

Industrials/Multi-Industry

Read across from AIT earnings: demand in line; potential for restock upside

Industry Overview

Read across on AIT earnings to our industrial coverage

Applied Industrial Technologies (ticker: AIT; not covered) is a leading industrial distributor of bearings, flow control, fluid power, and automation products. It reported Fiscal 2Q24 earnings yesterday. The company was up 50bps the day of reporting (in line with the S&P). EPS came in 6% above consensus estimates. AIT narrowed the midpoint of guidance to \$9.35-\$9.70 (from \$9.20-\$9.80), reflecting +1-3% y/y sales growth (+0-2% organic) and 12.1-12.3% EBITDA margins. The sales guide is 100bps lower on the high end. The lower guide reflects conservatism and a slow start to January, driven by weather. AIT anticipates low-single-digit declines organically in FQ3 (1Q) but a return to growth in FQ4. It was constructive on reacceleration into F25. Overall, we view the results and outlook as in line with expectations for industrial demand into 4Q23 earnings: growth is moderating, but companies are constructive that demand will reaccelerate in 2H24. On the margin, the potential for restocking would be a tailwind vs expectations.

A look at end market growth: semis is the weak spot...

The tech sector (semis, data centers) has been a drag on topline for a full year, largely driven by semis, with 100bp drag to growth on the total business. While orders were up >10% sequentially in F2Q, AIT is not underwriting an inflection in semis in F24. CEO Neil Schrimsher said on the call that he expects semis to “re-accelerate...late in CY24 or 2025.” AIT also flagged machinery, energy, & rubber and plastics declining y/y.

...but ample areas of strength

Of its top 30 end markets, AIT is seeing growth in 18 of them. This compares to 22 end markets last quarter. Key verticals where it highlighted growth are food & beverage, energy, and rubber and plastics. The company also continues to be constructive on flow control and fluid power ex-technology impact. The company is also starting to see decarbonization-related flow control projects pick up. This is constructive for process-exposed Honeywell (HON), Emerson (EMR), ITT (ITT), and Flowserve (FLS), all Buy-rated.

Closer to destock than restock: bullish for manufacturers

AIT sees itself as closer to destocking than restocking. The company has expanded the metrics that it uses to evaluate inventory levels and added a centralized inventory team. The company evaluates its end customer demand in determining appropriate inventory levels. Given where it expects growth in the next 12-18 months, AIT is starting to think about reinvesting in inventories. We view this as particularly constructive for Buy-rated Parker-Hannifin (PH), given investor perception surrounding fluid power and destocking.

Pricing likely coming in better than expectations

On the conference call, management disclosed that pricing was low-single digits for the quarter, slightly decelerating from last quarter. This is in line with our framework for manufacturers, as we forecast pricing deceleration. The company's framework is that pricing seems to be “higher-for-longer,” with more supplier price increases than it expected. This is in line with HON commentary, which we interpreted as more bullish on price into YE23. We view this as a tailwind for our coverage in 2024.

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Exhibit 1: Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
EMR	EMR US	Emerson	US\$ 96.24	B-1-7
FLS	FLS US	Flowserve	US\$ 40.86	B-1-7
HON	HON US	Honeywell	US\$ 202.56	B-1-7
ITT	ITT US	ITT Inc.	US\$ 120.07	B-1-7
PH	PH US	Parker Hannifin	US\$ 471.8	B-1-7

Source: BofA Global Research

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Price objective basis & risk

Emerson Electric Co (EMR)

We base our \$120 price objective on a 15x EV/EBITDA multiple of our CY25E EBITDA. Our target multiple is a premium to multi-industrial peers trading at 14x CY24 estimates. We argue that a premium is warranted, given above-peer margins and execution.

Downside risks to our PO are 1) deterioration in energy capex outlook or oil price correction 2) emerging market slowdown, which could impact the company's growth, and 3) acquisition integration risks.

Flowserve (FLS)

We base our \$44 price objective on a 10x EV/EBITDA multiple on our 2025 estimates. A 10x multiple puts the company at a discount to the 11x peer average multiple on 2024. We think the discount is warranted given below-peer margins.

Upside risks to our PO are: 1) Faster-than-expected recovery in oil & gas capital spending, and 2) Better than anticipated global industrial production growth. Downside risks: 1) a reduction in capital spending in the key end-markets, specifically oil & gas 2) Greater consolidation in the flow control market increases competition and reduces prices across the industry, and 3) weaker than anticipated global industrial production.

Honeywell International Inc. (HON)

We base our \$250 price objective on 15x 2025E EV/EBITDA. Our target multiple is a premium to peers trading at 14x EV/EBITDA on 2024E. We argue a premium multiple is warranted given top quartile execution and end market exposure to aerospace and oil & gas.

Downside risks to our price objective are: 1) Acquisitions, specifically that Honeywell overpays for deals in the pursuit of diversifying and expanding into new, faster-growing adjacent markets, 2) Unforeseen future sales deceleration due to economic pressures (e.g., slowing global flying hours, oil price volatility and muted O&G capex outlook), and 3) execution around ongoing simplification efforts.

ITT Inc. (ITT)

Our \$135 price objective reflects 12x our 2025 estimates, in line with peers trading at 12x 2024E. We believe an in-line valuation is warranted given better EPS growth and margin expansion in '24, offset by decelerating organic growth.

Downside risks to our PO are: 1) ITT may overpay for deals in the pursuit of diversifying and expanding its product portfolio, 2) Lower than expected capex spending in the auto, oil & gas, power gen, and other key end markets, 3) Short-cycle and chemical pumps

could slow, 4) above-peer exposure to European markets, and 5) declining backlog coverage may limit visibility.

Parker Hannifin Corporation (PH)

We base our \$525 price objective on a 14x EV/EBITDA multiple applied to our CY25E estimate. Our 14x target multiple is at a discount to the 16x multi-industrial peer average on 2024E and 17x Aerospace Suppliers peer average on 2024E. Parker has historically traded at a discount, but we believe it should start to close the gap with high quality peers AME and ITW.

Downside risks are: 1) industrial short-cycle destocking worse than expected, 2) Meggitt integration, and 3) the ability to offset material inflation through pricing. Upside risks: 1) Aerospace recovery has more upside given more exposure from Meggitt, and 2) Multiple expansion as the company closes the performance gap.

Analyst Certification

I, Andrew Obin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Multi-Industrials/Engineering and Construction Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	APi Group	APG	APG US	Andrew Obin
	AspenTech	AZPN	AZPN US	Andrew Obin
	Atmus Filtration	ATMU	ATMU US	Andrew Obin
	Dover Corp	DOV	DOV US	Andrew Obin
	Eaton Corp PLC	ETN	ETN US	Andrew Obin
	Emerson Electric Co	EMR	EMR US	Andrew Obin
	Flowserve	FLS	FLS US	Andrew Obin
	General Electric Company	GE	GE US	Andrew Obin
	Honeywell International Inc.	HON	HON US	Andrew Obin
	ITT Inc.	ITT	ITT US	Andrew Obin
	Montrose Environmental Group, Inc.	MEG	MEG US	Andrew Obin
	Parker Hannifin Corporation	PH	PH US	Andrew Obin
	PTC Inc.	PTC	PTC US	Andrew Obin
	Rush	RUSHA	RUSHA US	Andrew Obin
	Vertiv	VRT	VRT US	Andrew Obin
	Vontier	VNT	VNT US	Andrew Obin
NEUTRAL				
	3M Company	MMM	MMM US	Andrew Obin
	AMETEK Inc	AME	AME US	Andrew Obin
	Fortive Corporation	FTV	FTV US	Andrew Obin
	Johnson Controls International PLC	JCI	JCI US	Andrew Obin
	Pentair plc	PNR	PNR US	Andrew Obin
	Rockwell	ROK	ROK US	Andrew Obin
	Trane Technologies PLC	TT	TT US	Andrew Obin
UNDERPERFORM				
	Allegion	ALLE	ALLE US	Andrew Obin
	Carrier Global Corp.	CARR	CARR US	Andrew Obin
	Core & Main	CNM	CNM US	Andrew Obin
	Illinois Tool Works	ITW	ITW US	Andrew Obin
	John Bean Technologies	JBT	JBT US	Andrew Obin
	Keysight	KEYS	KEYS US	David Ridley-Lane, CFA

Disclosures

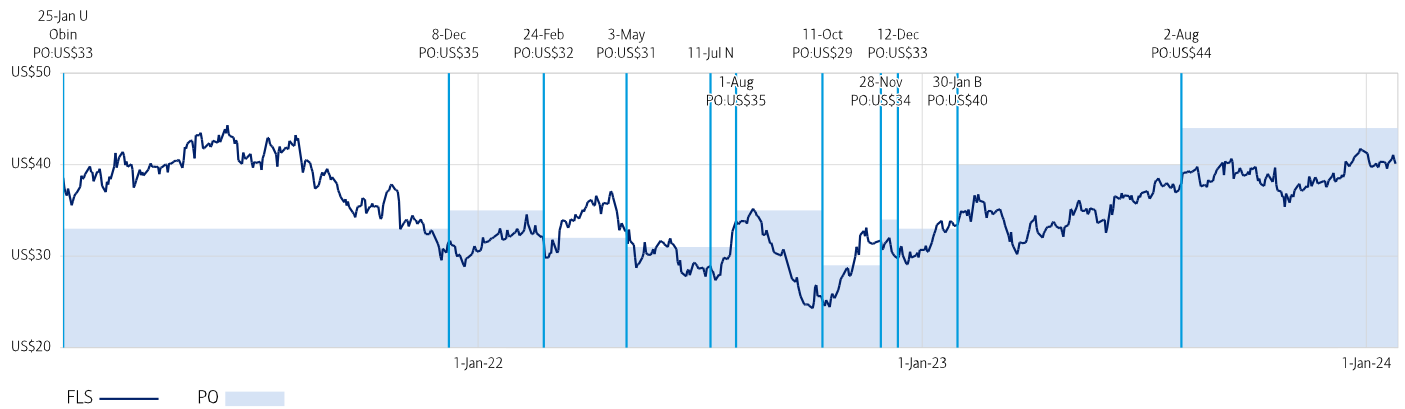
Important Disclosures

Emerson (EMR) Price Chart



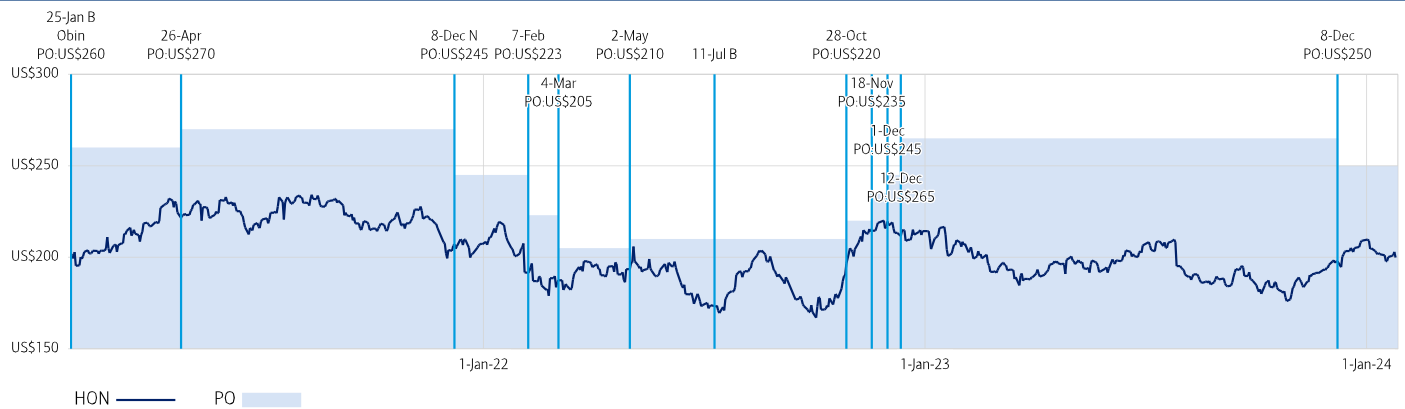
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Flowserve (FLS) Price Chart

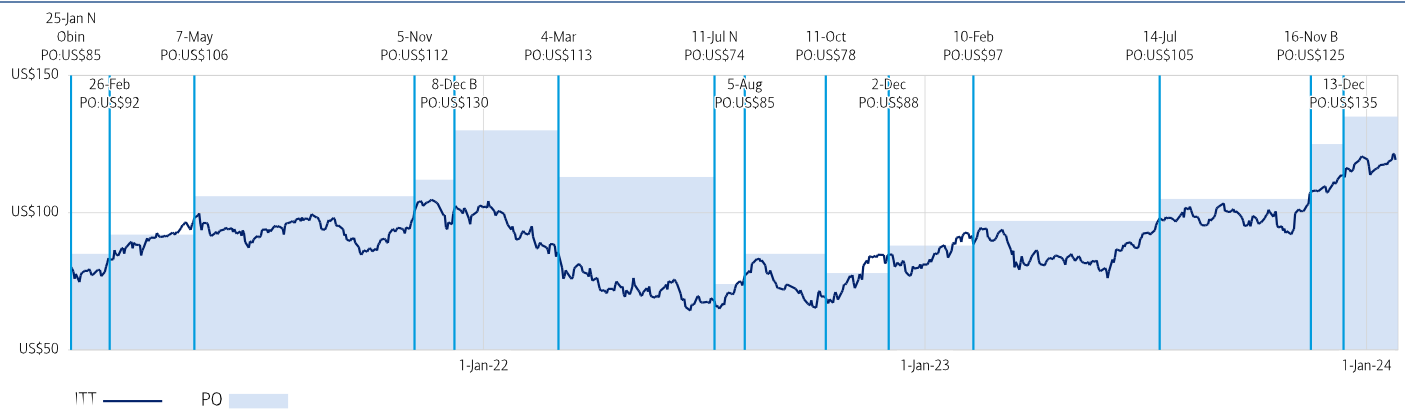
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Honeywell (HON) Price Chart

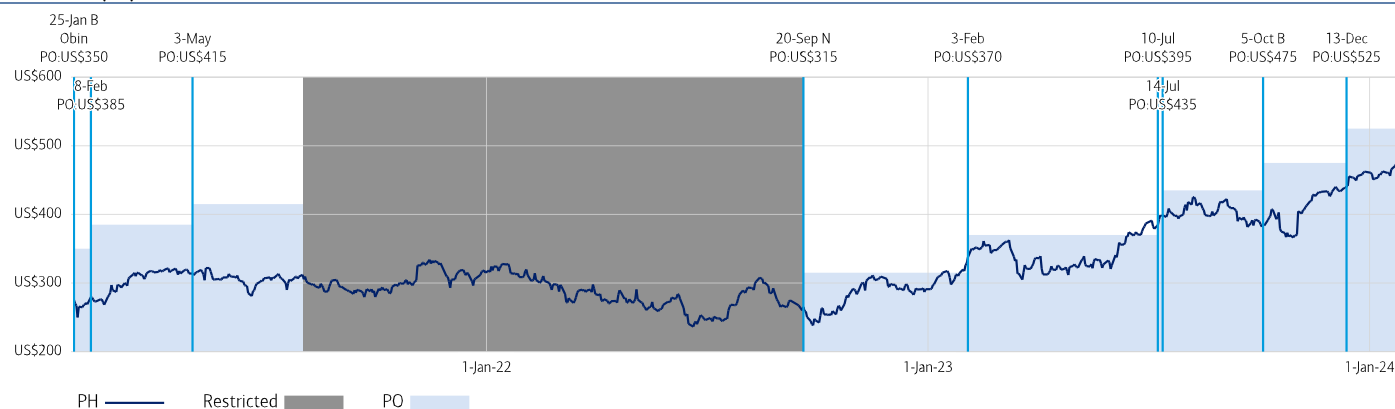
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ITT Inc. (ITT) Price Chart

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Parker Hannifin (PH) Price Chart

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Equity Investment Rating Distribution: Electrical Equipment Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	14	53.85%	Buy	10	71.43%
Hold	6	23.08%	Hold	3	50.00%
Sell	6	23.08%	Sell	1	16.67%

Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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