

APPLIED INDUSTRIAL TECHNOLOGIES INC

Form 10-Q

May 04, 2011

Table of Contents

**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, 2011

OR

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

For the transition period from _____ to _____

**Commission File Number 1-2299
APPLIED INDUSTRIAL TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

Ohio

34-0117420

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

One Applied Plaza, Cleveland, Ohio

44115

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (216) 426-4000

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer

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, 2011, 42,371,863 (No par value)

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
INDEX

	Page No.
<u>Part I: FINANCIAL INFORMATION</u>	
<u>Item 1: Financial Statements</u>	
<u>Condensed Statements of Consolidated Income Three and Nine Months Ended March 31, 2011 and 2010</u>	2
<u>Condensed Consolidated Balance Sheets March 31, 2011 and June 30, 2010</u>	3
<u>Condensed Statements of Consolidated Cash Flows Nine Months Ended March 31, 2011 and 2010</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
<u>Report of Independent Registered Public Accounting Firm</u>	15
<u>Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3: Quantitative and Qualitative Disclosures About Market Risk</u>	24
<u>Item 4: Controls and Procedures</u>	25
<u>Part II: OTHER INFORMATION</u>	
<u>Item 1: Legal Proceedings</u>	26
<u>Item 1A: Risk Factors</u>	26
<u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
<u>Item 6: Exhibits</u>	27
<u>Signatures</u>	29
<u>Exhibit Index</u>	
Exhibits	
<u>EX-15</u>	
<u>EX-31</u>	
<u>EX-32</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	

Table of Contents

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,	
	2011	2010	2011	2010
Net Sales	\$ 565,970	\$ 486,141	\$ 1,622,988	\$ 1,370,137
Cost of Sales	409,404	355,785	1,179,021	1,007,432
	156,566	130,356	443,967	362,705
Selling, Distribution and Administrative, including depreciation	118,365	103,319	337,819	299,124
Operating Income	38,201	27,037	106,148	63,581
Interest Expense, net	52	1,374	1,634	3,921
Other (Income) Expense, net	(2,645)	(397)	(3,409)	(642)
Income Before Income Taxes	40,794	26,060	107,923	60,302
Income Tax Expense	14,258	9,535	39,439	22,103
Net Income	\$ 26,536	\$ 16,525	\$ 68,484	\$ 38,199
Net Income Per Share Basic	\$ 0.63	\$ 0.39	\$ 1.61	\$ 0.90
Net Income Per Share Diluted	\$ 0.61	\$ 0.39	\$ 1.58	\$ 0.89
Cash dividends per common share	\$ 0.17	\$ 0.15	\$ 0.51	\$ 0.45
Weighted average common shares outstanding for basic computation	42,446	42,321	42,409	42,298
Dilutive effect of potential common shares	893	581	845	514
Weighted average common shares outstanding for diluted computation	43,339	42,902	43,254	42,812

See notes to condensed consolidated financial statements.

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	March 31, 2011 (Unaudited)	June 30, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 88,559	\$ 175,777
Accounts receivable, less allowances of \$6,882 and \$6,379	280,706	246,402
Inventories	196,427	173,253
Other current assets	26,791	23,428
Total current assets	592,483	618,860
Property, less accumulated depreciation of \$142,445 and \$138,790	67,949	58,471
Intangibles, net	90,324	85,916
Goodwill	75,605	63,405
Deferred tax assets	47,623	48,493
Other assets	17,874	16,375
TOTAL ASSETS	\$ 891,858	\$ 891,520
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable	\$ 110,143	\$ 94,529
Short-term debt		75,000
Compensation and related benefits	55,007	50,107
Other current liabilities	43,493	51,696
Total current liabilities	208,643	271,332
Postemployment benefits	49,777	48,560
Other liabilities	20,241	16,589
TOTAL LIABILITIES	278,661	336,481
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	148,112	143,185
Income retained for use in the business	648,232	601,370
Treasury shares at cost (11,846 and 11,837 shares)	(196,478)	(193,468)
Accumulated other comprehensive income (loss)	3,331	(6,048)
TOTAL SHAREHOLDERS EQUITY	613,197	555,039

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 891,858	\$ 891,520
--	------------	------------

See notes to condensed consolidated financial statements.

3

Table of Contents

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

	Nine Months Ended March 31,	
	2011	2010
Cash Flows from Operating Activities		
Net income	\$ 68,484	\$ 38,199
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,466	8,613
Amortization of intangibles	8,468	7,555
Amortization of stock options and appreciation rights	2,169	2,644
Gain on sale of property	(687)	(104)
Other share-based compensation	3,103	1,534
Changes in assets and liabilities, net of acquisitions	(29,275)	97,079
Other, net	3,254	500
Net Cash provided by Operating Activities	63,982	156,020
Cash Flows from Investing Activities		
Property purchases	(16,446)	(4,163)
Proceeds from property sales	1,079	443
Net cash paid for acquisition of businesses, net of cash acquired	(27,739)	(100)
Other	1,722	
Net Cash used in Investing Activities	(41,384)	(3,820)
Cash Flows from Financing Activities		
Repayments under revolving credit facility	(50,000)	(5,000)
Long-term debt repayments	(25,000)	
Settlements of cross currency swap agreements	(12,752)	
Purchases of treasury shares	(4,491)	(2,738)
Dividends paid	(21,649)	(19,054)
Excess tax benefits from share-based compensation	1,250	1,383
Exercise of stock options and appreciation rights	477	873
Net Cash used in Financing Activities	(112,165)	(24,536)
Effect of Exchange Rate Changes on Cash	2,349	960
(Decrease) increase in cash and cash equivalents	(87,218)	128,624
Cash and cash equivalents at beginning of period	175,777	27,642
Cash and Cash Equivalents at End of Period	\$ 88,559	\$ 156,266

See notes to condensed consolidated financial statements.

Table of Contents

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, 2011, and the results of its operations for the three and nine month periods ended March 31, 2011 and 2010 and its cash flows for the nine months ended March 31, 2011 and 2010, have been included. The condensed consolidated balance sheet as of June 30, 2010 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, 2010. Operating results for the three and nine month periods ended March 31, 2011 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending June 30, 2011.

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 quarter and nine months ended March 31, 2011, the Company recorded overall LIFO benefits of \$350 and \$2,500, respectively and the LIFO reserves were reduced by the same amounts. These reductions resulted from effective supplier price decreases in the first half of our fiscal year as well as LIFO layer liquidation benefits (\$2,000 for the quarter and \$2,700 year to date) from certain inventory levels decreasing. If inventory levels had remained constant, additional LIFO expense in the amount of the layer liquidation would have been recorded. In the prior year, overall LIFO benefits were \$4,800 for the three months ended March 31, 2010 and were \$7,300 for the nine months ended March 31, 2010. These benefits resulted from decreases in inventory quantities which generated overall LIFO layer liquidation benefits recorded in gross profit of \$9,600 for the three months ended March 31, 2010 and \$19,600 for the nine months ended March 31, 2010. If inventory levels had remained constant with the June 30, 2009 levels, the Company would have recorded LIFO expense of \$4,800 in the three months ended March 31, 2010 and \$12,300 for the nine months ended March 31, 2010.

Table of Contents

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

Property

Costs incurred for software developed or obtained for internal use are capitalized in accordance with Accounting Standard Codification 350-40. These costs are classified as property in the condensed consolidated balance sheets and are depreciated once placed in service over the estimated useful life of the software. The net book value of software is \$13,400 and \$3,800 at March 31, 2011 and June 30, 2010, respectively.

Antidilutive Common Stock Equivalents

In the three month and nine month periods ended March 31, 2011 and 2010, respectively, stock options and stock appreciation rights related to the acquisition of 127 and 782 shares of common stock in the three month periods and 322 and 1,346 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.

2. BUSINESS COMBINATIONS

In July and August 2010, the Company completed the acquisitions of UZ Engineered Products (UZ) and SCS Supply Group (SCS) for an aggregate cash purchase price of \$32,000. UZ is a distributor of industrial supply products for maintenance, repair, and operational needs, in the government and commercial sectors, in the U.S. and Canada. SCS is a distributor of bearings, power transmission components, electrical components, fluid power products and industrial supplies in Canada.

Results of operations for UZ and SCS are included in the Company's Service Center Based Distribution segment results of operations from the date of closing.

3. GOODWILL AND INTANGIBLES

The changes in the carrying amount of goodwill by reportable segment for the period ended March 31, 2011 are as follows:

	Service Center Based Distribution	Fluid Power Businesses	Total
Balance at July 1, 2010	\$ 63,405	\$ 0	\$ 63,405
Goodwill acquired during the period	10,637		10,637
Other, primarily currency translation	1,563		1,563
Balance at March 31, 2011	\$ 75,605	\$ 0	\$ 75,605

At March 31, 2011, accumulated goodwill impairment losses, subsequent to fiscal year 2002, totaled \$36,605 and related to the Fluid Power Businesses segment.

Table of Contents

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

	Amount	Accumulated Amortization	Net Book Value
March 31, 2011			
Amortized Intangibles:			
Customer relationships	\$ 76,213	\$ 21,062	\$ 55,151
Trade names	25,752	5,127	20,625
Vendor relationships	14,064	3,379	10,685
Non-competition agreements	4,948	2,375	2,573
Total Amortized Intangibles	120,977	31,943	89,034
Non-amortized trade name	1,290		1,290
Total Intangibles	\$ 122,267	\$ 31,943	\$ 90,324
June 30, 2010			
Customer relationships	\$ 65,324	\$ 15,328	\$ 49,996
Trade names	25,648	3,777	21,871
Vendor relationships	13,842	2,511	11,331
Non-competition agreements	4,394	1,676	2,718
Total Intangibles	\$ 109,208	\$ 23,292	\$ 85,916

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

Amortization expense for each of the following fiscal years (based on the Company's intangible assets as of March 31, 2011) is estimated to be \$11,300 for 2011, \$10,600 for 2012, \$9,900 for 2013, \$8,600 for 2014, \$8,000 for 2015 and \$7,400 for 2016.

4. DEBT

In September 2010, the Company repaid \$50.0 million under the revolving credit facility. In November 2010, the Company repaid \$25.0 million under the private placement borrowing. As of March 31, 2011, there are no amounts outstanding under our existing credit facilities.

Table of Contents

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

5. RISK MANAGEMENT ACTIVITIES

The derivative instruments outstanding at June 30, 2010 were settled in the first half of fiscal 2011.

The Company is exposed to market risks, primarily resulting from changes in currency exchange rates. To manage this risk, the Company may enter into derivative transactions pursuant to the Company's written policy. Derivative instruments are recorded on the condensed consolidated balance sheet at their fair value and changes in fair value are recorded each period in current earnings or comprehensive income. The Company does not hold or issue derivative financial instruments for trading purposes. The criteria for designating a derivative as a hedge include the assessment of the instrument's effectiveness in risk reduction, matching of the derivative instrument to its underlying transaction, and the probability that the underlying transaction will occur.

In the second quarter of fiscal 2011, the Company settled its cross-currency swap agreements which had been outstanding since November 2000. The interest rate swap entered into in September 2008 was settled in the first quarter of fiscal 2011.

The following table summarizes the fair value of derivative instruments as recorded in other current liabilities in the condensed consolidated balance sheet at June 30, 2010. There are no amounts outstanding at March 31, 2011.

	June 30, 2010 Fair Value
Derivatives designated as hedging instruments:	
Cross-currency swap	\$ 8,728
Interest rate swap	316
Total derivatives designated as hedging instruments	9,044
Derivative not designated as a hedging instrument - cross-currency swap	2,182
Total Derivatives	\$ 11,226

Table of Contents

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

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

The following table summarizes the effects of derivative instruments on income and other comprehensive income (OCI) for the three and nine months ended March 31, 2011 and 2010 (amounts presented exclude income tax effects):

Derivatives in Cash	Amount of Gain (Loss) Recognized in OCI on				Amount of Loss Reclassified from Accumulated OCI into Income (Effective Portion), Included			
	Derivatives (Effective Portion)				in Interest Expense, net			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
Flow Hedging Relationships	2011	2010	2011	2010	2011	2010	2011	2010
Cross-currency swap	\$0	\$(761)	\$0	\$(3,561)				
Interest rate swap		304		707	\$0	\$(351)	\$(316)	\$(1,057)
Total	\$0	\$(457)	\$0	\$(2,854)	\$0	\$(351)	\$(316)	\$(1,057)

Designated Not Derivative as Hedging Instrument	Amount of Gain (Loss) Recognized in Income on Derivative, Included in Other (Income) Expense, net			
	Three Months Ended		Nine Months Ended	
	2011	2010	2011	2010
Cross-currency swap	\$ 0	\$ (190)	\$ (368)	\$ (890)

6. FAIR VALUE MEASUREMENTS

Assets and liabilities measured at fair value are as follows at March 31, 2011 and June 30, 2010. There are currently no items categorized as Level 3 within the fair value hierarchy.

Fair Value Measurements

	Recorded Value		Quoted Prices in Active Markets for Identical Instruments Level 1		Significant Other Observable Inputs Level 2	
	March 31, 2011	June 30, 2010	March 31, 2011	June 30, 2010	March 31, 2011	June 30, 2010
	Assets:					
Marketable securities	\$ 10,563	\$ 8,592	\$ 10,563	\$ 8,592		
Liabilities:						
Cross-currency swaps	\$ 0	\$ 10,910			\$ 0	\$ 10,910
Interest rate swap		316				316

Total Liabilities	\$	0	\$ 11,226	\$	0	\$ 11,226
-------------------	----	---	-----------	----	---	-----------

Marketable securities in the previous table are held in a rabbi trust for a non-qualified deferred compensation plan. The marketable securities are included in other assets on the

9

Table of Contents**APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES**
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

condensed consolidated balance sheets. The fair values were derived using quoted market prices.

Fair values for cross-currency and interest rate swaps in the previous table were derived based on valuation models using foreign currency exchange rates and inputs readily available in the public swap markets for similar instruments adjusted for terms specific to these instruments. Since the inputs used to value these instruments were observable and the counterparties were creditworthy, the Company classified them as Level 2 inputs. These liabilities have all been settled in fiscal 2011, the balances at June 30, 2010 were included in other current liabilities on the condensed consolidated balance sheet.

7. COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended March 31,	
	2011	2010
Net income	\$ 26,536	\$ 16,525
Other comprehensive income (loss):		
Unrealized loss on cash flow hedges, net of income tax of \$(226) in the quarter ended 3/31/10		(492)
Reclassification of interest expense into income, net of income tax of \$133 in the quarter ended 3/31/10		218
Reclassification of pension and postemployment expense into income, net of income tax of \$213 and \$169	341	276
Foreign currency translation adjustment	7,037	354
Unrealized (loss) gain on investment securities available for sale, net of income tax of \$(103) and \$3	(170)	5
Total comprehensive income	\$ 33,744	\$ 16,886

Table of Contents

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

	Nine Months Ended March 31,	
	2011	2010
Net income	\$ 68,484	\$ 38,199
Other comprehensive (loss) income:		
Unrealized loss on cash flow hedges, net of income tax of \$(82) and \$(904)	(184)	(1,979)
Reclassification of interest expense into income, net of income tax of \$116 and \$401	200	656
Reclassification of pension and postemployment expense into income, net of income tax of \$560 and \$508	1,101	828
Foreign currency translation adjustment	8,328	2,105
Unrealized (loss) gain on investment securities available for sale, net of income tax of \$(35) and \$14	(66)	32
Total comprehensive income	\$ 77,863	\$ 39,841

8. BENEFIT PLANS

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	
	2011	2010	2011	2010
Three Months Ended March 31, Components of net periodic benefit cost:				
Service cost	\$ 115	\$ 144	\$ 10	\$ 13
Interest cost	565	673	59	65
Expected return on plan assets	(97)	(88)		
Recognized net actuarial loss (gain)	362	231	(21)	(22)
Amortization of prior service cost	178	199	35	37
Net periodic benefit cost	\$ 1,123	\$ 1,159	\$ 83	\$ 93

	Pension Benefits		Retiree Health Care Benefits	
	2011	2010	2011	2010
Nine Months Ended March 31, Components of net periodic benefit cost:				
Service cost	\$ 345	\$ 431	\$ 30	\$ 39
Interest cost	1,694	2,020	177	194
Expected return on plan assets	(289)	(263)		
Recognized net actuarial loss (gain)	1,086	693	(63)	(65)
Amortization of prior service cost	533	597	104	111
Net periodic benefit cost	\$ 3,369	\$ 3,478	\$ 248	\$ 279

Table of Contents**APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES**
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The Company contributed \$1,500 to its pension benefit plans and \$115 to its retiree health care plans in the nine months ended March 31, 2011. Expected contributions for all of fiscal 2011 are \$1,700 for the pension benefit plans and \$250 for retiree health care plans.

9. 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 segment and the Fluid Power Businesses segment have been eliminated in the table below.

Segment Financial Information for the three months ended:

	Service Center Based Distribution	Fluid Power Businesses	Total
March 31, 2011			
Net sales	\$ 451,982	\$ 113,988	\$ 565,970
Operating income for reportable segments	32,275	11,244	43,519
Depreciation	2,447	523	2,970
Capital expenditures	2,159	484	2,643
March 31, 2010			
Net sales	\$ 390,481	\$ 95,660	\$ 486,141
Operating income for reportable segments	20,235	7,842	28,077
Depreciation	2,320	523	2,843
Capital expenditures	1,163	49	1,212

Table of Contents

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

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

Segment Financial Information for the nine months ended:

	Service Center Based Distribution	Fluid Power Businesses	Total
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	6,910	1,556	8,466
Capital expenditures	15,707	739	16,446
March 31, 2010			
Net sales	\$ 1,120,163	\$ 249,974	\$ 1,370,137
Operating income for reportable segments	53,837	16,617	70,454
Assets used in the business	665,405	201,302	866,707
Depreciation	7,010	1,603	8,613
Capital expenditures	3,834	329	4,163

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Operating income for reportable segments	\$ 43,519	\$ 28,077	\$ 114,184	\$ 70,454
Adjustment for:				
Amortization of intangibles:				
Service Center Based Distribution	789	442	2,475	1,363
Fluid Power Businesses	2,001	2,066	5,993	6,192
Corporate and other expense (income), net	2,528	(1,468)	(432)	(682)
Total operating income	38,201	27,037	106,148	63,581
Interest expense, net	52	1,374	1,634	3,921
Other income, net	(2,645)	(397)	(3,409)	(642)
Income before income taxes	\$ 40,794	\$ 26,060	\$ 107,923	\$ 60,302

The change in corporate and other (income) expense, net is 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.

Table of Contents

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

Net sales are presented in geographic areas based on the location of the facility shipping the product and invoicing the sale and are as follows:

Geographic Areas:	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
United States	\$ 487,777	\$ 428,662	\$ 1,398,020	\$ 1,192,246
Canada	63,717	45,515	181,127	142,300
Mexico	14,476	11,964	43,841	35,591
Total	\$ 565,970	\$ 486,141	\$ 1,622,988	\$ 1,370,137

10. OTHER (INCOME) EXPENSE, NET

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Unrealized (gain) loss on assets held in rabbi trust for a nonqualified deferred compensation plan	\$ (473)	\$ (376)	\$ (1,978)	\$ (1,655)
Benefit from payouts on corporate-owned life insurance policies	(1,722)		(1,722)	
Foreign currency transaction (gains) losses	(333)	75	(184)	162
Loss on cross-currency swap		190	368	890
Other, net	(117)	(286)	107	(39)
Total other (income) expense, net	\$ (2,645)	\$ (397)	\$ (3,409)	\$ (642)

The Company is the owner and beneficiary under life insurance policies acquired in connection with a fiscal 1998 acquisition. In January 2011, the Company received death benefits under two of these policies and realized a gain of \$1,722 in the quarter ending March 31, 2011. At March 31, 2011, these policies have benefits in force of \$12,300 and a net cash surrender value of \$3,100.

Table of Contents

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, 2011, and the related condensed statements of consolidated income for the three-month and nine-month periods ended March 31, 2011 and 2010, and of consolidated cash flows for the nine-month periods ended March 31, 2011 and 2010. 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, 2010, 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 13, 2010, 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, 2010 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 4, 2011

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

Applied Industrial Technologies (Applied, the Company, We, Us or Our) is an industrial distributor that offers products critical to the operations of MRO and OEM customers in a wide range of industries. In addition, Applied provides engineering, design and systems integration for industrial and fluid power applications, as well as customized fluid power shop, mechanical and fabricated rubber services. Applied is an authorized distributor for more than 2,000 manufacturers, and we offer access to approximately 4 million stock keeping units (SKUs). A large portion of our business is selling replacement parts to manufacturers and other industrial concerns for repair or maintenance of machinery and equipment. 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 2011, business was conducted in the United States, Canada, Mexico and Puerto Rico from 474 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, 2011 increased \$79.8 million or 16.4% compared to the prior year quarter, with acquisitions contributing \$10.9 million and favorable foreign currency translation accounting for \$3.8 million of the increase. Operating margin increased to 6.7% of net sales from 5.6% for the prior year quarter and net income increased \$10.0 million or 60.6% compared to the prior year quarter. Shareholders' equity was \$613.2 million at March 31, 2011. The current ratio moved to 2.8 to 1 at March 31, 2011 from 2.3 to 1 at June 30, 2010 as we retired \$75.0 million of debt in fiscal 2011. Since November 30, 2010, we have had no borrowings outstanding under our existing credit facilities.

Applied monitors several economic indices that have been key indicators for industrial economic activity. These include the Manufacturing Capacity Utilization (MCU) index published by the Federal Reserve Board and the Manufacturing Index 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 on the upswing by up to six months and move closer in alignment with the declines.

These indices showed continued moderate growth in the industrial economy during the third quarter of fiscal 2011. The MCU for March was 75.8, up from December's 73.5 and still well above its last trough of 65.2 in June of 2009. The ISM was 61.2 in March, up from 57.0 in December. The ISM appears stable and is in keeping with a forecast for moderate growth. Our third quarter average sales per day increased 1.9% compared to our second quarter average sales

Table of Contents**APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES****ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

per day and was 14.6% above our prior year third quarter average sales per day. We believe that the recovery of the U.S. industrial economy will continue, and we should see further growth in our sales per day rate in the fourth quarter. The number of Company associates was 4,639 at March 31, 2011, 4,468 at June 30, 2010, and 4,491 at March 31, 2010. During the nine months ended March 31, 2011 acquisitions added a net 214 associates while headcount for pre-existing operations fell by 66 associates. The number of operating facilities totaled 474 at March 31, 2011 and 458 at March 31, 2010.

Results of Operations**Three Months Ended March 31, 2011 and 2010**

The following table is included to aid in review of Applied's condensed statements of consolidated income. The percent increase (decrease) column is comparative to the same period in the prior year.

	Three Months Ended March 31,		
	As a Percent of Net		Percent
	2011	2010	Increase (Decrease)
Net Sales	100.0%	100.0%	16.4%
Gross Profit	27.7%	26.8%	20.1%
Selling, Distribution & Administrative	20.9%	21.3%	14.6%
Operating Income	6.7%	5.6%	41.3%
Net Income	4.7%	3.4%	60.6%

During the quarter ended March 31, 2011, net sales increased \$79.8 million or 16.4% compared to the prior year quarter, with acquisitions accounting for additional sales of \$10.9 million or 2.2%, one additional sales day adding \$8.8 million or 1.8%, and favorable foreign currency translation adding \$3.8 million or 0.8%. The number of selling days for the quarters ended March 31, 2011 and 2010 were 64 and 63 days, respectively.

Net sales from our Service Center Based Distribution segment, which is heavily focused on the MRO market, increased \$61.5 million or 15.8% 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 \$10.9 million, or 2.8%. Net sales from our Fluid Power Businesses segment, which is heavily focused on the OEM market, increased \$18.3 million or 19.2% 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 \$59.1 million or 13.8%, with acquisitions accounting for \$5.8 million or 1.4% of the U.S. increase. Sales from our Canadian

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

operations increased \$18.2 million or 40.0%. This increase consists of \$5.0 million from acquisitions and \$3.0 million due to favorable foreign currency translation. Our Mexican operations increased \$2.5 million or 21.0%, with \$0.8 million due to favorable foreign currency translation.

During the quarter ended March 31, 2011, industrial products and fluid power products accounted for 70.2% and 29.8%, respectively, of net sales as compared to 70.6% and 29.4%, respectively, for the same period in the prior year. The increase in fluid power products is reflective of the increases in sales in the Fluid Power Businesses segment. Our gross profit margin for the quarter increased to 27.7% compared to the prior year quarter's 26.8%. The improvement can be largely attributed to increased contribution from our point-of-sale margins, primarily in our U.S. operations. Solid contributions from our two acquisitions also helped increase the margin. We had a minimal LIFO impact in the quarter due to a LIFO layer liquidation. Additional LIFO layer liquidation benefits could be achieved in the fourth quarter if further inventory reductions are achieved or realized.

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 20.9% of net sales in the quarter ended March 31, 2011 compared to 21.3% in the prior year quarter. On an absolute basis, SD&A increased \$15.0 million or 14.6% compared to the prior year quarter. Performance driven expenses and employee benefits increased \$7.0 million, acquisitions added \$5.0 million and incremental ERP expenses associated with the implementation of SAP announced in October 2010 totaled \$3.0 million.

Operating income increased 41.3% to \$38.2 million during the quarter compared to \$27.0 million during the prior year quarter. Operating income as a percentage of sales for the Service Center Based Distribution segment increased to 7.1% in the current year quarter, from 5.2% in the prior year quarter. The Fluid Power Businesses operating margins increased to 9.9% in the current year quarter from 8.2% in the prior year quarter. These increases as compared to the prior year quarter reflect improved operating leverage on the increases in sales.

Interest, net, is down \$1.3 million due to repayment in the first half of fiscal 2011 of all borrowings under our credit facilities.

Other income was \$2.6 million in the quarter and included a \$1.7 million gain from death benefits received under two life insurance policies.

The effective income tax rate was 35.0% for the quarter ended March 31, 2011 compared to 36.6% for the quarter ended March 31, 2010. Our effective tax rate decreased primarily due to the realization of a non-taxable gain on life insurance policies (approximately a 1.1% favorable

Table of Contents**APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES****ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

impact on the rate) and certain U.S. tax credits and deductions recognized in the quarter (approximately a 1.6% favorable impact on the rate). Partially offsetting these reductions was expense associated with providing for U.S. income tax expense on a portion of undistributed earnings not considered permanently reinvested in our Canadian subsidiaries (approximately a 1.6% increase in the rate). In the prior year third quarter, no such provision was made. As a result of the factors addressed above, net income increased \$10.0 million or 60.6% compared to the prior year quarter. Net income per share was \$0.61 per share for the quarter ended March 31, 2011, compared to \$0.39 in the prior year quarter.

Nine Months Ended March 31, 2011 and 2010

The following table is included to aid in review of Applied's condensed statements of consolidated income. The percent increase (decrease) column is comparative to the same period in the prior year.

	Nine Months Ended March 31,		
	As a Percent of Net		Percent
	2011	2010	Increase (Decrease)
Net Sales	100.0%	100.0%	18.5%
Gross Profit	27.4%	26.5%	22.4%
Selling, Distribution & Administrative	20.8%	21.8%	12.9%
Operating Income	6.5%	4.6%	66.9%
Net Income	4.2%	2.8%	79.3%

During the nine months ended March 31, 2011, net sales increased \$252.9 million or 18.5% compared to the same period in the prior year, with acquisitions accounting for additional sales of \$27.8 million or 2.0%, and favorable foreign currency translation adding \$11.1 million or 0.8%. The number of selling days for the nine months ended March 31, 2011 and 2010 were 189 days each.

Net sales from our Service Center Based Distribution segment, which is heavily focused on the MRO market, increased \$182.0 million or 16.2% during the nine months ended March 31, 2011 from the same period in the prior year, primarily attributed to improvement in the industrial economy. Acquisitions within this segment increased sales by \$27.8 million, or 2.5%.

Net sales from our Fluid Power Businesses segment, which is heavily focused on the OEM market, increased \$70.9 million or 28.4% during the nine months ended March 31, 2011 from the same period in the prior year, primarily attributed to improvement 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 increased \$205.8 million or 17.3%, with acquisitions accounting for 1.3% of the U.S. increase. Sales from our Canadian operations

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

increased \$38.8 million or 27.3%. Acquisitions accounted for \$12.2 million of the increase and favorable foreign currency translation accounted for \$9.0 million. Sales of our Mexican operations increased \$8.2 million or 23.2%, with \$2.1 million attributed to favorable foreign currency translation.

During the nine months ended March 31, 2011, industrial products and fluid power products accounted for 70.7% and 29.3%, respectively, of net sales as compared to 72.1% and 27.9%, respectively, for the same period in the prior year.

The increase in fluid power products is reflective of the increases in sales in the Fluid Power Businesses segment.

Our gross profit margin for the period increased to 27.4% compared to the prior year period's 26.5%. The gross profit for the first half of the year was positively impacted by LIFO benefits of \$4.4 million or 0.4% resulting from effective price decreases from increased supplier purchasing incentives in fiscal 2011. These decreases flow through the LIFO calculation as a benefit as the price paid for product (net of inventory purchasing incentives) is lower this year versus last. We also had a small positive impact from LIFO liquidations in the third quarter.

SD&A was 20.8% of net sales in the nine months ended March 31, 2011 compared to 21.8% in the prior year period.

On an absolute basis, SD&A increased \$38.7 million or 12.9% compared to the prior year period. Performance driven expenses and employee benefits increased \$21.4 million, acquisitions added \$13.0 million and ERP expenses added \$3.8 million.

Operating income increased 66.9% to \$106.1 million during the period compared to \$63.6 million during the prior year period. Operating income as a percentage of sales for the Service Center Based Distribution segment increased to 6.4% in the current year period, from 4.8% in the prior year period. The Fluid Power Businesses operating margins increased to 9.5% in the current year period from 6.6% in the prior year period. These increases as compared to the prior year period reflect improved operating leverage on the increases in sales.

Interest, net, is down \$2.3 million due to repayment of the revolver in September 2010 and the private placement debt in November 2010.

Other income was \$3.4 million for the year-to-date period and included \$2.0 million of unrealized gains on investments held by non-qualified deferred compensation trusts and a \$1.7 million gain from death benefits received under two life insurance policies.

The effective income tax rate was 36.5% for the nine months ended March 31, 2011 compared to 36.7% for the same period in the prior year. The decrease from the prior year is due to reversal of a valuation allowance in the second quarter and the favorable impact of realizing certain tax benefits and deductions in the third quarter. These decreases are largely offset by provision made for U.S. income tax expense on a portion of undistributed earnings not considered permanently reinvested in our Canadian subsidiaries.

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

As a result of the factors addressed above, net income increased \$30.3 million or 79.3% compared to the prior year period. Net income per share was \$1.58 per share for the nine months ended March 31, 2011, compared to \$0.89 in the prior year period.

Liquidity and Capital Resources

Net cash provided by operating activities for the nine months ended March 31, 2011 was \$64.0 million. This compares to \$156.0 million provided by operating activities in the same period a year ago. The most significant factor in the \$92.0 million fluctuation relates to changes in inventory. In fiscal 2010, the Company undertook an inventory management program which by June 30, 2010 had resulted in a \$101.4 million reduction in U.S. bearing and drives products from the June 30, 2009 levels. These inventory reductions were targeted to reduce excess quantities of certain products within our system. Inventory has increased in the current year, due to acquisitions, increased business levels and some increases to compensate for an increase in manufacturer lead times.

Net cash used in investing activities during the current year was \$41.4 million; \$27.7 million was used 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. In the nine months ended March 31, 2010, we used \$3.8 million in investing activities primarily for capital expenditures. The increase in capital expenditures primarily relates to spending on our ERP project announced in the first quarter of fiscal 2011.

Net cash used in financing activities was \$112.2 million for the nine months ended March 31, 2011. In the current year, 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. In the prior year, financing activities used \$24.5 million of cash; we repaid a net \$5.0 million on our revolving credit facility, paid dividends of \$19.1 million and repurchased 117,000 shares of treasury stock for \$2.7 million.

On October 1, 2010, Applied announced its selection of SAP to help transform the Company's technology platforms and enhance its business information and transaction systems for future growth. We expect capital expenditures for this ERP project for all of fiscal 2011 to be around \$13.4 million, a downward revision from our prior quarter as more of the current year expenditures are expected to be expensed versus capitalized. We expect SD&A expenses associated with this project to be approximately \$8.0 million in fiscal year 2011, approximately \$4.0 million of which is expected to come in the fourth quarter. Our overall capital expenditures for fiscal 2011, including ERP, are expected to be between \$20.0 million and \$22.0 million.

We have a \$150.0 million revolving credit facility with a group of banks expiring in June 2012. There are no borrowings outstanding under this facility at March 31, 2011. At March 31, 2011, unused lines under this facility, net of outstanding letters of credit, total \$143.1 million and are available to fund future acquisitions or other capital and operating requirements.

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

We have an uncommitted shelf facility with Prudential Insurance Company that enables us to borrow up to \$100.0 million in additional long-term financing with terms of up to fifteen years. This agreement expires in February 2013. At March 31, 2011, there were no outstanding borrowings under this agreement.

In November 2010, we repaid the \$25.0 million private placement debt, bringing our outstanding debt to zero.

The Board of Directors has authorized the repurchase of 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 acquired 142,800 shares of treasury stock on the open market in the nine months ended March 31, 2011. At March 31, 2011, we had authorization to repurchase an additional 694,400 shares.

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, 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, however, any additional debt may be at higher rates than under the terms of the revolving credit facility.

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, v should, could, would, anticipate, estimate, forecast, may, and derivative or similar words or expressions. S

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, 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

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

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: changes in customer preferences for products and services of the nature and brands sold by us; changes in customer procurement policies and practices; changes in the prices for products and services relative to the cost of providing them; loss of key supplier authorizations, lack of product availability, or changes in supplier distribution programs; the potential for product shortages if suppliers are unable to fulfill in a timely manner increased demand in the economic recovery; competitive pressures; the cost of products and energy and other operating costs; risks relating to the operations levels of our customers and the economic factors that affect them; 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 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; 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, 2010.

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC. AND SUBSIDIARIES

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has evaluated its exposure to various market risk factors, including its primary market risk exposure through the effects of changes in exchange rates. We occasionally utilize derivative instruments as part of our overall financial risk management policy, but do not use derivative instruments for speculative or trading purposes.

In November 2010, we settled the cross-currency swaps related to our private placement debt for \$12.8 million. In September 2010, we settled the interest rate swap outstanding at June 30, 2010. There were no additional material changes in our market risk exposure in the nine-months ended March 31, 2011. 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, 2010.

Table of Contents

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 2011, 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.

Table of Contents**PART II. OTHER INFORMATION****ITEM 1. Legal Proceedings.**

The Company is a party to pending legal proceedings with respect to various product liability, commercial, and other matters. Although it is not possible to predict the outcome of these proceedings or the range of 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 1A. Risk Factors.

In Part II, Item 1A, of its quarterly report on Form 10-Q for the quarter ended September 30, 2010, the Company set forth changes from the risk factors disclosed under Part I, Item 1A, of the annual report on Form 10-K for the fiscal year ended June 30, 2010. You should carefully consider the risk factors from these previous reports in addition to the other information set forth in this quarterly report that could materially affect our business, financial condition, or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also impact our business and operations.

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

Repurchases in the quarter ended March 31, 2011 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) (2)
January 1, 2011 to January 31, 2011	-0-	-0-	-0-	837,200
February 1, 2011 to February 28, 2011	-0-	-0-	-0-	837,200
March 1, 2011 to March 31, 2011	142,800	31.45	142,800	694,400
Total	142,800	31.45	142,800	694,400

26

Table of Contents

- (1) On January 23, 2008, the Board of Directors authorized the purchase of up to 1.5 million shares of the Company's common stock. The Company publicly announced the authorization that day. These purchases may be made in the open market or in privately negotiated transactions. This authorization is in effect until all shares are purchased or the authorization is revoked or amended by the Board of Directors.
- (2) During the quarter, the Company purchased 37 shares in connection with the deferred compensation program and vesting of stock awards.

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).

Table of Contents

Exhibit No.	Description
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 for the quarter ended December 31, 2009, 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).
15	Independent Registered Public Accounting Firm's Awareness Letter.
31	Rule 13a-14(a)/15d-14(a) certifications.
32	Section 1350 certifications.
101	Interactive data files: (i) the Condensed Statements of Consolidated Income for the three and nine month periods ended March 31, 2011 and 2010; (ii) the Condensed Consolidated Balance Sheets at March 31, 2011 and June 30, 2010; (iii) the Condensed Statements of Consolidated Cash Flows for the nine months ended March 31, 2011 and 2010; and (iv) the Notes to the Condensed Consolidated Financial Statements submitted herewith pursuant to Rule 406T.

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.

Table of Contents

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 4, 2011

By: /s/ David L. Pugh
David L. Pugh
Chairman & Chief Executive Officer

Date: May 4, 2011

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

Table of Contents

APPLIED INDUSTRIAL TECHNOLOGIES, INC.
EXHIBIT INDEX
TO FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2011

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 for the quarter ended December 31, 2009, SEC File No. 1-2299, and incorporated here by reference).

Table of Contents

EXHIBIT NO.	DESCRIPTION	
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).	
15	Independent Registered Public Accounting Firm's Awareness Letter.	Attached
31	Rule 13a-14(a)/15d-14(a) certifications.	Attached
32	Section 1350 certifications.	Attached
101	Interactive data files: (i) the Condensed Statements of Consolidated Income for the three and nine month periods ended March 31, 2011 and 2010; (ii) the Condensed Consolidated Balance Sheets at March 31, 2011 and June 30, 2010; (iii) the Condensed Statements of Consolidated Cash Flows for the nine months ended March 31, 2011 and 2010; and (iv) the Notes to the Condensed Consolidated Financial Statements submitted herewith pursuant to Rule 406T.	Attached