



Buy

Elkington

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I. Thesis

P&F Industries (NASDAQ:PFIN)

6/10/16

Recommendation: Buy

Current Price: \$9.13

Target Price: \$19.90

Catalysts

- Activist investor, Andrew Shapiro keeping management focused on realization of company's value
- International growth
- Potential sales from Craftsman brand and partnerships with Home Depot

Risks

- P&F has lost sales from declines in oil & gas market
- Will be edged out of aerospace market by larger companies
- Will not realize operational savings from Nationwide sale

Recent News

6/10/16

2016 Q1 Earnings Call

- Florida Pneumatic : 5.6% revenue growth YOY, but quarter-over-quarter declines in both the industrial catalog sector of \$224,000 and other product sales of \$97,000 mostly due to ongoing oil and gas exploration and extraction crisis
- The price of crude oil continues to negatively impact Hy-Tech's performance. With low crude oil pricing, many rotary rigs have closed and are temporarily not functioning
- Pneumatics' gross margin improved 0.8 percentage points , while HY-Tech's gross margin declined 9.1 percentage points
- Sale of Nationwide has helped reduce debt on balance sheet

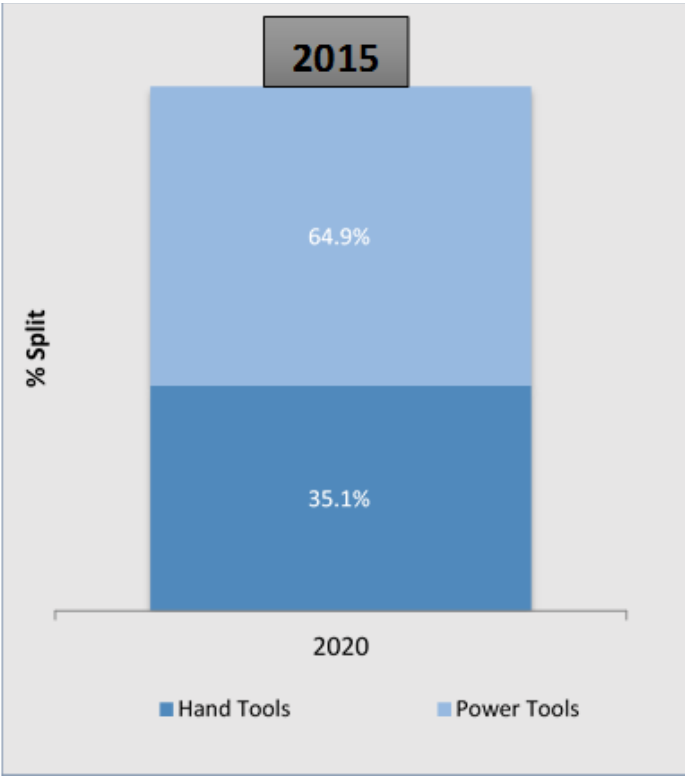
Q1 Lawndale Feedback

- Joseph Molino is confident that Hy-Tech can keep working relationship with major customer that has in-sourced
- Andrew is focused on where growth will come from
- Lawndale is pushing for development of products beyond AIRCAT lines and increasing distribution channels

II. Industry analysis

Global tools market

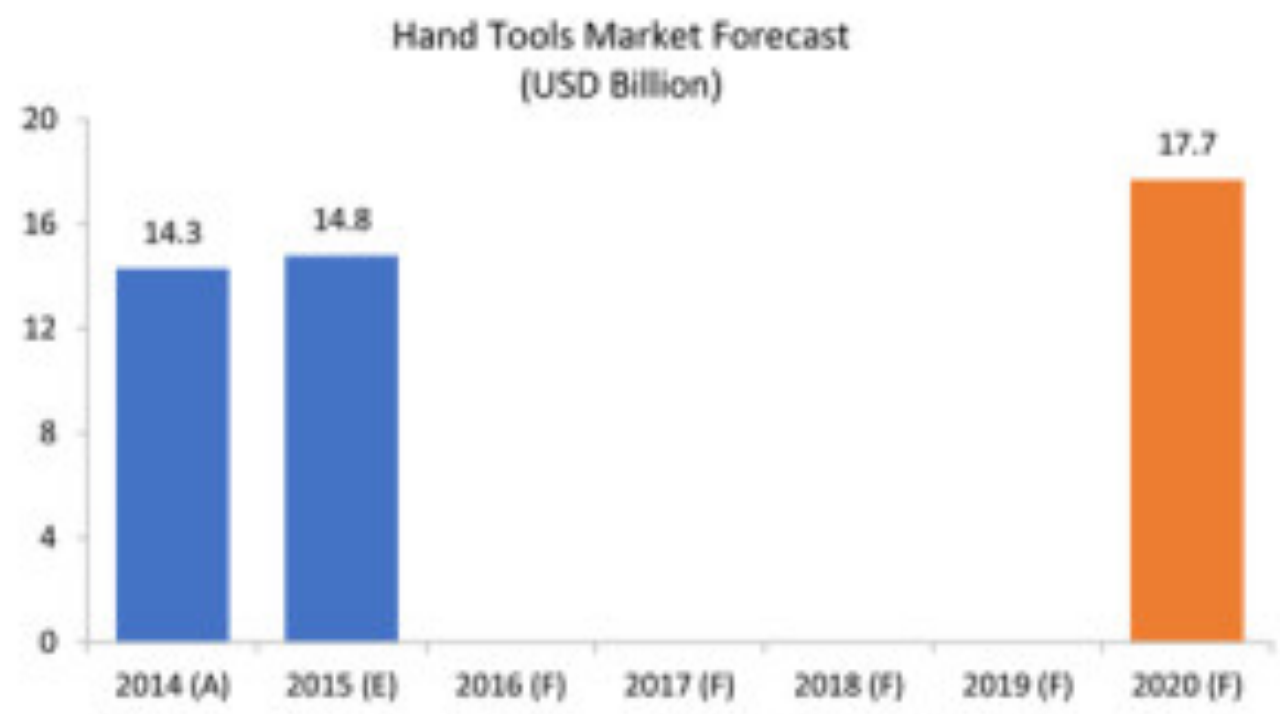
Growth



- 1. Power tools are outpacing hand tools
- 2. Global volume of construction is expected to grow ~7% and reach \$15 trillion by 2025 driven by increased demand from developing economies
- 3. China accounts for 80% of all power tools produced
- 4. U.S., China, and India account for ~60% of global tools market

Growth of hand tools market

Industry trends



III. Company research

Company

Business overview

P&F Industries operates two wholly-owned subsidiaries, Continental Tool Group Inc. and Countrywide Hardware, Inc. P&F is a manufacturer and importer of air-powered tools. It also owns Florida Pneumatic and Hy-Tech, which sell pneumatic tools for private label customers

Performance



Acquisitions

Year	Company	Price	Reason
2007	Hy-Tech	\$16.9 million in cash	Increase product offering
2014	Air Tool Service Company	\$7.65 million in cash	Boost Hy-Tech's product line
2014	Exhaust Technologies	\$10.37 million in cash	Obtain AIRCAT product
2014	Universal Air Tool Co	\$1.95 million in cash	Gain access to Europe

Management

Richard Horowitz	Chairman, President & CEO
Joseph Molino	COO & CFO
Richard Goodman	General Counsel

Overview of P&F's operational structure



Continental Tool Group Incorporated

Richard A. Horowitz, President
445 Broadhollow Road
Suite 100
Melville, New York 11747
Phone: 631-694-9800



Countrywide Hardware Incorporated

445 Broadhollow Road
Suite 100
Melville, New York 11747
Phone: 631-694-9800



Florida Pneumatic

[» View Products and Services](#)

Bart Swank, President
851 Jupiter Park Lane
Jupiter, Florida 33458-8998
Toll Free: 800-327-9403
www.florida-pneumatic.com



Hy-Tech Machine Incorporated

[» View Products and Services](#)

Robert Ober, President, COO
25 Leonberg Road
Mashuda Industrial Park
Cranberry Township, Pennsylvania 16066
Phone: 724-776-6800
www.hy-techinc.com

P&F: Florida Pneumatic



- Florida Pneumatic imports or manufactures approximately 50 types of pneumatic hand tools under the names "Florida Pneumatic", "Universal Tool" and "Fuji", as well as for other private label customers
- Pneumatic tools are similar to electric hand tools, but are powered by compressed air, rather than by electricity, and are generally less expensive to operate, lighter in weight and more powerful than their electric counterparts

P&F: Hy-Tech



- Hy-Tech manufactures and distributes pneumatic tools and parts for industrial applications
- Hy-Tech manufactures approximately sixty types of industrial pneumatic tools, most of which are sold at prices ranging from \$300 to \$7,000, under the names "ATP", "Thaxton", "THOR" and "Eureka" as well as under the names for private label customers
- The line of products includes grinders, drills, saws, impact wrenches and pavement breakers powered by compressed air
- Hy-Tech's products are sold to distributors and private label customers through in-house sales personnel and manufacturers' representatives.
- Customers include refineries, chemical plants, power generation facilities, the heavy construction industry, oil and mining companies and heavy industry

Portfolio of Product Lines

- Hy-Tech's *ATP, Thaxton, THOR and Eureka* brands
- Florida Pneumatic's FP, Fuji, and Universal brands
- Partnership with Sears' Craftsman brand
- Continental Tool and Countrywide portfolio of products and services



Improved revenue growth and operational synergies

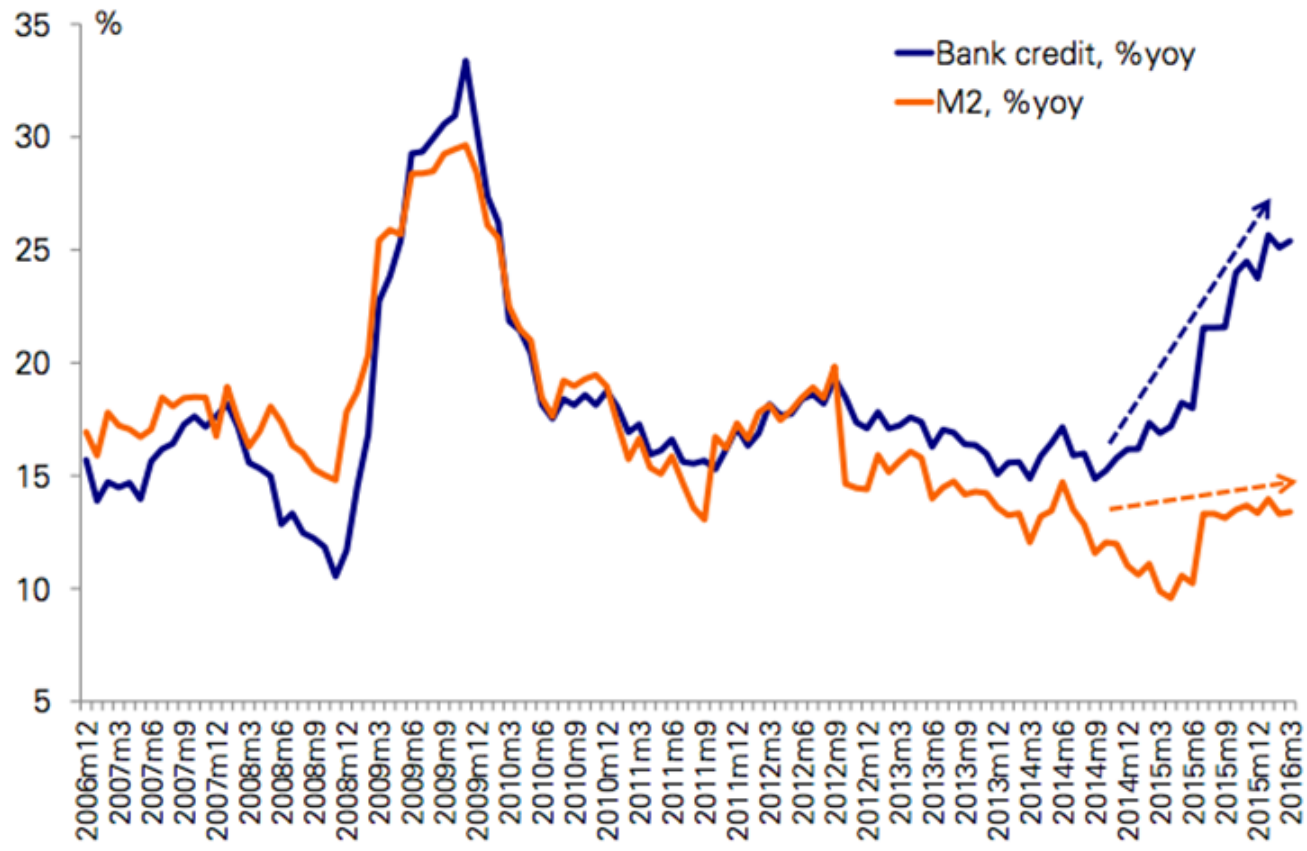
IV. Risks

Risks

- P&F is still highly exposed to declining oil & gas market
- P&F offers ~75%-80% of products required for aerospace market that may not be competitive enough
- Larger competitors such as Ingersoll Rand, Atlas Copco , and JP Tools have the scale to undercut on price
- International expansion may not work without more focus on product quality and development

V. Macroeconomic trends

Bank credit and M2 growth



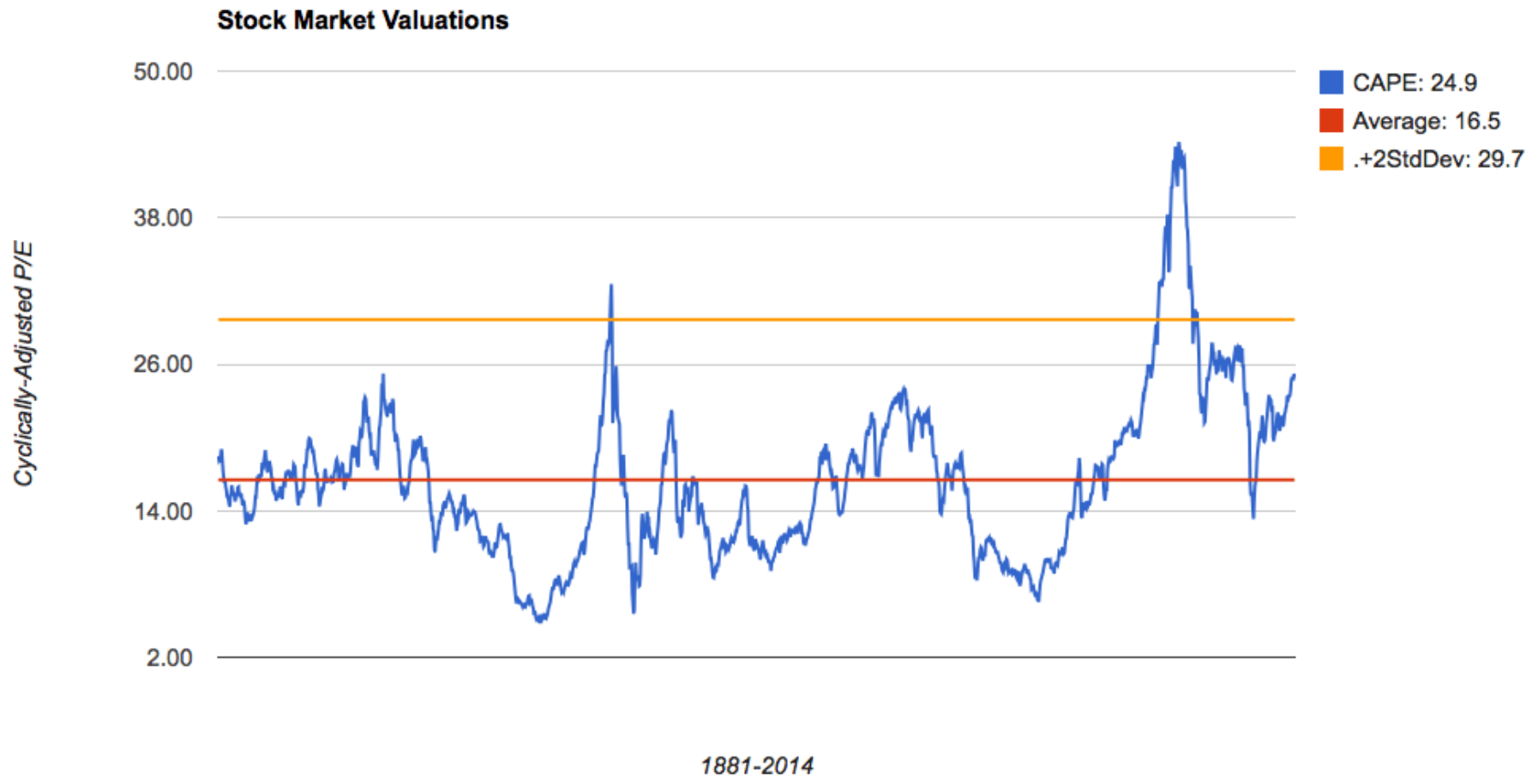
Debt and EBITDA growth diverging

US non-financials

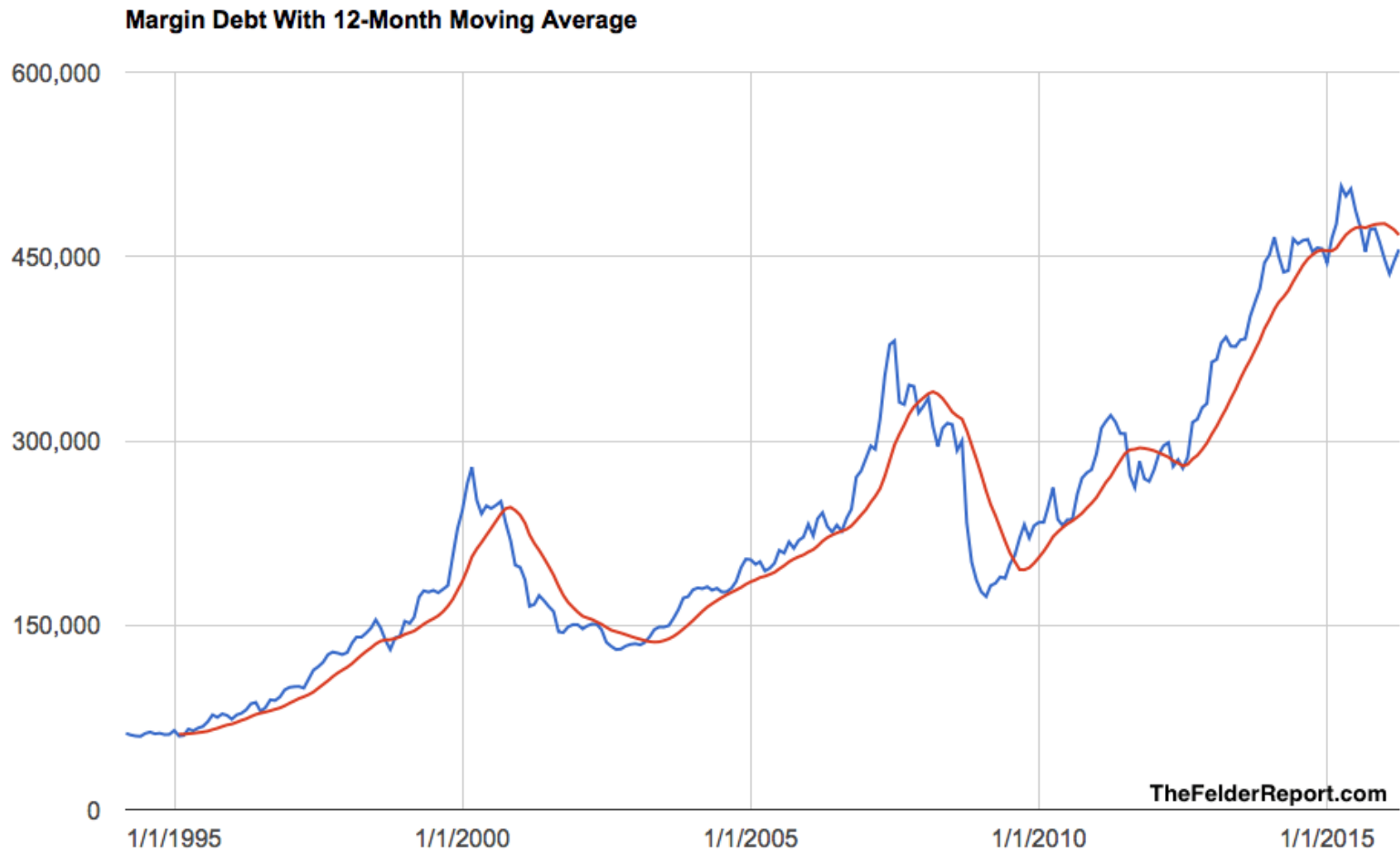
Year-on-year change in net debt versus operating cash flow (%)



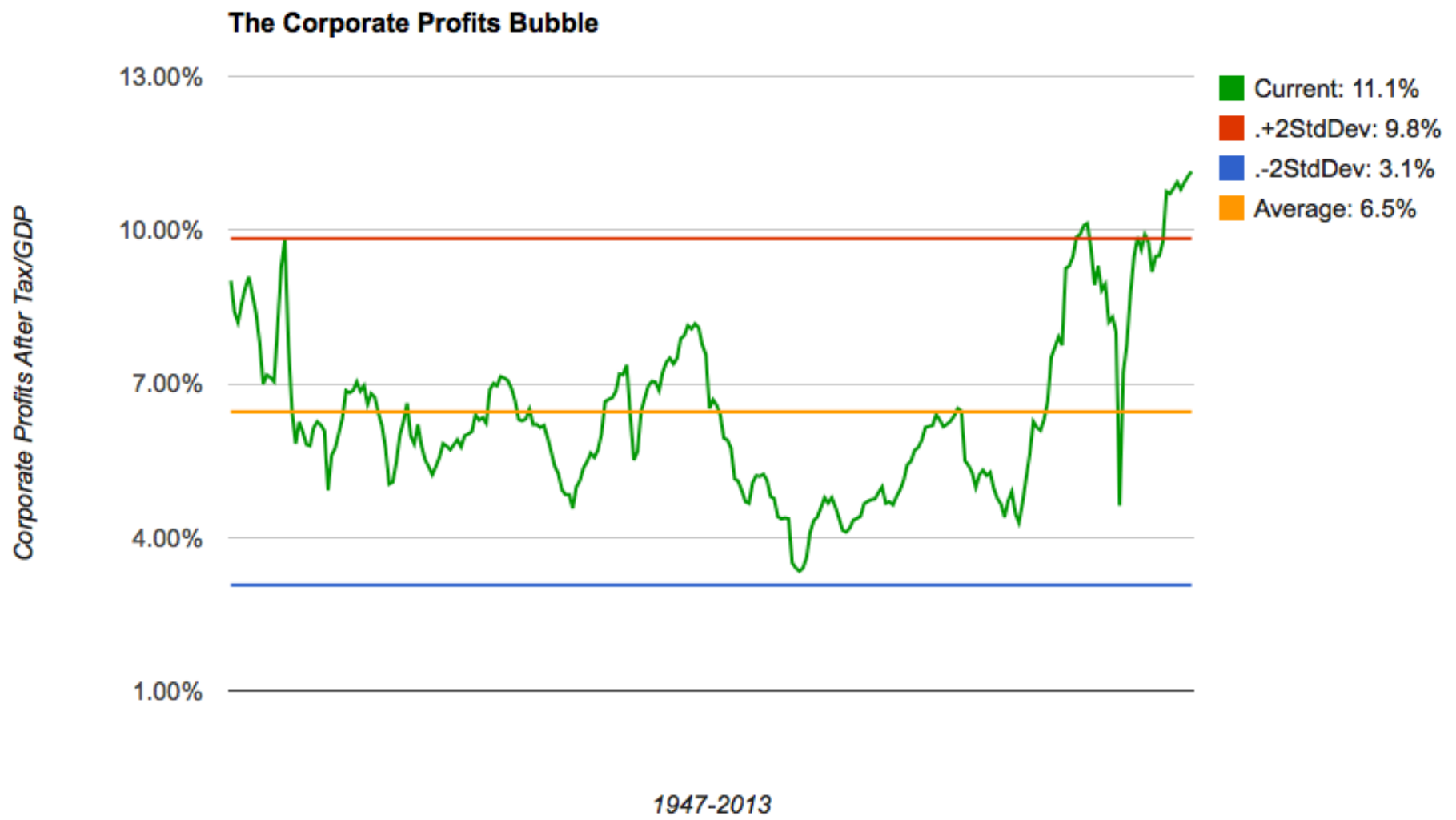
Market valuations are creeping upwards



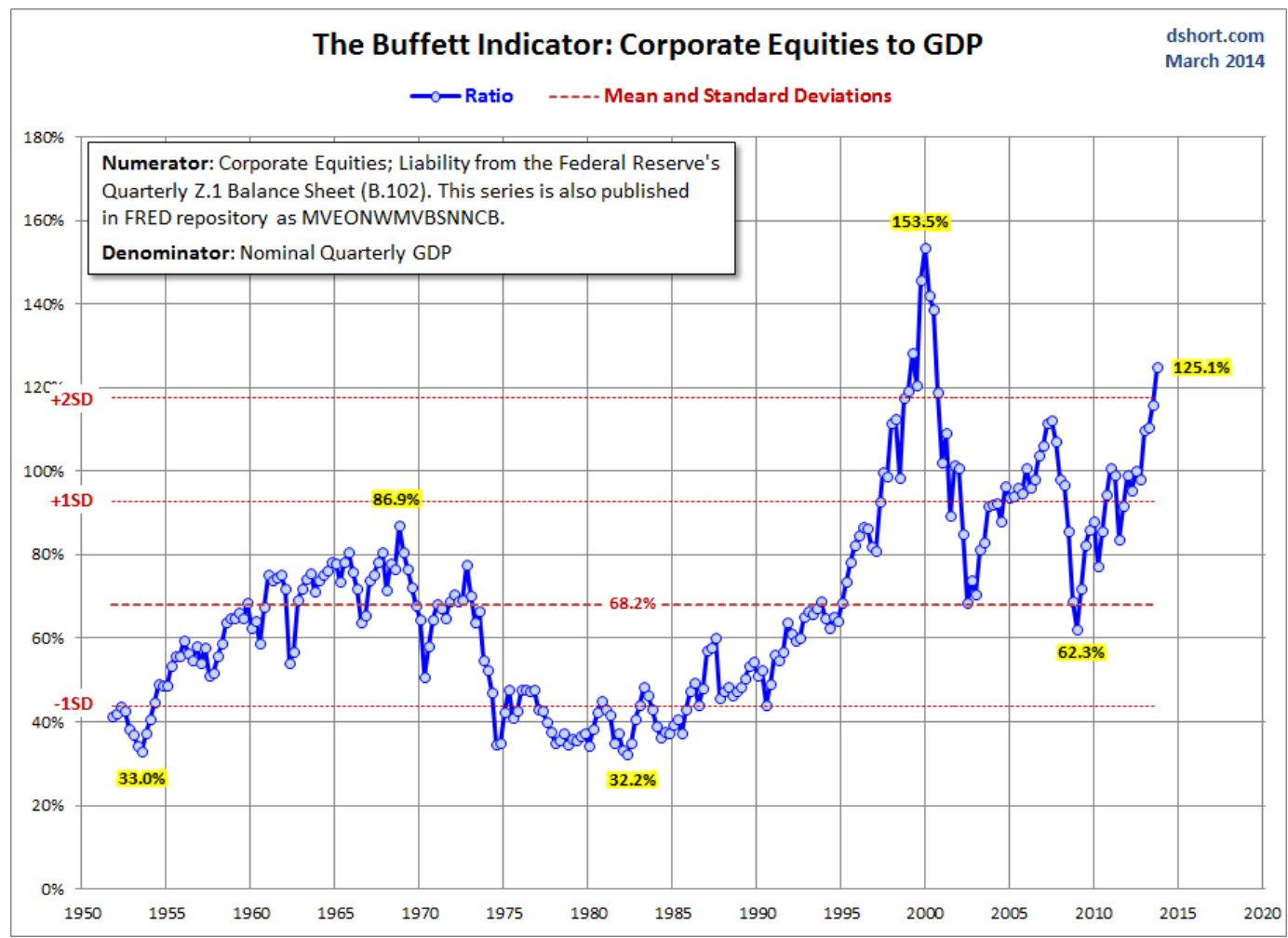
Market stability not being helping by increase in margin



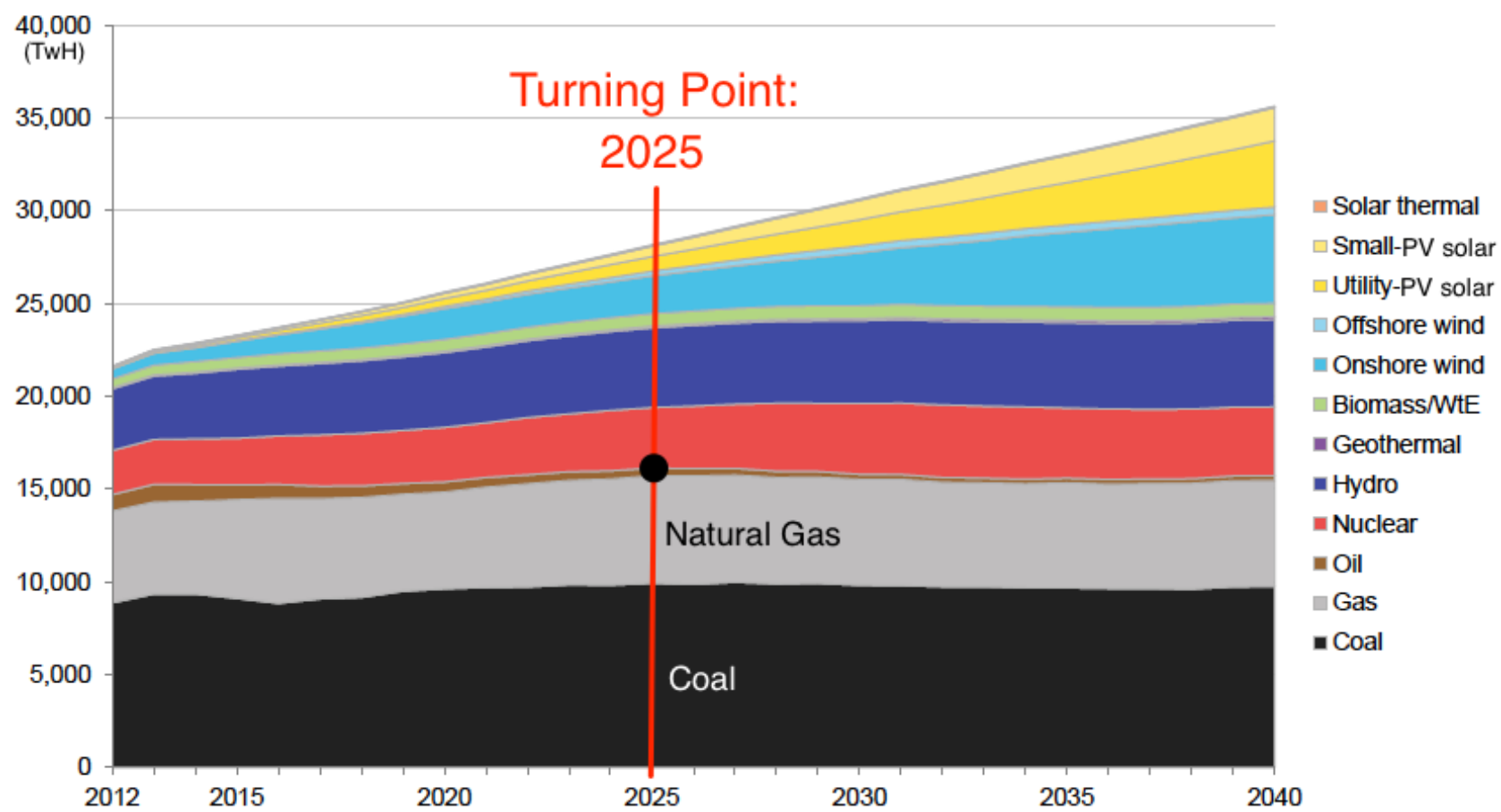
Corporate profits may have already hit a ceiling



Buffett Indicators signals overpriced market



Fossil Fuels will still be part of energy portfolio



Source: BNEF

VI. Valuation

Comparable companies

Company (as of 5/20/2016)	Share Price (\$)	Market Cap (\$B)	Enterprise value (\$B)	Rev. Growth %	Current P/E	Forward P/E	EV/EBITDA	EV/Revenue	PEG Ratio
GHM	18.42	177.31M	112.84M	-40.50%	30.20	42.84	12.37	1.25	4.27
SWK	112.94	16.74B	20.97B	1.60%	18.68	16.09	11.80	1.87	1.80
SNA	155.90	8.81B	9.84B	1.70%	18.58	15.61	11.47	2.73	1.78
QEPC	16.50	53.23M	72.87M	8.20%	13.41	N/A	5.88	0.24	N/A
ATLKY	25.04	22.00B	31.69B	-6.50%	21.87	N/A	11.19	2.56	N/A
Mean	65.76	9.56B	12.54B	-35.5%	20.55	24.85	10.54	1.73	2.62
Median	25.04	8.81B	9.84B	1.60%	18.68	15.61	11.47	1.87	1.78
High	155.90	22.00B	31.69B	8.20%	30.20	42.84	12.37	2.73	4.27
Low	16.50	53.23M	72.87M	-40.50%	13.41	15.61	5.88	0.24	1.78
P&F	9.13	32.80M	32.05M	-0.40%	12.18	15	3.73	0.39	0.3

Comparable companies cont.

- Among it's peers, P&F trades at a severe discount across every important statistic
- This discount is not justified due to the company's product power, change of capital structure, and long term earnings power

Discounted Cash Flow Analysis

PFIN										
(in million)	Actual				CAGR	Forecast period				
	2012	2013	2014	2015	(12 - 15)	2016	2017	2018	2019	2020
Sales	60	76	75	82	11%	89	96	103	111	118
% growth		27.1%	-1.4%	8.9%		9.0%	8.0%	7.5%	7.0%	6.5%
Total costs	56	71	71	76	11%	-83	-89	-96	-103	-110
% sales	-93.6%	-93.4%	-94.3%	-92.7%		93.0%	93.0%	93.0%	93.0%	93.0%
EBITDA	4	5	4	6	16%	6	7	7	8	8
% margin	6.4%	6.6%	5.7%	7.3%		7.0%	7.0%	7.0%	7.0%	7.0%
Depreciation & Amortization:	2	2	2	3		-3	-3	-4	-4	-4
% sales	-3.4%	-2.4%	-3.0%	-3.7%		3.5%	3.5%	3.5%	3.5%	3.5%
EBIT	6	7	7	9	15%	3	3	4	4	4
Taxes (30%)	2	-1	-2	-2		-1	-1	-1	-1	-1
% taxes	36%	-20%	-26%	-20%		-30%	-30%	-30%	-30%	-30%
Capex	-2	-1	-1	-1		-1	-1	-2	-2	-2
% sales	3.6%	0.9%	1.4%	1.7%		1.5%	1.5%	1.5%	1.5%	1.5%
Increase/Decrease in NWC		-4	-1	5		-4	-4	0	-4	0
% sales		-5%	-1%	6%		1%	1%	1%	1%	1%
Unlevered Free Cash Flow		-1	1	8		0	0	4	1	5
WACC	8.8%									
Discount Period						0.5	1.5	2.5	3.5	4.5
Discount Factor						0.96	0.88	0.81	0.75	0.69
Present value of free cash flow						0	0	4	0	4

Discounted Cash Flow Analysis cont.

Input		Output	
Wacc Calculation		Enterprise value	
Target Capital Structure (1)		Present value of Free Cash Flow	8
Debt to Total Capitalization	21.2%	Terminal Value	96
Equity to Total Capitalization	78.8%	Discount Factor	0.66
Debt to Equity Ratio	33.1%	Present Value of Terminal Value	63
		% of Enterprise Value	89%
Cost of Equity		Enterprise value	71
Risk-free rate (2)	2.0%	Less: Total debt	0
Market risk Premium (3)	5.0%	Plus: Cash and Cash Equi.	1
Levered Beta (4)	1.23	Net Debt	-1
Size Premium (5)	1.3%		
Cost of Equity	9.4%	Implied Equity Value	72
Cost of Debt		Outstanding shares	4
Cost of Debt	9.0%	Implied share price	19.90
Taxes	30.0%		
After Tax Cost of Debt	6.3%	Implied multiples	
WACC	8.8%	Enterprise Value	71
		SALES 2016	89
		EBITDA 2016	6
		Implied EV/SALES	0.8x
		Implied EV/EBITDA	11.4x

(1) Obtained from Beta and Capital Structure tab
 (2) Interpolated Yield on 10-year Treasury bond
 (3) Obtained from Ibbotson SBBI Valuation Yearbook
 (4) Obtained from Beta and Capital Structure tab
 (5) Low-Cap Decile size premium based on market capitalization, per Ibbotson

Discounted Cash Flow Analysis Cont.

Terminal Value	
Terminal Year Free Cash Flow	5
Perpetuity Growth Rate	3.0%
Terminal Year EBITDA	8
Terminal Value	96
Implied Exit Multiple	12.2x
Discount Period	5.0
Discount Factor	0.7
Present Value of Terminal Value	63
<i>% of Enterprise Value</i>	<i>89%</i>

<i>(in million)</i>	Actual				Forecast period				
Net Working Capital	2012	2013	2014	2015	2016	2017	2018	2019	2020
Account receivables	7	9	10	8					
Inventory	24	23	24	20					
Prepaid expenses and other	1	1	2	1					
Total Current Assets	31	33	35	29	36	38	41	44	47
<i>% sales</i>	52.3%	42.8%	47.2%	35.9%	40.0%	40.0%	40.0%	40.0%	40.0%
Account payable	5	3	3	3					
Accrued Liabilities	4	4	6	3					
Other Current Liabilities	0	0	0	1					
Total Current Liabilities	-9	-7	-9	-8	-10	-9	-11	-10	-13
<i>% sales</i>	15.3%	8.6%	11.5%	9.2%	11.0%	9.0%	11.0%	9.0%	11.0%
Net Working Capital	22	26	27	22	26	30	30	34	34
<i>% sales</i>	37%	34%	36%	27%	29%	31%	29%	31%	29%

Discounted Cash Flow Analysis Cont.

Comparable Companies Unlevered Beta							
Company	Levered Beta (1)	Market Value of Debt (2)	Market Value of Equity (3)	Debt/ Equity	Equity/ Total Assets	Marginal Tax Rate	Unlevered Beta (4)
GHM	1.38	0.21	177	0.1%	99.9%	30%	1.38
SWK	1.49	3,799.70	16740	22.7%	81.5%	22%	1.27
SNA	1.34	880.1	8810	10.0%	90.9%	32%	1.25
QEPC	0.06	45.44	53	85.4%	53.9%	25%	0.04
ATLKY	1.42	10400	22000	47.3%	67.9%	30%	1.07
Median	1.38			22.7%	81.5%		1.25
Mean	1.14			33.1%	78.8%		1.00

(1) From Bloomberg

(2) Book Value of Debt

(3) From Bloomberg

(4) Unlevered Beta = Predicted Levered Beta / (1 + Debt/Equity) x (1-t))

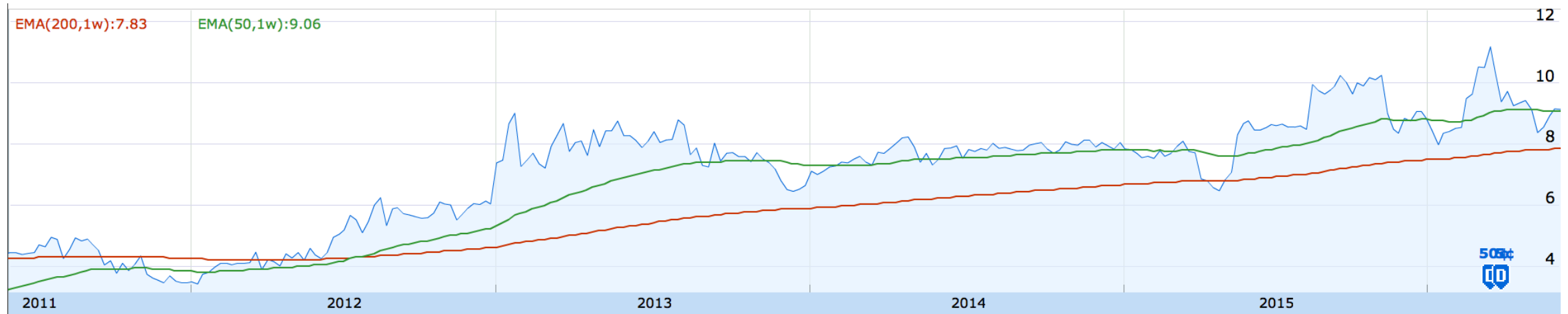
Relevered Beta	Mean Unlevered Beta	Mean Target Debt/ Equity	Target Marginal Tax Rate	Relevered Beta
PFIN	1.00	33.1%	30%	1.23

Discounted Cash Flow Analysis Cont.

Sensitivity Analysis						
WACC	Perpetuity growth %					
		2.0%	2.5%	3.0%	3.5%	4.0%
	6.2%	105	119	137	161	197
	7.2%	83	91	101	114	132
	8.2%	68	73	80	88	98
	9.2%	57	61	65	71	77
	10.2%	49	52	55	59	63

Annual sales growth %						
EBITDA %		7.0%	7.5%	8.0%	8.5%	9.0%
	5.0%	69	69	69	70	70
	6.0%	70	70	70	70	71
	7.0%	70	70	71	71	71
	8.0%	71	71	71	71	72
	9.0%	71	72	72	72	72

Technical Analysis



PFIN is trading above its 200 day EMA signaling long-term price strength

Debt Analysis

Capital Structure

Most Recent (Mar 2016)



Type	%	Amount
Debt	0.2	127,000.0
Preferred	---	---
Equity	99.8	53.7 Mil

Historical



Dec 2015



Mar 2015



Mar 2013

Type	%	Amount
Debt	37.4	24.3 Mil
Preferred	---	---
Equity	62.6	40.7 Mil

- PFIN has recently paid off most of its debt providing a company that will be relatively more stable in a rising interest rate environment

Catalysts

1. Andrew Shapiro from Lawndale Capital Management has been management aligned with the goals of unlocked P&F's intrinsic value
2. International growth in Europe as well as in Canada with Home Depot should contribute to revenue growth
3. Potential sales from Craftsman brand becoming available outside of Sears should act as another distribution channel
4. Potential partnerships with Home Depot encouraged by Lawndale
5. Company has little debt and should be able to weather macroeconomic cycle
6. Oil & gas market may have bottomed out and P&F should be able to see a benefit of a recovery
7. Can remain competitive with larger corporations as long as product development is focused on
8. Sale of Nationwide has allowed debt to come off balance sheet

Price target

Base: \$19.90

- Aligned with historical revenue growth
- 7% gross margin; in line with historical margins
- 12x exit multiple, implying 3.0% perpetual growth

Best: \$24.89

- High revenue growth
- 8% gross margin; slight improvement from historical margins
- 15x exit multiple, implying 5.0% perpetual growth

Worst: \$15.91

- No revenue growth
- 5% gross margin; in line with historical margins
- 9-10x exit multiple, implying 1-2% perpetual growth

VII. Conclusion

Conclusion



Operational Growth:

- Growth opportunities in Europe and Canada
- Expansion of product lines

Financial Discipline:

- Lawndale should be able to keep company and straight and narrow

Acquisition Opportunities:

- With little debt, company is in a position to find deals that will synergize with existing product lines