings and power transmission products, plus hydraulic, pneumatic and electrical components. The acquired businesses are included in the Service Center Based Distribution segment. The results of operations for these acquisitions are not material for any year presented.

## 3. GOODWILL AND INTANGIBLES

The changes in the carrying amount of goodwill for the Service Center Based Distribution segment for the period ended March 31, 2012 are as follows:

|                                     |          |
|-------------------------------------|----------|
| Balance at July 1, 2011             | \$76,981 |
| Goodwill acquired during the period | 8,533    |

|                                       |          |   |
|---------------------------------------|----------|---|
| Other, primarily currency translation | (824     | ) |
| Balance at March 31, 2012             | \$84,690 |   |

At March 31, 2012, accumulated goodwill impairment losses, subsequent to fiscal year 2002, totaled \$36,605 and related to the Fluid Power Businesses segment.

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

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

| March 31, 2012                 | Amount    | Accumulated<br>Amortization | Net Book<br>Value |
|--------------------------------|-----------|-----------------------------|-------------------|
| Finite-Lived Intangibles:      |           |                             |                   |
| Customer relationships         | \$85,238  | \$28,299                    | \$56,939          |
| Trade names                    | 25,920    | 7,066                       | 18,854            |
| Vendor relationships           | 13,887    | 4,368                       | 9,519             |
| Non-competition agreements     | 4,897     | 2,731                       | 2,166             |
| Total Finite-Lived Intangibles | 129,942   | 42,464                      | 87,478            |
| Indefinite-Lived Trade Names   | 1,290     |                             | 1,290             |
| Total Intangibles              | \$131,232 | \$42,464                    | \$88,768          |

| June 30, 2011                  | Amount    | Accumulated<br>Amortization | Net Book<br>Value |
|--------------------------------|-----------|-----------------------------|-------------------|
| Finite-Lived Intangibles:      |           |                             |                   |
| Customer relationships         | \$78,084  | \$23,111                    | \$54,973          |
| Trade names                    | 25,944    | 5,666                       | 20,278            |
| Vendor relationships           | 14,211    | 3,696                       | 10,515            |
| Non-competition agreements     | 5,127     | 2,632                       | 2,495             |
| Total Finite-Lived Intangibles | 123,366   | 35,105                      | 88,261            |
| Indefinite-Lived Trade Names   | 1,290     |                             | 1,290             |
| Total Intangibles              | \$124,656 | \$35,105                    | \$89,551          |

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

During 2012, the Company acquired intangible assets with an initial purchase price allocation and weighted-average life as follows:

|                            | Purchase Price<br>Allocation | Weighted-Average<br>Life |
|----------------------------|------------------------------|--------------------------|
| Customer relationships     | \$7,715                      | 15 years                 |
| Trade names                | 260                          | 2 years                  |
| Non-competition agreements | 430                          | 2 years                  |
| Total Intangibles Acquired | \$8,405                      | 14 years                 |

Estimated future amortization expense by fiscal year (based on the Company's intangible assets as of March 31, 2012) is as follows: \$2,800 for the remainder of 2012, \$11,300 for 2013, \$9,900 for 2014, \$9,000 for 2015, \$8,300 for 2016 and \$7,700 for 2017.

**4. FAIR VALUE MEASUREMENTS**

Marketable securities measured at fair value at March 31, 2012 and June 30, 2011 totaled \$10,583 and \$10,881. 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).



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

## 5. SHAREHOLDERS' EQUITY

## Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

|  | Three Months Ended March 31, |          |
|--|------------------------------|----------|
|  | 2012                         | 2011     |
| Net income   | \$29,418                     | \$26,536 |
| Other comprehensive income (loss):   |                              |          |
| Foreign currency translation adjustment  | 5,912                        | 7,037    |
| Unrealized gain (loss) on investment securities available for sale, net of income tax of \$25 and \$(103)  | 44                           | (170)    |
| Postemployment Benefits: Reclassification of actuarial losses and prior service cost into selling, distribution and administrative expense (included in net periodic pension costs), net of income tax of \$20 and \$213 | 75                           | 341      |
| Total comprehensive income   | \$35,449                     | \$33,744 |
|  | Nine Months Ended March 31,  |          |
|  | 2012                         | 2011     |
| Net income   | \$76,735                     | \$68,484 |
| Other comprehensive (loss) income:   |                              |          |
| Foreign currency translation adjustment  | (5,247)                      | ) 8,328  |
| Unrealized loss on investment securities available for sale, net of income tax of \$(39) and \$(35)  | (67)                         | ) (66)   |
| Postemployment benefits:   |                              |          |
| Reclassification of actuarial losses and prior service cost into selling, distribution and administrative expense (included in net periodic pension costs), net of income tax of \$380 and \$560                         | 649                          | 1,101    |
| Actuarial loss on remeasurement, net of income tax of \$(190)  | (302)                        | )        |
| Impact of reduction in postemployment benefit liability (as forecasted salary increases will not be realized) due to the plan curtailment, net of income tax of \$3,411  | 5,449                        |          |
| Reclassification of prior service cost into selling, distribution and administrative expense upon plan curtailment, net of income tax of \$1,200   | 1,917                        |          |
| Cash flow hedging activity, net of income tax of \$(82)  |                              | (184)    |
| Reclassification of interest expense into income, net of income tax of \$116   |                              | 200      |
| Total comprehensive income   | \$79,134                     | \$77,863 |

## Antidilutive Common Stock Equivalents

In the three and nine month periods ended March 31, 2012 and 2011, respectively, stock options and stock appreciation rights related to the acquisition of 112 and 127 shares of common stock in the three month periods and 263 and 322 shares of common stock in the nine month periods were not included in the computation of diluted earnings per share for the periods then ended as they were anti-dilutive.

## 6. BENEFIT PLANS

On December 19, 2011, the Executive Organization and Compensation Committee of the Board of Directors froze participant benefits (credited service and final average earnings) and entry into the Supplemental Executive Retirement Benefits Plan (SERP) effective December 31, 2011. This action constitutes a plan curtailment.

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

The plan liability was remeasured in conjunction with the curtailment using a 3.5% discount rate and participant final average earnings through the curtailment date. The plan was last remeasured at June 30, 2011, using a 4.5% discount rate. This latest remeasurement resulted in an actuarial loss (recorded in other comprehensive income) of \$302 (\$492 loss, net of income tax of \$190).

The curtailment is reflected in the Company's condensed consolidated balance sheets as: 1) a reduction to the overall SERP liability (included in postemployment benefits) of \$8,860, 2) a reduction to deferred tax assets of \$3,411 and 3) an increase in accumulated other comprehensive income of \$5,449. Prior service costs previously recorded through accumulated other comprehensive income were reclassified into the condensed statements of consolidated income (\$3,117 gross expense, net of income tax of \$1,200). The gross expense is recorded in selling, distribution and administrative expense in the second quarter of fiscal 2012.

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

|   | Pension Benefits |         | Retiree Health Care Benefits |       |
|---|------------------|---------|------------------------------|-------|
|   | 2012             | 2011    | 2012                         | 2011  |
| Three Months Ended March 31, 2012                       |                  |         |                              |       |
| Components of net periodic cost:                        |                  |         |                              |       |
| Service cost  | \$17             | \$115   | \$7                          | \$10  |
| Interest cost   | 436              | 565     | 59                           | 59    |
| Expected return on plan assets                          | (99)             | (97)    |                              |       |
| Recognized net actuarial loss (gain)                    | 57               | 362     | (18)                         | (21)  |
| Amortization of prior service cost                      | 21               | 178     | 35                           | 35    |
| Net periodic cost                                       | \$432            | \$1,123 | \$83                         | \$83  |
| Nine Months Ended March 31, 2012                        |                  |         |                              |       |
| Components of net periodic cost:                        |                  |         |                              |       |
| Service cost  | \$271            | \$345   | \$22                         | \$30  |
| Interest cost   | 1,612            | 1,694   | 177                          | 177   |
| Expected return on plan assets                          | (297)            | (289)   |                              |       |
| Recognized net actuarial loss (gain)                    | 586              | 1,086   | (54)                         | (63)  |
| Amortization of prior service cost                      | 391              | 533     | 105                          | 104   |
| Recognition of prior service cost upon plan curtailment | 3,117            |         |                              |       |
| Net periodic cost                                       | \$5,680          | \$3,369 | \$250                        | \$248 |

The Company contributed \$570 to its pension benefit plans and \$139 to its retiree health care plans in the nine months ended March 31, 2012. Expected contributions for the remainder of fiscal 2012 are \$3,650 for the pension benefit plans to fund scheduled retirement payments and \$100 for retiree health care plans.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

## 7. SEGMENT AND GEOGRAPHIC INFORMATION

The accounting policies of the Company's reportable segments are 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 \$5,021 and \$4,630, in the three months ended March 31, 2012 and 2011, respectively, and \$12,976 and \$13,228 in the nine months ended March 31, 2012 and 2011, respectively, have been eliminated in the tables below.

Segment Financial Information for the three months ended:

|   | Service Center<br>Based Distribution | Fluid Power<br>Businesses | Total     |
|---|--------------------------------------|---------------------------|-----------|
| March 31, 2012                            |                                      |                           |           |
| Net sales                                 | \$486,808                            | \$118,653                 | \$605,461 |
| Operating income for reportable segments  | 35,910                               | 10,491                    | 46,401    |
| Depreciation and amortization of property | 2,355                                | 435                       | 2,790     |
| Capital expenditures                      | 3,628                                | 645                       | 4,273     |
| March 31, 2011                            |                                      |                           |           |
| Net sales                                 | \$451,982                            | \$113,988                 | \$565,970 |
| Operating income for reportable segments  | 32,275                               | 11,244                    | 43,519    |
| Depreciation and amortization of property | 2,447                                | 523                       | 2,970     |
| Capital expenditures                      | 2,159                                | 484                       | 2,643     |

Segment Financial Information for the nine months ended:

|   | Service Center<br>Based Distribution | Fluid Power<br>Businesses | Total       |
|---|--------------------------------------|---------------------------|-------------|
| March 31, 2012                            |                                      |                           |             |
| Net sales                                 | \$1,408,980                          | \$346,452                 | \$1,755,432 |
| Operating income for reportable segments  | 94,584                               | 31,878                    | 126,462     |
| Assets used in the business               | 725,735                              | 228,601                   | 954,336     |
| Depreciation and amortization of property | 7,007                                | 1,381                     | 8,388       |
| Capital expenditures                      | 16,974                               | 1,321                     | 18,295      |
| March 31, 2011                            |                                      |                           |             |
| Net sales                                 | \$1,302,096                          | \$320,892                 | \$1,622,988 |
| Operating income for reportable segments  | 83,631                               | 30,553                    | 114,184     |
| Assets used in the business               | 676,921                              | 214,937                   | 891,858     |
| Depreciation and amortization of property | 6,910                                | 1,556                     | 8,466       |
| Capital expenditures                      | 15,707                               | 739                       | 16,446      |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

A reconciliation of operating income for reportable segments to the condensed consolidated income before income taxes is as follows:

|   | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | March 31,<br>2012  | 2011     | March 31,<br>2012 | 2011      |
| Operating income for reportable segments                  | \$46,401           | \$43,519 | \$126,462         | \$114,184 |
| Adjustment for:   |                    |          |                   |           |
| Intangible amortization—Service Center Based Distribution | 1,009              | 789      | 2,727             | 2,475     |
| Intangible amortization—Fluid Power Businesses            | 1,902              | 2,001    | 5,728             | 5,993     |
| Corporate and other expense (income), net                 | 1,471              | 2,528    | (614              | ) (432    |
| Total operating income                                    | 42,019             | 38,201   | 118,621           | 106,148   |
| Interest expense, net                                     | 54                 | 52       | 111               | 1,634     |
| Other (income) expense, net                               | (1,887             | ) (2,645 | ) 823             | (3,409    |
| Income before income taxes                                | \$43,852           | \$40,794 | \$117,687         | \$107,923 |

Corporate and other expense (income), net includes the SERP curtailment loss of \$3,117 recognized in the second quarter of fiscal 2012. Additional fluctuations in corporate and other expense (income), net are due to changes in the levels and amounts of expenses being allocated to the segments. The expenses being allocated include corporate charges for working capital, logistics support and other items.

Net sales are presented in geographic areas based on the location of the company making the sale and are as follows:

|                   | Three Months Ended |           | Nine Months Ended |             |
|-------------------|--------------------|-----------|-------------------|-------------|
|                   | March 31,<br>2012  | 2011      | March 31,<br>2012 | 2011        |
| Geographic Areas: |                    |           |                   |             |
| United States     | \$522,870          | \$487,777 | \$1,488,520       | \$1,398,020 |
| Canada            | 65,316             | 63,717    | 212,391           | 181,127     |
| Mexico            | 17,275             | 14,476    | 54,521            | 43,841      |
| Total             | \$605,461          | \$565,970 | \$1,755,432       | \$1,622,988 |

## 8. OTHER (INCOME) EXPENSE , NET

Other (income) expense, net consists of the following:

|   | Three Months Ended |          | Nine Months Ended |            |
|---|--------------------|----------|-------------------|------------|
|   | March 31,<br>2012  | 2011     | March 31,<br>2012 | 2011       |
| Unrealized gain on assets held in rabbi trust for a nonqualified deferred compensation plan | \$(1,249           | ) \$(473 | ) \$(244          | ) \$(1,978 |
| Benefit from payouts on corporate-owned life insurance policies                             | —                  | (1,722   | ) —               | (1,722     |
| Foreign currency transaction (gains) losses   | (385               | ) (333   | ) 1,171           | (184       |

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|                                   |          |            |         |            |
|-----------------------------------|----------|------------|---------|------------|
| Loss on cross-currency swap       | —        | —          | —       | 368        |
| Other, net                        | (253     | ) (117     | ) (104  | ) 107      |
| Total other (income) expense, net | \$(1,887 | ) \$(2,645 | ) \$823 | \$(3,409 ) |

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

9. SUBSEQUENT EVENT

On April 25, 2012, the Company announced a definitive agreement to acquire SKF's company-owned distribution businesses in Australia and New Zealand. The acquisition is expected to be completed by July 1, 2012. The Company intends to fund the acquisition from its available cash. Results of operations acquired will be included in the Company's results of operations from the date of closing.

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES  
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The accompanying condensed consolidated financial statements of the Company have been reviewed by the Company's independent registered public accounting firm, Deloitte & Touche LLP, whose report covering their reviews of the condensed consolidated financial statements follows.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of  
Applied Industrial Technologies, Inc.  
Cleveland, Ohio

We have reviewed the accompanying condensed consolidated balance sheet of Applied Industrial Technologies, Inc. and subsidiaries (the "Company") as of March 31, 2012, and the related condensed statements of consolidated income for the three-month and nine-month periods ended March 31, 2012 and 2011, and of consolidated cash flows for the nine-month periods ended March 31, 2012 and 2011. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of June 30, 2011, and the related statements of consolidated income, shareholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated August 17, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of June 30, 2011 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Deloitte & Touche LLP

Cleveland, Ohio  
May 2, 2012

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APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES  
ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
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Applied Industrial Technologies (“Applied,” the “Company,” “We,” “Us” or “Our”) is a leading industrial distributor serving MRO, OEM and Government markets. Applied is an authorized source for a diverse range of products, including bearings, power transmission components, fluid power components and systems, industrial rubber products, linear motion components, tools, safety products, and general maintenance and mill supply products. The Company also provides customized shop services for mechanical, fabricated rubber and fluid power products, as well as services to meet storeroom management and maintenance training needs. We have a long tradition of growth dating back to 1923, the year our business was founded in Cleveland, Ohio. During the third quarter of fiscal 2012, business was conducted in the United States, Canada, Mexico and Puerto Rico from 477 facilities.

The following is Management's Discussion and Analysis of significant factors which have affected our financial condition, results of operations and cash flows during the periods included in the accompanying condensed statements of consolidated income and consolidated cash flows. When reviewing the discussion and analysis set forth below, please note that the majority of SKUs we sell in any given period were not sold in the comparable period of the prior year, resulting in the inability to quantify certain commonly used comparative metrics analyzing sales, such as changes in product mix and volume.

Overview

Consolidated net sales for the quarter ended March 31, 2012 increased \$39.5 million or 7.0% compared to the prior year quarter, with acquisitions contributing \$3.0 million or 0.5% and with unfavorable foreign currency translation of \$2.5 million or 0.4% partially offsetting the increase. Operating margin increased to 6.9% of net sales from 6.7% for the prior year quarter largely driven by the impact of higher sales volumes. Net income of \$29.4 million increased 10.9% compared to the prior year quarter. Shareholders' equity was \$672.2 million at March 31, 2012 up from the June 30, 2011 level of \$633.6 million. The current ratio was 2.9 to 1 at March 31, 2012 and at June 30, 2011. Since November 30, 2010, we have had no borrowings outstanding under our credit facilities.

Applied monitors several economic indices that have been key indicators for industrial economic activity in the United States. These include the Industrial Production and Manufacturing Capacity Utilization (MCU) indices published by the Federal Reserve Board and the Purchasing Managers Index (PMI) published by the Institute for Supply Management (ISM). Historically, our performance correlates well with the MCU, which measures productivity and calculates a ratio of actual manufacturing output versus potential full capacity output. When manufacturing plants are running at a high rate of capacity, they tend to wear out machinery and require replacement parts. Our sales tend to lag the MCU by up to six months.

These indices showed continued moderate growth in the industrial economy during the third quarter of fiscal 2012. In the March quarter, Industrial Production rose at an annual rate of 5.4%. The MCU for March was 77.8, up from the December 2011 reading of 76.7. The ISM PMI averaged 53.3 in the March quarter, a modest improvement from 52.4 in the December quarter, and holding above 50 (its expansionary threshold). Based upon these indices, we believe that the U.S. industrial economy is performing well.

The number of Company associates was 4,645 at March 31, 2012, 4,640 at June 30, 2011, and 4,639 at March 31, 2011. The number of operating facilities totaled 477 at March 31, 2012 and 474 at June 30, 2011.

Results of Operations

Three Months Ended March 31, 2012 and 2011

The following table is included to aid in review of Applied's condensed statements of consolidated income.

|  | Three Months Ended March 31,<br>As a Percent of Net Sales |   |       |   | Change in \$'s<br>Versus Prior Period |   |
|--|---|---|-------|---|---------------------------------------|---|
|  | 2012  |   | 2011  |   | % Increase                            |   |
| Net Sales                              | 100.0   | % | 100.0 | % | 7.0                                   | % |
| Gross Profit                           | 27.7  | % | 27.7  | % | 7.1                                   | % |
| Selling, Distribution & Administrative | 20.7  | % | 20.9  | % | 6.1                                   | % |
| Operating Income                       | 6.9   | % | 6.7   | % | 10.0                                  | % |
| Net Income                             | 4.9   | % | 4.7   | % | 10.9                                  | % |

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During the quarter ended March 31, 2012, net sales increased \$39.5 million or 7.0% compared to the prior year quarter, with acquisitions accounting for \$3.0 million or 0.5%, and foreign currency translation unfavorably reducing sales by \$2.5 million or 0.4%. There were 64 selling days in both the 2012 and 2011 quarters.

Net sales from our Service Center Based Distribution segment, which is heavily focused on the MRO market, increased \$34.8 million or 7.7% during the quarter from the same period in the prior year, primarily attributed to improvement in the industrial economy. Acquisitions within this segment increased sales by \$3.0 million or 0.7%.

Net sales from our Fluid Power Businesses segment, which is heavily focused on the OEM market, increased \$4.7 million or 4.1% during the quarter from the same period in the prior year, primarily attributed to improvements in the industrial economy.

Improvements in the industrial economy helped drive sales increases in all of the geographic areas of the Company. Sales in our U.S. operations were up \$35.1 million or 7.2%, with acquisitions accounting for \$1.2 million or 0.3% of the U.S. increase. Sales from our Canadian operations increased \$1.6 million or 2.5%, with acquisitions adding \$1.8 million and unfavorable foreign currency translation reducing Canadian sales by \$0.9 million. Sales from our Mexican operations increased \$2.8 million or 19.3%, despite unfavorable foreign currency translation of \$1.6 million.

During the quarter ended March 31, 2012, industrial products and fluid power products accounted for 71.1% and 28.9%, respectively, of net sales as compared to 70.2% and 29.8%, respectively, for the same period in the prior year.

Our gross profit margin for the quarter was 27.7%, the same level as the third quarter of fiscal 2011.

Selling, distribution and administrative expense (SD&A) consists of associate compensation, benefits and other expenses associated with selling, purchasing, warehousing, supply chain management and providing marketing and distribution of the Company's products, as well as costs associated with a variety of administrative functions such as human resources, information technology, treasury, accounting, legal, and facility related expenses. SD&A was 20.7% of net sales in the quarter ended March 31, 2012 compared to 20.9% in the prior year quarter. On an absolute basis, SD&A increased \$7.2 million or 6.1% compared to the prior year quarter. The ERP project expenses were \$5.9 million in the quarter (\$2.9 million above the prior year quarter) and acquisitions added \$0.9 million.

Operating income increased 10.0% or \$3.8 million, and as a percent of sales increased to 6.9% from 6.7% during the prior year quarter. The quarterly increase in operating income primarily reflects the items highlighted above; higher sales levels and the associated impact of leverage on the sales increase as we lowered our SD&A as a percent of sales to 20.7% versus 20.9% in the third quarter of fiscal 2011.

Operating income as a percentage of sales for the Service Center Based Distribution segment increased to 7.4% in the current year quarter, from 7.1% in the prior year quarter. This increase is attributable to higher sales levels without a commensurate increase in SD&A (representing 0.3% of the improvement) as gross margins were comparable quarter over quarter.

The Fluid Power Businesses operating margins decreased to 8.8% in the current year quarter from 9.9% in the prior year quarter. This reduction is attributable to higher operating expenses as a percent of sales driven in part by incremental ERP expenses (representing 0.7% of the reduction) and lower net gross profit margins primarily from one

vertical market within one of our Fluid Power Businesses (representing 0.4% of the reduction).

Other income was \$1.9 million in the quarter which included unrealized gains on investments held by non-qualified deferred compensation trusts of \$1.2 million and net favorable foreign currency transaction gains of \$0.4 million. In the third quarter of fiscal 2011, we recognized a \$1.7 million gain from death benefits received under two life insurance policies.

The effective income tax rate was 32.9% for the quarter ended March 31, 2012 compared to 35.0% for the quarter ended March 31, 2011. The impact of lower effective tax rates in foreign jurisdictions favorably reduced our rate when compared to the U.S. federal statutory rate by 2.6% in the quarter. Further reducing our rate were certain discrete items recorded (\$0.4 million or a reduction of 0.9%) and a permanent dividend deduction benefit (\$0.2 million or 0.5%) in the quarter. These reductions compared to the federal rate were partially offset by the impact of state and local taxes which increased the rate by 2.1%. We expect our full year tax rate to be approximately 35.0%.

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In the third quarter of fiscal 2011, we accrued U.S. income taxes on Canadian subsidiaries' earnings which increased the fiscal 2011 third quarter effective tax rate. Decreasing the rate were discrete items which included non-taxable life insurance benefits and certain U.S. tax credits and deductions.

As a result of the factors addressed above, net income increased \$2.9 million or 10.9% compared to the prior year quarter. Net income per share was \$0.69 per share for the quarter ended March 31, 2012, compared to \$0.61 in the prior year quarter.

## Nine Months Ended March 31, 2012 and 2011

The following table is included to aid in review of Applied's condensed statements of consolidated income.

|  | Nine Months Ended March 31, |   |       |   | Change in \$'s      |   |
|--|-----------------------------|---|-------|---|---------------------|---|
|  | As a Percent of Net Sales   |   |       |   | Versus Prior Period |   |
|  | 2012                        |   | 2011  |   | % Increase          |   |
| Net Sales                              | 100.0                       | % | 100.0 | % | 8.2                 | % |
| Gross Profit                           | 27.4                        | % | 27.4  | % | 8.5                 | % |
| Selling, Distribution & Administrative | 20.7                        | % | 20.8  | % | 7.5                 | % |
| Operating Income                       | 6.8                         | % | 6.5   | % | 11.8                | % |
| Net Income                             | 4.4                         | % | 4.2   | % | 12.0                | % |

During the nine months ended March 31, 2012, net sales increased \$132.4 million or 8.2% compared to the same period in the prior year, with acquisitions accounting for \$11.3 million or 0.6%, and favorable foreign currency translation adding \$2.3 million or 0.1%. There were 189 selling days in both 2012 and 2011.

Net sales from our Service Center Based Distribution segment, which is heavily focused on the MRO market, increased \$106.9 million or 8.2% during the nine months ended March 31, 2012 from the same period in the prior year, primarily attributed to improvement in the industrial economy. Acquisitions within this segment increased sales by \$11.3 million or 0.9%.

Net sales from our Fluid Power Businesses segment, which is heavily focused on the OEM market, increased \$25.6 million or 8.0% during the nine months ended March 31, 2012 from the same period in the prior year, primarily attributed to improvements in the industrial economy.

Improvements in the industrial economy helped drive sales increases in all of the geographic areas of the Company. Sales in our U.S. operations were up \$90.5 million or 6.5%, with acquisitions accounting for \$5.1 million or 0.4% of the U.S. increase. Sales from our Canadian operations increased \$31.3 million or 17.3%. This increase includes \$6.2 million from acquisitions and \$3.9 million due to favorable foreign currency translation. Sales from our Mexican operations increased \$10.7 million or 24.4%, with \$1.6 million of unfavorable year-to-date foreign currency translation.

During the nine months ended March 31, 2012, industrial products and fluid power products accounted for 70.9% and 29.1%, respectively, of net sales as compared to 70.7% and 29.3%, respectively, for the same period in the prior year.

Our gross profit margin for the period was 27.4%, consistent with the prior year period's rate. Positive impacts as a result of higher supplier purchasing incentives offset LIFO benefits recognized in the prior year (\$2.5 million or 0.2%) which did not recur in the current year.

SD&A was 20.7% of net sales in the nine months ended March 31, 2012 compared to 20.8% in the prior year period. On an absolute basis, SD&A increased \$25.3 million or 7.5% compared to the prior period. ERP project expenses were \$13.9 million in the nine months ended March 31, 2012 (\$10.1 million above the prior year period) and SD&A of businesses acquired accounted for a \$4.1 million increase in SD&A. The Executive Organization and Compensation Committee of the Board of Directors froze participant benefits (credited service and final average earnings) and entry into the SERP effective December 31, 2011. This action constitutes a plan curtailment. As a result, we recognized \$3.1 million in prior service costs upon curtailment of the plan in the second quarter of fiscal 2012. Also we incurred one time expenses associated with our CEO transition of \$1.4 million.

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Operating income increased \$12.5 million to 6.8% during the period compared to 6.5% during the prior year period. The increase in operating income primarily reflects the items highlighted above; higher sales levels and the associated impact of leverage on the sales increase as we lowered our SD&A as a percent of sales to 20.7% versus 20.8% in the prior year period.

Operating income as a percentage of sales for the Service Center Based Distribution segment increased to 6.7% in the current year period, from 6.4% in the prior year period. This increase is attributable to higher sales levels without a commensurate increase in SD&A (representing 0.2% of the improvement); gross margins were up slightly.

The Fluid Power Businesses operating margins decreased to 9.2% in the current year period from 9.5% in the prior year period. This reduction is attributable to lower net gross profit margins primarily from one vertical market within one of our Fluid Power Businesses (representing 0.4% of the reduction).

Interest, net, is down \$1.5 million due to repayment in the first half of fiscal 2011 of all borrowings under our credit facilities.

Other expense was \$0.8 million in the period and included \$1.2 million of net foreign currency transaction losses. Fiscal 2011 included a \$1.7 million gain from death benefits received under two life insurance policies and \$2.0 million of unrealized gains on investments held by non-qualified deferred compensation trusts.

The effective income tax rate was 34.8% for the nine months ended March 31, 2012 compared to 36.5% for the same period in the prior year. The impact of lower effective tax rates and higher income in foreign jurisdictions favorably reduced our rate when compared to the U.S. federal statutory rate by 1.8% on a year-to-date basis. Further reducing our rate is a permanent dividend deduction benefit of 0.5%, and certain U.S. tax credits and deductions of 0.3%. These reductions compared to the federal rate were partially offset by the impact of state and local taxes which increased the rate by 2.4%. We expect our full year tax rate to be approximately 35.0%.

Year-to-date in fiscal 2011, we accrued U.S. income taxes on Canadian subsidiaries' earnings which increased the effective tax rate; this was partially offset by reversal of a valuation allowance in the second quarter and non-taxable life insurance benefits in the third quarter of fiscal 2011. These items did not recur in fiscal 2012.

As a result of the factors addressed above, net income increased \$8.3 million or 12.0% compared to the prior year period. Net income per share was \$1.79 per share for the nine months ended March 31, 2012, compared to \$1.58 in the prior year period.

Liquidity and Capital Resources

Our primary source of capital is cash flow from operations, supplemented as necessary by bank borrowings or other sources of debt. At March 31, 2012, we have no outstanding borrowings. Management expects that our existing cash, cash equivalents, funds available under the revolving credit facility, cash provided from operations, and the use of operating leases will be sufficient to finance normal working capital needs in each of the countries we operate in, payment of dividends, acquisitions, investments in properties, facilities and equipment, and the purchase of additional Company common stock. Management also believes that additional long-term debt and line of credit financing could be obtained based on the Company's credit standing and financial strength.

The Company's working capital at March 31, 2012 was \$423.3 million, compared to \$404.2 million at June 30, 2011. The current ratio was 2.9 to 1 at March 31, 2012 and at June 30, 2011.

The Executive Organization and Compensation Committee of the Board of Directors froze participant benefits (credited service and final average earnings) and entry into the SERP effective December 31, 2011. This action constitutes a plan curtailment, resulting in a reduction of postemployment benefits of \$8.9 million and deferred tax assets of \$3.4 million in the condensed consolidated balance sheet.

On April 25, 2012, the Company announced a definitive agreement to acquire SKF's company-owned distribution businesses in Australia and New Zealand. The acquisition is expected to be completed by July 1, 2012. The Company intends to fund the acquisition from its available cash.

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## Net Cash Flows

The following table is included to aid in review of Applied's condensed statements of consolidated cash flows; all amounts are in thousands.

|                                       | Nine-Months Ended March 31, |             |
|---------------------------------------|-----------------------------|-------------|
|                                       | 2012                        | 2011        |
| Net Cash Provided by (Used in):       |                             |             |
| Operating Activities                  | \$61,971                    | \$63,982    |
| Investing Activities                  | (31,383                     | ) (41,384   |
| Financing Activities                  | (41,342                     | ) (112,165  |
| Exchange Rate Effect                  | (930                        | ) 2,349     |
| Decrease in Cash and Cash Equivalents | \$(11,684                   | ) \$(87,218 |

Improved net income generated \$8.3 million of operating cash flow which was more than offset by investments in working capital.

Net cash used in investing activities during the current year was \$31.4 million; \$18.3 million was used for capital expenditures (including capitalized costs associated with our ERP project) and \$14.3 million for acquisitions. These uses of cash were partially offset by \$1.2 million of proceeds from property sales. In the nine months ended March 31, 2011, investing activities used \$41.4 million including \$27.7 million for acquisitions and \$16.4 million for capital expenditures. Partially offsetting these uses of cash was receipt of \$2.8 million related to life insurance death benefits and property sales.

Net cash used in financing activities was \$41.3 million for the nine months ended March 31, 2012. We used \$24.9 million to pay dividends and \$19.0 million to repurchase 664,100 shares of treasury stock. In the prior year, financing activities used \$112.2 million of cash; we repaid \$50.0 million under our revolving credit facility, \$25.0 million under our private placement debt and \$12.8 million related to the associated cross-currency swaps. Additionally, we paid dividends of \$21.6 million and repurchased 142,800 shares of treasury stock for \$4.5 million. The increase in the dividend payments relates to our dividend rate increases. Through the third quarter of fiscal 2011, we paid dividends at a quarterly rate of \$0.17 per share, this was increased to \$0.19 per share in the fourth quarter of fiscal 2011 through the second quarter of fiscal 2012 and increased again to \$0.21 per share in the third quarter of fiscal 2012.

## ERP Project

In the second quarter of fiscal 2011, Applied commenced its ERP project to transform the Company's technology platforms and enhance its business information and transaction systems for future growth. In fiscal 2011, project spend totaled \$21.1 million (\$12.5 million capital and \$8.6 million expense). During the current quarter, spending on the project totaled \$7.8 million (\$1.9 million capital and \$5.9 million expense). On a year-to-date basis, spending on the project for fiscal 2012 totaled \$26.3 million (\$12.4 million capital and \$13.9 million expense). We expect spending in fiscal year 2012 to reach \$34.0 million to \$36.0 million (\$15.0 million to \$16.0 million capital and \$19.0 million to \$20.0 million expense). We have deployed our solution in a portion of our Canadian operations and are preparing for further deployments in Canada this fiscal year. U.S. deployments are planned for fiscal 2013 and 2014.

## Share Repurchases

In October 2011, the Board of Directors authorized the repurchase of 1.5 million shares of the Company's common stock. These purchases may be made in open market and negotiated transactions, from time to time, depending upon market conditions. We did not acquire any shares of treasury stock in the three months ended March 31, 2012. At March 31, 2012, we had authorization to repurchase an additional 1,475,900 shares. Through the nine months ended

March 31, 2012, we acquired 664,100 shares of treasury stock for \$19.0 million.

#### Borrowing Arrangements

We have a \$150.0 million revolving credit facility with a group of banks expiring in June 2012, which we are in the process of renewing for an additional five year term. There are no borrowings outstanding under this facility at March 31, 2012. At March 31, 2012, unused capacity under this facility, net of outstanding letters of credit, was \$143.1 million and is available to fund future acquisitions or other capital and operating requirements.

We also have an uncommitted long-term financing shelf facility which expires in February 2013 and enables us to borrow up to \$100.0 million with terms of up to fifteen years. At March 31, 2012, there were no outstanding borrowings under this

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agreement.

## Accounts Receivable Analysis

The following table is included to aid in analysis of accounts receivable and the associated provision for losses on accounts receivable:

|   | March 31,<br>2012                   | June 30,<br>2011 |   |
|---|-------------------------------------|------------------|---|
| Accounts receivable, gross                              | \$316,230                           | \$297,767        |   |
| Allowance for doubtful accounts                         | 8,570                               | 7,016            |   |
| Accounts receivable, net                                | \$307,660                           | \$290,751        |   |
| Allowance for doubtful accounts, % of gross receivables | 2.7                                 | %2.4             | % |
|   | For the nine months ended March 31, |                  |   |
|   | 2012                                | 2011             |   |
| Provision for losses on accounts receivable             | \$2,947                             | \$1,469          |   |
| Provision as a % of net sales                           | 0.17                                | %0.09            | % |

Accounts receivable are reported at net realizable value and consist of trade receivables from customers. Management monitors accounts receivable by reviewing Days Sales Outstanding (DSO) and the aging of receivables for each of the Company's locations.

On a consolidated basis, DSO was 44.3 at March 31, 2012 versus 44.2 at June 30, 2011. Accounts receivable increased 5.8% this year, compared to a 8.2% increase in sales in the nine months ended March 31, 2012. We primarily attribute the increase in DSO to higher sales to large contract accounts.

Less than 3% of our accounts receivable balances are more than 90 days past due. On an overall basis, our provision for losses from uncollected receivables represents 0.17% of our sales in the nine months ended March 31, 2012. Historically, this percentage is around 0.15%. Management believes the overall receivables aging and provision for losses on uncollected receivables are at reasonable levels.

## Inventory Analysis

Inventories are valued at the lower of cost or market, using the last-in, first-out (LIFO) method for U.S. inventories and the average cost method for foreign inventories. Management uses an inventory turnover ratio to monitor and evaluate inventory. Management calculates this ratio on an annual as well as a quarterly basis and uses inventory valued at current costs. The annualized inventory turnover for the period ended March 31, 2012 was 4.6 versus 4.7 at June 30, 2011. We believe our inventory turnover ratio in fiscal 2012 will remain similar to the fiscal 2011 levels.

## Cautionary Statement Under Private Securities Litigation Reform Act

Management's Discussion and Analysis and other sections of this report, including documents incorporated by reference, contain statements that are forward-looking, based on management's current expectations about the future. Forward-looking statements are often identified by qualifiers, such as "guidance," "expect," "believe," "plan," "intend," "will," "should," "could," "would," "anticipate," "estimate," "forecast," "may," and derivative or similar

words or expressions. Similarly, descriptions of objectives, strategies, plans, or goals are also forward-looking statements. These statements may discuss, among other things, expected growth, future sales, future cash flows, future capital expenditures, future performance, and the anticipation and expectations of the Company and its management as to future occurrences and trends. The Company intends that the forward-looking statements be subject to the safe harbors established in the Private Securities Litigation Reform Act of 1995 and by the Securities and Exchange Commission in its rules, regulations and releases.

Readers are cautioned not to place undue reliance on any forward-looking statements. All forward-looking statements are based on current expectations regarding important risk factors, many of which are outside the Company's control. Accordingly,

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AND RESULTS OF OPERATIONS

actual results may differ materially from those expressed in the forward-looking statements, and the making of those statements should not be regarded as a representation by the Company or any other person that the results expressed in the statements will be achieved. In addition, the Company assumes no obligation publicly to update or revise any forward-looking statements, whether because of new information or events, or otherwise, except as may be required by law.

Important risk factors include, but are not limited to, the following: risks relating to the operations levels of our customers and the economic factors that affect them; changes in the prices for products and services relative to the cost of providing them; reduction in supplier inventory purchase incentives; loss of key supplier authorizations, lack of product availability, or changes in supplier distribution programs; the cost of products and energy and other operating costs; changes in customer preferences for products and services of the nature and brands sold by us; changes in customer procurement policies and practices; competitive pressures; our reliance on information systems; our ability to implement our ERP system in a timely, cost-effective, and competent manner, and to capture its planned benefits while maintaining an adequate internal control environment; the impact of economic conditions on the collectability of trade receivables; reduced demand for our products in targeted markets due to reasons including consolidation in customer industries and the transfer of manufacturing capacity to foreign countries; our ability to retain and attract qualified sales and customer service personnel; our ability to identify and complete acquisitions, integrate them effectively, and realize their anticipated benefits; the variability and timing of new business opportunities including acquisitions, alliances, customer relationships, and supplier authorizations; the incurrence of debt and contingent liabilities in connection with acquisitions; our ability to access capital markets as needed on reasonable terms; disruption of operations at our headquarters or distribution centers; risks and uncertainties associated with our foreign operations, including volatile economic conditions, political instability, cultural and legal differences, and currency exchange fluctuations; the potential for goodwill and intangible asset impairment; changes in accounting policies and practices; organizational changes within the Company; the volatility of our stock price and the resulting impact on our consolidated financial statements; risks related to legal proceedings to which we are a party; adverse regulation and legislation, including potential changes in tax regulations (e.g., those affecting the use of the LIFO inventory accounting method and the taxation of foreign-sourced income); and the occurrence of extraordinary events (including prolonged labor disputes, natural events and acts of God, terrorist acts, fires, floods, and accidents). Other factors and unanticipated events could also adversely affect our business, financial condition or results of operations. We discuss certain of these matters more fully in our Annual Report on Form 10-K for the year ended June 30, 2011.

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For quantitative and qualitative disclosures about market risk, see Item 7A "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended June 30, 2011.

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES  
ITEM 4: CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of the end of the period covered by this report. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective.

During the third quarter of fiscal 2012, there were no changes in the Company's internal controls or in other factors that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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## PART II. OTHER INFORMATION

## ITEM 1. Legal Proceedings

The Company is a party to pending legal proceedings with respect to various product liability, negligence, and other matters. Although it is not possible to predict the outcome of these proceedings or the range of reasonably possible loss, the Company believes, based on circumstances currently known, that the likelihood is remote that the ultimate resolution of any of these proceedings will have, either individually or in the aggregate, a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases in the quarter ended March 31, 2012 were as follows:

| Period                                | (a) Total Number of Shares | (b) Average Price Paid per Share (\$) | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---------------------------------------|----------------------------|---------------------------------------|--|--|
| January 1, 2012 to January 31, 2012   | 0                          | —                                     | 0  | 1,475,900  |
| February 1, 2012 to February 29, 2012 | 0                          | —                                     | 0  | 1,475,900  |
| March 1, 2012 to March 31, 2012       | 0                          | —                                     | 0  | 1,475,900  |
| Total                                 | 0                          | —                                     | 0  | 1,475,900  |

On October 25, 2011, the Board of Directors authorized the purchase of up to 1.5 million shares of the Company's (1) common stock. The Company publicly announced the authorization that day. Purchases can be made in the open market or in privately negotiated transactions.

## ITEM 5. Other Information

Richard C. Shaw, Vice President-Communications and Learning, an executive officer of the Company, retired on February 2, 2012.

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ITEM 6. Exhibits

Exhibit No. Description

- 3.1 Amended and Restated Articles of Incorporation of Applied Industrial Technologies, Inc., as amended on October 25, 2005 (filed as Exhibit 3(a) to the Company's Form 10-Q for the quarter ended December 31, 2005, SEC File No. 1-2299, and incorporated here by reference).
- 3.2 Code of Regulations of Applied Industrial Technologies, Inc., as amended on October 19, 1999 (filed as Exhibit 3(b) to the Company's Form 10-Q for the quarter ended September 30, 1999, SEC File No. 1-2299, and incorporated here by reference).
- 4.1 Certificate of Merger of Bearings, Inc. (Ohio) (now named Applied Industrial Technologies, Inc.) and Bearings, Inc. (Delaware) filed with the Ohio Secretary of State on October 18, 1988, including an Agreement and Plan of Reorganization dated September 6, 1988 (filed as Exhibit 4(a) to the Company's Registration Statement on Form S-4 filed May 23, 1997, Registration No. 333-27801, and incorporated here by reference).
- 4.2 Private Shelf Agreement dated as of November 27, 1996, between the Company and Prudential Investment Management, Inc. (assignee of The Prudential Insurance Company of America), conformed to show all amendments (filed as Exhibit 4.2 to the Company's Form 10-Q for the quarter ended March 31, 2010, SEC File No. 1-2299, and incorporated here by reference).
- 4.3 Credit Agreement dated as of June 3, 2005 among the Company, KeyBank National Association as Agent, and various financial institutions (filed as Exhibit 4.7 to the Company's Form 10-Q dated February 9, 2010, SEC File No. 1-2299, and incorporated here by reference).
- 4.4 First Amendment Agreement dated as of June 6, 2007, among the Company, KeyBank National Association as Agent, and various financial institutions, amending June 3, 2005 Credit Agreement (filed as Exhibit 4 to the Company's Form 8-K dated June 11, 2007, SEC File No. 1-2299, and incorporated here by reference).
- 10.1 Restricted Stock Awards Terms and Conditions (Directors) (January 2012 revision).
- 15 Independent Registered Public Accounting Firm's Awareness Letter.
- 31 Rule 13a-14(a)/15d-14(a) certifications.
- 32 Section 1350 certifications.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

The Company will furnish a copy of any exhibit described above and not contained herein upon payment of a specified reasonable fee which shall be limited to the Company's reasonable expenses in furnishing the exhibit.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

APPLIED INDUSTRIAL TECHNOLOGIES, INC.  
(Company)

Date: May 2, 2012

By: /s/ Neil A.Schrimsher  
Neil A. Schrimsher  
Chief Executive Officer

Date: May 2, 2012

By: /s/ Mark O. Eisele  
Mark O. Eisele  
Vice President-Chief Financial Officer & Treasurer