

APPLIED INDUSTRIAL TECHNOLOGIES INC
Form 10-K
August 24, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended June 30, 2016, 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 (I.R.S. Employer
incorporation or organization) Identification No.)

1 Applied Plaza, Cleveland, Ohio 44115
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (216) 426-4000.
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, without par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
x Yes " No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. " Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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. x Yes " No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 X Accelerated filer ___
Non-accelerated filer ___ 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 x No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter (December 31, 2015): \$1,565,290,000.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 5, 2016
Common Stock, without par value	39,057,155

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Applied's proxy statement for the annual meeting of shareholders to be held October 25, 2016, are incorporated by reference into Parts II, III, and IV of this Form 10-K.

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CAUTIONARY STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT

This report, including the documents incorporated by reference, contains statements that are forward-looking, based on management's current expectations about the future. Forward-looking statements are often identified by qualifiers such as "guidance," "expect," "believe," "plan," "intend," "will," "should," "could," "would," "anticipate," "estimate," "foreca," "optimistic" and derivative or similar words or expressions. Similarly, descriptions of our 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 Applied and its management as to future occurrences and trends. Applied 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 forward-looking statements. All forward-looking statements are based on current expectations regarding important risk factors, many of which are outside Applied'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 Applied or another person that the results expressed in the statements will be achieved. In addition, Applied assumes no obligation publicly to update or revise forward-looking statements, whether because of new information or events, or otherwise, except as may be required by law.

Applied believes its primary risk factors include, but are not limited to, those identified in the following sections of this annual report on Form 10-K: "Risk Factors" in Item 1A; "Narrative Description of Business," in Item 1, section (c); and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7. PLEASE READ THOSE DISCLOSURES CAREFULLY.

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PART I

ITEM 1. BUSINESS.

In this annual report on Form 10-K, “Applied” refers to Applied Industrial Technologies, Inc., an Ohio corporation. References to “we,” “us,” “our,” and “the Company” refer to Applied and its subsidiaries.

We are a leading industrial distributor in North America, Australia, and New Zealand, serving MRO (maintenance, repair, and operations) and OEM (original equipment manufacturing) customers in virtually every industry. In addition, the Company provides engineering, design, and systems integration for industrial and fluid power applications, as well as customized mechanical, fabricated rubber, and fluid power shop services.

We add value for our customers by providing product-related technical application support and solutions to help customers minimize their production downtime, improve machine performance, and reduce overall procurement and maintenance costs.

Applied and its predecessor companies have engaged in this business since 1923. Applied reincorporated in Ohio in 1988.

Our Internet address is www.applied.com. The following documents are available free of charge via hyperlink from the investor relations area of our website:

Applied's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, together with Section 16 insider beneficial stock ownership reports - these documents are posted as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission

▲Applied's Code of Business Ethics

▲Applied's Board of Directors Governance Principles and Practices

▲Applied's Director Independence Standards

●Charters for the Audit, Corporate Governance, and Executive Organization & Compensation Committees of Applied's Board of Directors

The information available via hyperlink from our website is not incorporated into this annual report on Form 10-K.

(a) General Development of Business.

Information regarding developments in our business can be found in Item 7 under the caption “Management's Discussion and Analysis of Financial Condition and Results of Operations.” This information is incorporated here by reference.

(b) Financial Information about Segments.

We have identified two reportable segments, service center-based distribution and fluid power businesses.

The service center-based distribution segment provides customers with a wide range of industrial products primarily through a network of service centers. The fluid power businesses segment consists of specialized regional companies that distribute fluid power components, design and assemble fluid power systems and perform equipment repair. The fluid power businesses primarily sell products and services directly to customers rather than through the service centers.

Segment financial information can be found in note 12 to the consolidated financial statements, included in Item 8 under the caption “Financial Statements and Supplementary Data.” That information is incorporated here by reference.

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(c) Narrative Description of Business.

Overview. Our field operating structure is built on two platforms - service center-based distribution and fluid power businesses:

Service Center-Based Distribution. We distribute a wide range of industrial products through service centers across North America, Australia, and New Zealand. Customers primarily purchase our products for scheduled maintenance of their machinery and equipment and for emergency repairs.

The service center-based distribution business accounts for a substantial majority of our field operations and 82.8% of our 2016 sales dollars.

The service center-based distribution segment includes operations specialized in serving customers in the upstream oil and gas industry; the Applied Maintenance Supplies & Solutions service offering; regional fabricated rubber shops, which modify and repair conveyor belts and make hose assemblies in accordance with customer requirements; and rubber service field crews, which install and repair conveyor belts and rubber linings at customer locations.

Fluid Power Businesses. Our specialized fluid power businesses primarily market products and services to customers within the businesses' geographic regions. In the United States, the businesses also market products and services through our service center network. In addition to distributing fluid power components, the businesses design and assemble hydraulic and electro-hydraulic power units and control systems, pneumatic and electro-pneumatic panels and sub-assemblies, fabricated aluminum assemblies, lubrication systems, hydraulic manifolds, and custom-machined metal parts. They also perform equipment repair and offer technical advice to customers. Customers include firms purchasing for maintenance, repair, and operational needs, as well as for original equipment manufacturing applications.

Products. We are a leading distributor of products including bearings, power transmission components, fluid power components and systems, industrial rubber products, linear motion components, tools, safety products, oilfield supplies, and other industrial and maintenance supplies. Fluid power products include hydraulic, electro-hydraulic, pneumatic, electro-pneumatic, lubrication, and filtration components and systems.

These products are generally supplied to us by manufacturers whom we serve as a non-exclusive distributor. The suppliers also may provide us product training, as well as sales and marketing support. Authorizations to represent particular suppliers and product lines may vary by geographic region, particularly for our fluid power businesses. We believe our supplier relationships are generally good, and many have existed for decades. The disruption of relationships with certain suppliers, or the disruption of their operations, could adversely affect our business.

Our product suppliers typically confine their direct sales activities to large-volume transactions, mainly with large original equipment manufacturers. The suppliers generally do not sell maintenance and repair products directly to the customer, but instead refer the customer to us or another distributor.

Net sales by product category for the most recent three fiscal years is detailed in note 12 to the consolidated financial statements, included in Item 8 under the caption "Financial Statements and Supplementary Data."

That information is incorporated here by reference.

Services. Our employees advise and assist customers in selecting and applying products, and in managing inventory. We consider this advice and assistance to be an integral part of our product sales efforts. Beyond logistical distribution services, we offer product and process solutions involving multiple technologies. These solutions help customers minimize production downtime, improve machine performance, and reduce overall procurement and maintenance costs. By providing high levels of service, product and industry expertise, and technical support, while at the same time offering product breadth and competitive pricing, we believe we develop stronger, longer-lasting, and more profitable customer relationships.

Our service center sales employees include customer sales and service representatives and account managers, as well as product and industry specialists. Customer sales and service representatives receive, process, and expedite customer orders, provide product information, and assist account managers in serving customers. Account managers make on-site calls to customers to provide product information, identify customer requirements, make recommendations, and assist in implementing equipment maintenance and storeroom management programs, as well as automated supplies dispensing systems. Account managers also measure and document the value of the cost savings and increased productivity we help generate. Product and industry specialists assist with applications in their areas of

expertise.

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We maintain product inventory levels at each service center tailored to the local market. These inventories consist of standard items as well as other items specific to local customer demand. Distribution centers replenish service center inventories and also may ship products directly to customers. Having product in stock helps us satisfy customers' immediate needs.

Timely delivery of products is an integral part of our service, particularly when customers require products for emergency repairs. Service centers and distribution centers use the most effective method of transportation available to meet customer needs. These methods include our own delivery vehicles, dedicated third-party transportation providers, as well as surface and air common carrier and courier services. Customers can also pick up items at our service centers.

Our information systems enhance our customer service. Customers can turn to our website at www.applied.com to search for products in a comprehensive electronic catalog, research product attributes, view prices, check inventory levels, place orders, and track order status. We also use electronic data interchange (EDI) and other electronic interfaces with customers' technology platforms and plant maintenance systems.

In addition to our electronic capabilities, we provide customers our paper catalog, a comprehensive purchasing tool and resource guide for industrial and maintenance products (also available in a mobile-friendly digital version).

The Applied Maintenance Supplies & Solutions service offering provides traditional vendor managed inventory (VMI) services, at customer sites, for industrial and maintenance supplies, including fasteners, cutting tools, paints and chemicals, fluid flow, safety, and janitorial products.

In addition to distributing products, we offer shop services in select geographic areas. Our fabricated rubber shops modify and repair conveyor belts and provide hose assemblies (also available at select service centers and distribution centers) in accordance with customer requirements. Field crews install and repair conveyor belts and rubber lining, primarily at customer locations. Among the other services we offer, either performed by us directly or by third party providers, are the rebuilding or assembly of speed reducers, pumps, valves, cylinders, and electric and hydraulic motors, and custom machining.

Our specialized fluid power businesses generally operate independently of the service centers, but as product distributors, share the same focus on customer service. Product and application recommendations, inventory availability, and delivery speed are all important to the businesses' success.

The fluid power businesses distinguish themselves from most component distributors by offering engineering, design, system fabrication, installation, and repair services for fluid power systems. Our capabilities extend to the following specialties: fluid power system integration; manifold design, machining, and assembly; and the integration of hydraulic and pneumatic equipment with electronics for complete machine design.

Each business has account managers with technical knowledge, who handle sophisticated projects, including original equipment manufacturing applications. The businesses also provide technical support to our service centers and their customers.

Markets. We purchase from thousands of product manufacturers and resell the products to thousands of customers in a wide variety of industries, including agriculture and food processing, automotive, chemicals and petrochemicals, fabricated metals, forest products, industrial machinery and equipment, mining, oil and gas, primary metals, transportation, and utilities, as well as to government entities. Customers range from very large businesses, with which we may have multiple-location relationships, to very small ones. We are not significantly dependent on a single customer or group of customers, the loss of which would have a material adverse effect on our business as a whole, and no single customer accounts for more than 3% of our net sales.

Competition. We consider our business to be highly competitive. In addition, our markets present few economic or technological barriers to entry, contributing to a high fragmentation of market share. Longstanding supplier and customer relationships, geographic coverage, name recognition, and our employees' knowledge and experience do, however, support our competitive position. Competition is based generally on breadth and quality of product and service offerings, product availability, price, ease of product selection and ordering, e-commerce capabilities, catalogs, and having a local presence. In the fluid power businesses, product manufacturer authorizations are often more selective and can be a more significant competitive factor, along with market reputation and product application knowledge.

Our principal competitors are other bearing, power transmission, industrial rubber, fluid power, linear motion, tools, and safety product distributors, as well as specialized oilfield supply distributors and distributors of other industrial and maintenance supplies and catalog companies. These competitors include local, regional, national, and multinational operations. We also compete with original equipment manufacturers and their distributors in the sale

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of maintenance and replacement components. Some competitors have greater financial resources than we do. The identity and number of our competitors vary throughout the geographic, industry, and product markets we serve. Although we are one of the leading distributors in North America, Australia, and New Zealand for the primary categories of products we provide in those areas, our market share for those products in a given geographic market may be relatively small compared to the portion of the market served by original equipment manufacturers and other distributors.

Backlog Orders and Seasonality. Because of the type of industrial distribution we provide, backlog orders are not material to our business as a whole, although they are a more important factor for our fluid power businesses. Our business has exhibited minor seasonality - in particular, sales per day during the first half of our fiscal year have tended in the past to be slightly lower compared with the second half due, in part, to the impact of customer plant shutdowns, summer vacations and holidays.

Patents, Trademarks, Trade Names, and Licenses. Customer recognition of our service marks and trade names, including Applied Industrial Technologies®, Applied®, and AIT®, is an important contributing factor to our sales. Patents and licenses are not of material importance to our business.

Raw Materials and General Business Conditions. Our operations are dependent on general industrial and economic conditions. We would be adversely affected by the unavailability of raw materials to our suppliers, prolonged labor disputes experienced by suppliers or customers, or by events or conditions that have an adverse effect on industrial activity generally in the markets we serve or on key customer industries.

Number of Employees. At June 30, 2016, we had 5,569 employees.

Working Capital. Our working capital position is discussed in Item 7 under the caption “Management's Discussion and Analysis of Financial Condition and Results of Operations.” This information is incorporated here by reference.

We require substantial working capital related to accounts receivable and inventories. Significant amounts of inventory are carried to meet customers' delivery requirements. We generally require payments for sales on account within 30 days. Returns are not considered to have a material effect on our working capital requirements.

We believe these practices are generally consistent among companies in our industry.

Environmental Laws. We believe that compliance with laws regulating the discharge of materials into the environment or otherwise relating to environmental protection will not have a material adverse effect on our capital expenditures, earnings, or competitive position.

(d) Financial Information about Geographic Areas.

Information regarding our foreign operations, including information about revenues and long-lived assets, is included in note 12 to the consolidated financial statements, included in Item 8 under the caption “Financial Statements and Supplementary Data,” as well as in Item 7A under the caption “Quantitative and Qualitative Disclosures about Market Risk.” That information is incorporated here by reference.

ITEM 1A. RISK FACTORS.

In addition to other information set forth in this report, you should carefully consider the following factors that could materially affect our business, financial condition, or results of operations. The risks described below are not the only risks facing our Company. Certain risks are identified below in Item 7 under the caption “Management's Discussion and Analysis of Financial Condition and Results of Operations.” This information is incorporated here by reference. Additional risks not currently known to us, risks that could apply broadly to issuers, or risks that we currently deem immaterial, may also impact our business and operations. Risks can also change over time.

Our business depends heavily on the operating levels of our customers and the economic factors that affect them. The markets for the products and services we sell are subject to conditions or events that affect demand for goods and materials that our customers produce. Consequently, demand for our products and services has been and will continue to be influenced by most of the same economic factors that affect demand for and production of customers' goods and materials.

When customers or prospective customers reduce production levels because of lower demand, increased supply, higher costs, tight credit conditions, unfavorable currency exchange rates, foreign competition, other competitive disadvantage, offshoring of production, or other reasons, their need for our products and services diminishes. Selling prices and terms of sale come under pressure, adversely affecting the profitability and the durability of customer

relationships, and credit losses may increase. Inventory management becomes more difficult in times of

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economic uncertainty. Volatile economic and credit conditions also make it more difficult for us, as well as our customers and suppliers, to forecast and plan future business activities.

Consolidation in our customers' and suppliers' industries could adversely affect our business and financial results.

Consolidation continues to occur among our product suppliers and customers. As customers industries consolidate, a greater proportion of our sales could be derived from higher volume contracts, which could adversely impact margins. Consolidation among customers can trigger changes in their purchasing strategies, potentially moving large blocks of business among competing distributors and contributing to volatility in our sales and pressure on prices. Similarly, continued consolidation among our suppliers could reduce our ability to negotiate favorable pricing and other commercial terms for our inventory purchases. There can be no assurance we will be able to take advantage of consolidation trends.

Loss of key supplier authorizations, lack of product availability, or changes in distribution programs could adversely affect our sales and earnings. Our business depends on maintaining an immediately available supply of various products to meet customer demand. Many of our relationships with key product suppliers are longstanding, but are terminable by either party. The loss of key supplier authorizations, or a substantial decrease in the availability of their products, could put us at a competitive disadvantage and have a material adverse effect on our business. Supply interruptions could arise from raw materials shortages, inadequate manufacturing capacity or utilization to meet demand, financial problems, trade issues, labor disputes, or weather conditions affecting suppliers' production, transportation disruptions, or other reasons beyond our control.

In addition, as a distributor, we face the risk of key product suppliers changing their relationships with distributors generally, or Applied in particular, in a manner that adversely impacts us. For example, key suppliers could change the following: the prices we must pay for their products relative to other distributors or relative to competing products; the geographic or product line breadth of distributor authorizations; supplier purchasing incentive or other support programs; or product purchase or stocking expectations.

An increase in competition could decrease sales or earnings. We operate in a highly competitive industry. The industry remains fragmented, but is consolidating. Our competitors include local, regional, national, and multinational distributors of industrial machinery parts, equipment, and supplies. Competition is largely focused in the local service area and is generally based on product line breadth, product availability, service capabilities, and price. Existing competitors have, and future competitors may have, greater financial or other resources than we do, broader product or service offerings, greater market presence, or better name recognition. If existing or future competitors seek to gain or to retain market share by aggressive pricing strategies and sales methods, or otherwise through competitive advantage, our sales and profitability could be adversely affected. Our success will also be affected by our ability to continue to provide competitive offerings as customer preferences or demands evolve, for example with respect to our product portfolio or our e-commerce and inventory management solutions.

The purchasing incentives we earn from product suppliers can be impacted if we reduce our purchases in response to declining customer demand. Certain of our product suppliers have historically offered to their distributors, including us, incentives for purchasing their products. In addition to market or customer account-specific incentives, certain suppliers pay incentives to the distributor for attaining specific purchase volumes during the program period. In some cases, in order to earn incentives, we must achieve year-over-year growth in purchases with the supplier. When demand for our products declines, we may be less inclined to add inventory to take advantage of certain incentive programs, thereby potentially adversely impacting our profitability.

Changes in customer or product mix and downward pressure on sales prices could cause our gross profit percentage to fluctuate or decline. Because we serve thousands of customers in many end markets, and offer millions of products, with varying profitability levels, changes in our customer or product mix could cause our gross profit percentage to fluctuate or decline. Downward pressure on sales prices could also cause our gross profit percentage to fluctuate or decline. We can experience downward pressure on sales prices as a result of deflation, pressure from customers to reduce costs, or increased competition.

Our ability to transact business is highly reliant on information systems. A disruption or security breach could materially affect our business, financial condition, or results of operation. We depend on information systems to process customer orders, manage inventory and accounts receivable collections, purchase products, manage accounts

payable processes, ship products to customers on a timely basis, maintain cost-effective operations, provide superior service to customers, and accumulate financial results. A serious, prolonged disruption of our information systems, due to manmade or natural causes, or breach in security, could materially impair fundamental business processes and increase expenses, decrease sales, or otherwise reduce earnings.

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Because of our reliance on information systems, we may be vulnerable to the growing threat of damage or intrusion from computer viruses or other cyber-attacks on our systems. Despite precautions taken to prevent or mitigate the risks of such incidents, an attack on our systems could not only cause business disruption, but could also result in the theft or disclosure of proprietary or confidential information, or a breach of customers, supplier, or employee information. Such an incident could negatively impact our sales, damage our reputation, and cause us to incur unanticipated legal liability and costs.

In recent years, we replaced multiple legacy applications with an SAP software platform, to enhance our business information and transaction systems to support future growth. We are considering additional enterprise resource planning system conversions, on a smaller scale, in discrete business operations. Despite extensive planning, we could experience disruptions related to the implementation because of the projects' complexity. The potential adverse consequences could include delays, loss of information, diminished management reporting capabilities, damage to our ability to process transactions, harm to our control environment, diminished employee productivity and unanticipated increases in costs. Further, our ability to achieve anticipated operational benefits from new platforms is not assured. Volatility in product and energy costs can affect our profitability. Changes in costs of raw materials and energy can lead product manufacturers to adjust the prices of products we distribute. In addition, a portion of our own distribution costs is comprised of fuel for our sales and delivery vehicles, freight, and utility expenses for our facilities. Our ability to pass along increases in our product and distribution costs to our customers depends on market conditions. Raising our prices could result in decreased sales volume, which could significantly reduce our profitability. While increases in the cost of energy or products could be damaging to us, decreases in those costs, particularly if severe, could also adversely impact us by creating deflation in selling prices, which could cause our gross profit margin to deteriorate. Changes in energy or raw materials costs can also adversely affect customers; for example, declines in oil and gas prices negatively impacted customers operating in those industries and, consequently, our sales to those customers. Acquisitions are a key component of our anticipated growth. We may not be able to identify or to complete future acquisitions, to integrate them effectively into our operations, or to realize their anticipated benefits. Many industries we serve are mature. As a result, acquisitions of businesses have been important to our growth. While we wish to continue to acquire businesses, we may not be able to identify and to negotiate suitable acquisitions, to obtain financing for them on satisfactory terms, or otherwise to complete acquisitions. In addition, existing or future competitors may increasingly seek to compete with us for acquisitions, which could increase prices and reduce the number of suitable opportunities.

We seek acquisition opportunities that complement and expand our operations. However, substantial costs, delays, or other difficulties related to integrating acquisitions could adversely affect our business or financial results. We could face significant challenges in consolidating functions, integrating information systems, personnel, and operations, and implementing procedures and controls in a timely and efficient manner.

Further, even if we successfully integrate the acquisitions with our operations, we may not be able to realize cost savings, sales, profit levels, or other benefits that we anticipate from these acquisitions, either as to amount or in the time frame we expect. Our ability to realize anticipated benefits may be affected by a number of factors, including the following: our ability to achieve planned operating results, to reduce duplicative expenses and inventory effectively, and to consolidate facilities; economic and market factors; the incurrence of significant integration costs or charges in order to achieve those benefits; our ability to retain key product supplier authorizations, customer relationships, and employees; and our ability to address competitive, distribution, and regulatory challenges arising from entering into new markets, especially those in which we may have limited or no direct experience. In addition, acquisitions could place significant demand on administrative, operational, and financial resources.

Goodwill and other intangible assets recorded as a result of our acquisitions could become impaired. We review long-lived assets, including property, plant and equipment and identifiable amortizing intangible assets, for impairment whenever changes in circumstances or events may indicate that the carrying amounts are not recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference. Factors which may cause an impairment of long-lived assets include significant changes in the manner of use of these assets, negative industry or market trends, a significant underperformance relative to historical or projected future operating results, or a likely sale or disposal of the asset before the end of its estimated useful life. In 2016 we recorded a \$64.8 million

non-cash impairment charge for goodwill associated with the service center-based distribution reporting units in Canada, Australia, and New Zealand.

As of June 30, 2016, we had remaining \$202.7 million of goodwill and \$191.2 million of other intangible assets, net. We assess all existing goodwill at least annually for impairment on a reporting unit basis. The techniques used

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in our qualitative assessment and goodwill impairment tests incorporate a number of estimates and assumptions that are subject to change. Although we believe these estimates and assumptions are reasonable and reflect market conditions forecasted at the assessment date, any changes to these assumptions and estimates due to market conditions or otherwise may lead to an outcome where impairment charges would be required in future periods.

Tight credit markets could impact our ability to obtain financing on reasonable terms or increase the cost of future financing. Although the credit market turmoil of several years ago did not have a significant adverse impact on our liquidity or borrowing costs, the availability of funds tightened and credit spreads on corporate debt increased. If credit market volatility were to return, then obtaining additional or replacement financing could be more difficult and the cost of issuing new debt or replacing a credit facility could be higher than under our current facilities. Tight credit conditions could limit our ability to finance acquisitions on terms acceptable to us.

For more information relating to borrowing and interest rates, see the following sections below: “Liquidity and Capital Resources” in Item 7 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations;” Item 7A under the caption “Quantitative and Qualitative Disclosures about Market Risk;” and note 5 to the consolidated financial statements, included below in Item 8 under the caption “Financial Statements and Supplementary Data.” That information is incorporated here by reference.

Our ability to maintain effective internal control over financial reporting may be insufficient to allow us to accurately report our financial results or prevent fraud, and this could cause our financial statements to become materially misleading and adversely affect the trading price of our common stock. We require effective internal control over financial reporting in order to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud. Internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Therefore, even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we cannot provide reasonable assurance with respect to our financial statements and effectively prevent fraud, our financial statements could become materially misleading, which could adversely affect the trading price of our common stock.

If we are not able to maintain the adequacy of our internal control over financial reporting, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business, financial condition and operating results could be harmed. Any material weakness could affect investor confidence in the accuracy and completeness of our financial statements. As a result, our ability to obtain any additional financing, or additional financing on favorable terms, could be materially and adversely affected. This, in turn, could materially and adversely affect our business, financial condition, and the market value of our stock and require us to incur additional costs to improve our internal control systems and procedures. In addition, perceptions of the Company among customers, suppliers, lenders, investors, securities analysts, and others could also be adversely affected. We can give no assurances that any material weaknesses will not arise in the future due to our failure to implement and maintain adequate internal control over financial reporting. In addition, although we have been successful historically in strengthening our controls and procedures, those controls and procedures may not be adequate to prevent or identify irregularities or ensure the fair presentation of our financial statements included in our periodic reports filed with the SEC.

There is no assurance that we will continue to pay dividends on our common stock, and our indebtedness could limit our ability to pay dividends. The timing, declaration, amount, and payment of dividends to our shareholders fall within the discretion of our Board of Directors and depend on many factors, including our financial condition and results of operations, as well as applicable law and business considerations that our Board of Directors considers relevant. There can be no assurance that we will continue to pay a quarterly dividend.

Additionally, if we cannot generate sufficient cash flow from operations to meet our debt payment obligations, then our ability to pay dividends, if so determined by the Board of Directors, will be impaired and we may be required to attempt to restructure or refinance our debt, raise additional capital, or take other actions such as selling assets, reducing, or delaying capital expenditures, or reducing our dividend. There can be no assurance, however, that any such actions could be effected on satisfactory terms, if at all, or would be permitted by the terms of our debt or our other credit and contractual arrangements.

Our growth outside the United States increases our exposure to global economic and political conditions and currency exchange volatility. Foreign operations contributed 16.0% of our sales in 2016. If we continue to grow outside the U.S., risks associated with exposure to more volatile economic conditions, political instability,

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cultural and legal differences in conducting business, (including corrupt practices), and currency exchange fluctuations will increase.

Our foreign operations' results are reported in the local currency and then translated into U.S. dollars at applicable exchange rates for inclusion in our consolidated financial statements. Fluctuations in currency exchange rates affect our operating results and financial position and affect the comparability of results between financial periods.

Our business depends on our ability to attract, develop, motivate, and retain qualified employees. Our success depends on hiring, developing, motivating, and retaining key employees, including executive, managerial, sales, professional, and other personnel. We may have difficulty identifying and hiring qualified personnel. In addition, we may have difficulty retaining such personnel once hired, and key people may leave and compete against us. With respect to sales and customer service positions in particular, we greatly benefit from having employees who are familiar with the products we sell and their applications, as well as with our customer and supplier relationships. The loss of key employees or our failure to attract and retain other qualified workers could disrupt or adversely affect our business. In addition, our operating results could be adversely affected by increased competition for employees, shortages of qualified workers, higher employee turnover (including through retirement as the workforce ages), or increased employee compensation or benefit costs.

An interruption of operations at our headquarters or distribution centers, or in our means of transporting product, could adversely impact our business. Our business depends on maintaining operating activity at our headquarters and distribution centers, and being able to receive and deliver product in a timely manner. A serious, prolonged interruption due to power or telecommunications outage, terrorist attack, earthquake, extreme weather events, other natural disasters, fire, flood, or other interruption could have a material adverse effect on our business and financial results.

We are subject to litigation and regulatory risk due to the nature of our business, which may have a material adverse effect on our business. From time to time, we are involved in lawsuits or other legal proceedings that arise from our business. These may, for example, relate to product liability claims, commercial disputes, personal injuries, or employment-related matters. In addition, we could face claims over other matters, such as claims arising from our status as a public company or government contractor, or otherwise relating to our compliance with a wide array of laws and regulations to which we are subject. The defense and ultimate outcome of lawsuits or other legal proceedings or inquiries may result in higher operating expenses, which could have a material adverse effect on our business, financial condition, or results of operations.

Our business is subject to risks, some for which we maintain third-party insurance and some for which we self-insure. We may incur losses and be subject to liability claims that could have a material adverse effect on our financial condition, results of operations, or cash flows. We maintain insurance policies that provide limited coverage for some, but not all, of the potential risks and liabilities associated with our business. The policies are subject to deductibles and exclusions that result in our retention of a level of risk on a self-insured basis. For some risks, we may not obtain insurance if we believe the cost of available insurance is excessive relative to the risks presented. Because of market conditions, premiums and deductibles for certain insurance policies can increase substantially, and in some instances, certain insurance may become unavailable or available only for reduced amounts of coverage. As a result, we may not be able to renew existing insurance policies or procure other desirable insurance on commercially reasonable terms, if at all. Even where insurance coverage applies, insurers may contest their obligations to make payments. Our financial condition, results of operations, and cash flows could be materially and adversely affected by losses and liabilities from uninsured or under-insured events, as well as by delays in the payment of insurance proceeds, or the failure by insurers to make payments.

In addition to the risks identified above, other risks to our future performance include, but are not limited to, the following:

- changes in customer preferences for products and services of the nature, brands, quality, or cost sold by us;
- changes in customer procurement policies and practices;
- changes in the market prices for products and services relative to the costs of providing them;
- changes in operating expenses;

organizational changes within the Company;
adverse regulation and legislation, both enacted and under consideration, including with respect to federal tax policy (e.g., affecting the use of the LIFO inventory accounting method and the taxation of foreign-sourced income);
the variability and timing of new business opportunities including acquisitions, customer relationships, and supplier authorizations;

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the incurrence of debt and contingent liabilities in connection with acquisitions; volatility of our stock price and the resulting impact on our consolidated financial statements; and changes in accounting policies and practices that could impact our financial reporting and increase compliance costs.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not applicable.

ITEM 2. PROPERTIES.

We believe having a local presence is important to serving our customers, so we maintain service centers and other operations in local markets throughout the countries in which we operate. At June 30, 2016, we owned real properties at 125 locations and leased 405 locations. Certain properties house more than one operation.

The following were our principal owned real properties (each of which has more than 30,000 square feet of floor space) at June 30, 2016.

Location of Principal Owned Real Property	Type of Facility
Cleveland, Ohio	Corporate headquarters
Lake City, Florida	Office and warehouse
Atlanta, Georgia	Distribution center and service center
Florence, Kentucky	Distribution center
Highland Heights, Ohio	Fluid power shop
Agawam, Massachusetts	Office and warehouse
Carlisle, Pennsylvania	Distribution center
Fort Worth, Texas	Distribution center and rubber shop
Clairmont, Alberta	Service center

Our principal leased real properties (each of which has more than 30,000 square feet of floor space) at June 30, 2016 were:

Location of Principal Leased Real Property	Type of Facility
Fontana, California	Distribution center, rubber shop, fluid power shop, and service center
Newark, California	Fluid power shop
Denver, Colorado	Rubber shop and service center
Lenexa, Kansas	Fluid power shop
Chanhassen, Minnesota	Fluid power shop
Billings, Montana	Fluid power shop
Elyria, Ohio	Product return center and service center
Parma, Ohio	Offices and warehouse
Portland, Oregon	Distribution center
Houston, Texas	Service center and shop
Kent, Washington	Offices and fluid power shop
Longview, Washington	Service center, rubber shop, and fluid power shop
Appleton, Wisconsin	Offices, service center, and rubber shop
Edmonton, Alberta	Service center and shop
Winnipeg, Manitoba	Distribution center and service center

The properties in Highland Heights, Newark, Lenexa, Chanhassen, Billings and Kent are used in our fluid power businesses segment.

The Fontana and Longview properties are used in both the service center-based distribution segment and the fluid power businesses segment. The remaining properties are used in the service center-based distribution segment.

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We consider our properties generally sufficient to meet our requirements for office space and inventory stocking. A service center's size is primarily influenced by the amount and types of inventory the service center requires to meet customers' needs.

When opening new operations, we have tended to lease rather than purchase real property. We do not consider any service center, distribution center, or shop property to be material, because we believe that, if it becomes necessary or desirable to relocate an operation, other suitable property could be found.

In addition to operating locations, we own or lease certain properties which in the aggregate are not material and are either for sale, lease, or sublease to third parties due to a relocation or closing. We also may lease or sublease to others unused portions of buildings.

Additional information regarding our properties can be found in note 11 to the consolidated financial statements, included below in Item 8 under the caption "Financial Statements and Supplementary Data." That information is incorporated here by reference.

ITEM 3. LEGAL PROCEEDINGS.

Applied and/or one of its subsidiaries is a party to pending legal proceedings with respect to product liability, commercial, personal injury, and other matters. Although it is not possible to predict the outcome of these proceedings or the range of reasonably possible loss, we believe, 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 Applied's consolidated financial position, results of operations, or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES.

Information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of the SEC Regulation S-K is included in Exhibit 95 to this annual report on Form 10-K.

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EXECUTIVE OFFICERS OF THE REGISTRANT.

Applied's executive officers are elected by the Board of Directors for a term of one year, or until their successors are chosen and qualified, at the Board's organizational meeting held following the annual meeting of shareholders. The following is a list of the executive officers and a description of their business experience during the past five years. Except as otherwise stated, the positions and offices indicated are with Applied, and the persons were most recently elected to their current positions on October 27, 2015:

Name	Positions and Experience	Age
Neil A. Schrimsher	President (since August 2013) and Chief Executive Officer (since October 2011). From 2010 to August 2011, Mr. Schrimsher was Executive Vice President of Cooper Industries plc (formerly NYSE: CBE), a global electrical products manufacturer, where he led Cooper's Electrical Products Group and headed numerous domestic and international growth initiatives. He was President of Cooper Lighting, Inc. from 2006 to 2010.	52
Thomas E. Arnold	Vice President-Sales since February 2015. Prior to that, he had served as Vice President-Marketing and Strategic Accounts since 2008.	61
Todd A. Barlett	Vice President-Acquisitions and Global Business Development since 2004.	61
Fred D. Bauer	Vice President-General Counsel & Secretary since 2002.	50
Mark O. Eisele	Vice President-Chief Financial Officer & Treasurer since 2004.	59
Warren E. Hoffner	Vice President-General Manager, Fluid Power since 2003. The Board of Directors designated him an executive officer in October 2015.	56
Kurt W. Loring	Vice President-Chief Human Resources Officer since July 2014. From October 2011 to July 2014 he was Vice President, Human Resources for the Forged Products segment of Precision Castparts Corporation (formerly NYSE: PCP). The \$4.3 billion segment, with greater than 5,000 employees, is a world-leading producer of complex forgings and high-performance nickel-based alloys and super alloys for aerospace, power generation, and general industrial applications. Prior to that he served with Danaher Corporation (NYSE: DHR), most recently as the Vice President, Human Resources for its Fluke Corporation subsidiary, a leader in the manufacture, distribution, and service of electronic test tools and software worldwide.	47

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Applied's common stock, without par value, is listed for trading on the New York Stock Exchange with the ticker symbol "AIT." Information concerning the quarterly stock dividends for the fiscal years ended June 30, 2016, 2015, and 2014 and the number of shareholders of record as of August 5, 2016 are set forth in Item 8, "Financial Statements and Supplementary Data," in the "Quarterly Operating Results" table. That information is incorporated here by reference. Set forth below is market information on Applied's common stock.

	Shares Traded	Average Daily Volume	Price Range	
			High	Low
2016				
First Quarter	17,146,300	267,900	\$42.65	\$37.15
Second Quarter	14,832,500	231,800	43.54	37.00
Third Quarter	14,619,200	239,700	44.24	35.55
Fourth Quarter	12,583,200	196,600	47.18	42.52
2015				
First Quarter	9,932,400	155,200	\$52.62	\$45.54
Second Quarter	11,023,400	172,200	50.00	42.92
Third Quarter	17,181,400	281,700	46.05	39.76
Fourth Quarter	16,892,300	268,100	45.22	39.54
2014				
First Quarter	9,157,400	143,100	\$53.57	\$47.21
Second Quarter	12,634,700	197,400	53.45	45.62
Third Quarter	10,107,300	165,700	52.27	45.74
Fourth Quarter	12,799,900	203,200	51.44	45.62

The following table summarizes Applied's repurchases of its common stock in the quarter ended June 30, 2016.

Period	(a) Total Number of Shares (1)	(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 (2)
April 1, 2016 to April 30, 2016	87	\$45.62	—	296,200
May 1, 2016 to May 31, 2016	—	—	—	296,200
June 1, 2016 to June 30, 2016	—	—	—	296,200
Total	87	\$45.62	—	296,200

(1) During the quarter ended June 30, 2016, Applied purchased 87 shares in connection with an employee deferred compensation program. This purchase is not counted in the authorization in note (2).

On April 28, 2015, the Board of Directors authorized the purchase of up to 1.5 million shares of Applied's common stock.

(2) We publicly announced the authorization on April 30, 2015. Purchases can be made in the open market or in privately negotiated transactions. The authorization is in effect until all shares are purchased, or the Board revokes or amends the authorization.

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ITEM 6. SELECTED FINANCIAL DATA.

This selected financial data should be read in conjunction with Applied's consolidated financial statements and related notes included elsewhere in this annual report as well as the section of the annual report titled Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(In thousands, except per share amounts and statistical data)

	2016	2015	2014	2013	2012	
Consolidated Operations — Year Ended						
June 30						
Net sales	\$2,519,428	\$2,751,561	\$2,459,878	\$2,462,171	\$2,375,445	
Depreciation and amortization of property	15,966	16,578	13,977	12,501	11,236	
Amortization:						
Intangible assets	25,580	25,797	14,023	13,233	11,465	
SARs and stock options	1,543	1,610	1,808	2,317	2,058	
Operating income ^(a)	88,801	184,619	164,358	176,399	168,395	
Net income ^(a)	29,577	115,484	112,821	118,149	108,779	
Per share data:						
Net income:						
Basic	0.75	2.82	2.69	2.81	2.58	
Diluted ^(a)	0.75	2.80	2.67	2.78	2.54	
Cash dividend	1.10	1.04	0.96	0.88	0.80	
Year-End Position — June 30						
Working capital	\$507,238	\$535,938	\$545,193	\$491,380	\$435,593	
Long-term debt (including portion classified as current)	328,334	320,995	170,712	—	—	
Total assets	1,312,529	1,432,556	1,334,169	1,058,706	962,183	
Shareholders' equity	657,916	741,328	800,308	759,615	672,131	
Year-End Statistics — June 30						
Current ratio	2.8	2.7	2.9	3.0	2.9	
Operating facilities	559	565	538	522	476	
Shareholders of record ^(b)	5,372	6,016	6,330	6,319	6,225	
Return on assets ^{(a) (c)}	2.2	% 7.9	% 10.2	% 11.6	% 11.8	%
Return on equity ^(d)	4.2	% 15.0	% 14.5	% 16.5	% 16.7	%
Capital expenditures ^(e)	\$13,130	\$14,933	\$20,190	\$12,214	\$26,021	
Cash Returned to Shareholders During the Year						
Dividends paid	\$43,330	\$42,663	\$40,410	\$37,194	\$33,800	
Purchases of treasury shares	37,465	76,515	36,732	53	31,032	
Total	\$80,795	\$119,178	\$77,142	\$37,247	\$64,832	

A goodwill impairment charge in fiscal 2016 reduced operating income by \$64.8 million, net income by \$63.8

(a) million, and diluted earnings per share by \$1.62. Excluding the goodwill impairment charge, the fiscal 2016 return on assets would be 6.7%.

(b) Includes participant-shareholders in the Applied Industrial Technologies, Inc. Retirement Savings Plan and shareholders in the Company's direct stock purchase program.

(c) Return on assets is calculated as net income divided by monthly average assets.

(d)

Return on equity is calculated as net income divided by the average shareholders' equity (beginning of the year plus end of the year divided by 2).

Capital expenditures for fiscal 2014 included the purchase of our headquarters facility which used \$10.0 million of cash.

(e) Capital expenditures for 2013 and 2012 include \$5.6 million and \$16.7 million related to Applied's Enterprise Resource Planning (ERP) system project, respectively. See Item 7 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further description of the ERP project.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

With more than 5,500 employees across North America, Australia and New Zealand, Applied Industrial Technologies ("Applied," the "Company," "We," "Us" or "Our") is a leading industrial distributor serving MRO (Maintenance, Repair & Operations) and OEM (Original Equipment Manufacturer) customers in virtually every industry. In addition, Applied provides engineering, design and systems integration for industrial and fluid power applications, as well as customized mechanical, fabricated rubber and fluid power shop services. We have a long tradition of growth dating back to 1923, the year our business was founded in Cleveland, Ohio. At June 30, 2016, business was conducted in the United States, Puerto Rico, Canada, Mexico, Australia and New Zealand from 559 facilities.

The following is Management's Discussion and Analysis of significant factors that have affected our financial condition, results of operations and cash flows during the periods included in the accompanying consolidated balance sheets, statements of consolidated income, consolidated comprehensive income and consolidated cash flows in Item 8 under the caption "Financial Statements and Supplementary Data." When reviewing the discussion and analysis set forth below, please note that the majority of SKUs (Stock Keeping Units) we sell in any given year 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.

Our fiscal 2016 consolidated sales were \$2.52 billion, a decrease of \$232.1 million or 8.4% compared to the prior year, with acquisitions contributing \$57.1 million or 2.1% and unfavorable foreign currency translation of \$60.1 million decreasing sales by 2.2%. Gross profit margin remained stable at 28.1% for fiscal 2016 and 28.0% for fiscal 2015. Operating margin decreased to 3.5% in fiscal 2016, down from 6.7% in fiscal 2015 due to a non-cash goodwill impairment charge recorded during the third quarter of fiscal 2016, totaling \$64.8 million, related to the goodwill associated with the Company's Canada and Australia/New Zealand reporting units within the Service Center Based Distribution segment.

During fiscal 2016, the Company recorded charges of \$8.8 million for restructuring activities within the Service Center Based Distribution segment to reduce headcount and consolidate locations. Of the total, \$3.6 million related to inventory reserves for excess and obsolete inventory recorded within cost of sales, and \$5.2 million related to severance and facility consolidation recorded within selling, distribution and administrative expense.

Our earnings per share was \$0.75 in fiscal 2016 versus \$2.80 in fiscal year 2015, a decrease of 73.2%. The current year results include negative impacts on earnings per share of \$1.62 per share for the non-cash goodwill impairment charge and \$0.16 per share for restructuring charges.

Shareholders' equity was \$657.9 million at June 30, 2016, down from \$741.3 million at June 30, 2015. Working capital decreased \$28.7 million from June 30, 2015 to \$507.2 million at June 30, 2016. The current ratio was 2.8 to 1 at June 30, 2016, compared to 2.7 to 1 at June 30, 2015.

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

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The MCU (total industry) and IP indices have generally trended lower during fiscal 2016 correlating with the overall downturn in the industrial economy, although they increased in the June 2016 quarter. The ISM PMI registered 53.2 in June 2016, the highest reading in fiscal 2016, and an increase from the June 2015 revised reading of 53.1. A reading above 50 generally indicates expansion. The index readings for the months during the current quarter, along with the revised indices for previous quarter ends, were as follows:

Month	Index Reading		
	MCU	PMI	IP
June 2016	75.4	53.2	103.2
May 2016	74.9	51.3	102.8
April 2016	75.2	50.8	103.0
March 2016	74.8	51.8	103.0
December 2015	75.4	48.0	103.0
September 2015	77.8	50.0	105.8
June 2015	76.4	53.1	105.1

YEAR ENDED JUNE 30, 2016 vs. 2015

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

	Year Ended June 30,			Change in \$'s Versus Prior Period
	As a % of Net Sales			
	2016	2015	% Change	
Net Sales	100.0%	100.0%	(8.4)%
Gross Profit Margin	28.1 %	28.0 %	(8.1)%
Selling, Distribution & Administrative	22.0 %	21.3 %	(5.4)%
Operating Income	3.5 %	6.7 %	(51.9)%
Net Income	1.2 %	4.2 %	(74.4)%

Sales in fiscal 2016 were \$2.52 billion, which was \$232.1 million or 8.4% below the prior year, with unfavorable foreign currency translation accounting for \$60.1 million or 2.2% of the decrease, offset by sales from acquisitions of \$57.1 million or 2.1%. Excluding the impact of businesses acquired and prior to the impact of foreign currency translation, sales were down \$229.1 million or 8.3% during the year. Of the 8.3% decrease, 5.1% pertains to our upstream oil and gas-focused operations (which experienced sales declines of 50.1% during the year) and 3.2% is within our traditional core operations. There were 253.5 selling days in fiscal 2016 and 252.5 selling days in fiscal 2015.

Sales of our Service Center Based Distribution segment, which operates primarily in MRO markets, decreased \$167.7 million, or 7.4%. Acquisitions within this segment increased sales by \$38.7 million or 1.7%, while unfavorable foreign currency translation decreased sales by \$50.7 million or 2.2%. Excluding the impact of businesses acquired and unfavorable currency translation impact, sales decreased \$155.7 million or 6.9%, the majority of which relates to the upstream oil and gas-focused operations, as the traditional core operations had a decrease of only 1.7%.

Sales of our Fluid Power Businesses segment, which operates primarily in OEM markets, decreased \$64.4 million or 13.0%. Acquisitions within this segment increased sales \$18.4 million or 3.7%, while unfavorable foreign currency translation decreased sales by \$9.4 million or 1.9%. Excluding the impact of businesses acquired and unfavorable currency translation impact, sales decreased \$73.4 million or 14.8%.

Sales in our U.S. operations were down \$120.8 million or 5.4%, while acquisitions added \$56.9 million or 2.5%. Excluding the impact of businesses acquired, U.S. sales were down \$177.7 million or 7.9%, of which 3.7% is from our upstream oil and gas-focused operations and 4.2% is within our traditional core operations. Sales from our Canadian operations decreased \$100.8 million or 28.1%, with unfavorable foreign currency translation decreasing Canadian sales by \$33.6 million or 9.4%. Acquisitions added \$0.2 million, or less than 1.0%. Prior to the impact of foreign currency translation and excluding businesses acquired, Canadian sales were down \$67.4 million or 18.7%, of which 15.4% related to upstream oil and gas operations with the remaining 3.3% decrease from the traditional core

operations. Consolidated sales from our other country operations, which include Mexico, Australia and New

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Zealand, decreased \$10.5 million or 6.8% compared to the prior year. Unfavorable foreign currency translation decreased other country sales by \$26.5 million or 17.1%. Prior to the impact of currency translation, other country sales were up \$16.0 million or 10.3% compared to the prior year, driven by growth in operations in Mexico.

The sales product mix for fiscal 2016 was 72.9% industrial products and 27.1% fluid power products compared to 73.2% industrial and 26.8% fluid power in the prior year.

Our gross profit margin remained stable at 28.1% in fiscal 2016 and 28.0% in fiscal 2015. The increase is due to the impact of LIFO layer liquidations recorded in fiscal 2016 which increased gross profit by \$2.1 million.

Selling, distribution and administrative expenses (SD&A) consist 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, facility related expenses and expenses incurred with acquiring businesses. SD&A decreased \$31.4 million or 5.4% during fiscal 2016 compared to the prior year, and as a percent of sales increased to 22.0% from 21.3% in fiscal 2015. Changes in foreign currency exchange rates had the effect of decreasing SD&A by \$14.9 million or 2.5% compared to the prior year. Additional SD&A from businesses acquired in the current year added \$16.0 million or 2.7% of SD&A expenses including \$2.1 million associated with intangibles amortization. Further, severance expense and other restructuring charges related to consolidating facilities added \$5.2 million or 0.9% of SD&A for the twelve months ended June 30, 2016. Excluding the impact of businesses acquired, restructuring expenses, and the favorable currency translation impact, SD&A declined \$37.7 million or 6.5% during fiscal 2016 compared to fiscal 2015 as a result of continuous efforts to minimize such expenses. These efforts to minimize expense were led by efforts to control headcount. Excluding the effect of acquisitions, overall headcount is down by over 400 associates from June 30, 2015 to June 30, 2016. Total salaries and wages were down \$17.0 million for fiscal 2016 compared to fiscal 2015 while all other expenses within SD&A were down \$14.4 million.

During the third quarter of fiscal 2016, the Company performed its annual goodwill impairment test. As a result of this test, the Company determined that all of the goodwill associated with the Australia/New Zealand Service Center Based Distribution reporting unit was impaired as of January 1, 2016. This impairment is the result of the decline in the mining and extraction industries in Australia and the resulting reduced customer spending due to a decline in demand throughout Asia. Further, due to a sustained decline in oil prices and reduced customer spending in Canada, the Company determined that a portion of the goodwill associated with the Canada Service Center Based Distribution reporting unit was also impaired as of January 1, 2016. Accordingly, the Company recognized a combined non-cash impairment charge of \$64.8 million for goodwill during fiscal 2016, which decreased net income by \$63.8 million and earnings per share by \$1.62. Changes in future results, assumptions, and estimates used in calculating the goodwill impairment test could result in additional impairment charges in future periods.

Operating income decreased \$95.8 million, or 51.9%, to \$88.8 million during fiscal 2016 from \$184.6 million during fiscal 2015, and as a percent of sales, decreased to 3.5%, primarily due to the non-cash goodwill impairment charge of \$64.8 million. Excluding the goodwill impairment charge, operating income as a percent of sales was 6.1%, down from 6.7% in the prior year primarily due to the \$8.8 million of restructuring charges incurred during fiscal 2016 and lower sales volume.

Operating income, before the goodwill impairment charge, as a percentage of sales for the Service Center Based Distribution segment decreased to 5.2% in fiscal 2016 from 6.2% in fiscal 2015. This decrease is primarily attributable to the impact of lower sales and the \$8.8 million of restructuring charges recorded to costs of sales and SD&A during fiscal 2016.

Operating income as a percentage of sales for the Fluid Power Businesses segment decreased to 9.4% in fiscal 2016 from 9.8% in fiscal 2015. This decrease is primarily attributable to a decline in sales without a commensurate decline in the business segment's SD&A expenses.

Segment operating income is impacted by changes in the amounts and levels of expenses allocated to the segments. The expense allocations include corporate charges for working capital, logistics support and other items and impact segment gross profit and operating expense.

Other expense (income), net, represents certain non-operating items of income and expense. This was \$1.1 million of expense in fiscal 2016 compared to \$0.9 million of expense in fiscal 2015. Current year expense primarily consists of foreign currency transaction losses of \$1.0 million offset by unrealized gains on investments held by non-qualified deferred compensation trusts of \$0.1 million. Fiscal 2015 expense consisted primarily of foreign currency transaction losses of \$1.3 million offset by unrealized gains on investments held by non-qualified deferred compensation trusts of \$0.4 million.

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The effective income tax rate was 62.6% for fiscal 2016 compared to 34.3% for fiscal 2015. The increase in the effective tax rate is due to the recording of \$64.8 million of goodwill impairment during the current period, of which \$61.3 million is not tax deductible. The goodwill impairment increased the effective tax rate for fiscal 2016 by 27.1%. The remaining increase in the effective tax rate, adjusted for goodwill impairment, was due to state and local taxes and mix of income negatively impacting the rate. All undistributed earnings of our foreign subsidiaries are considered to be permanently reinvested at June 30, 2016 and 2015.

We expect our income tax rate for fiscal 2017 to be in the range of 34.0% to 35.0%.

As a result of the factors addressed above, net income for fiscal 2016 decreased \$85.9 million or 74.4% from the prior year. Net income per share was \$0.75 per share for fiscal 2016 compared to \$2.80 for fiscal 2015, a decrease of 73.2%. The current year results include negative impacts on earnings per share of \$1.62 per share for goodwill impairment charges and \$0.16 per share for restructuring charges. Net income per share was favorably impacted by lower weighted average common shares outstanding in fiscal 2016 as a result of our share repurchase program. At June 30, 2016, we had a total of 559 operating facilities in the United States, Puerto Rico, Canada, Mexico, Australia and New Zealand, versus 565 at June 30, 2015.

The number of Company employees was 5,569 at June 30, 2016 and 5,839 at June 30, 2015.

YEAR ENDED JUNE 30, 2015 vs. 2014

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

	Year Ended June 30,		Change in	
	As a % of Net Sales		\$'s Versus Prior Period % Change	
	2015	2014		
Net Sales	100.0 %	100.0 %	11.9	%
Gross Profit Margin	28.0 %	27.9 %	12.1	%
Selling, Distribution & Administrative	21.3 %	21.2 %	12.0	%
Operating Income	6.7 %	6.7 %	12.3	%
Net Income	4.2 %	4.6 %	2.4	%

Sales in fiscal 2015 were \$2.75 billion, which was \$291.7 million or 11.9% above fiscal 2014, with acquisitions accounting for \$280.2 million or 11.4%. Unfavorable foreign currency translation decreased sales by \$43.3 million or 1.8%. Excluding the impact of businesses acquired and prior to the impact of currency translation, sales were up \$54.8 million or 2.3% during fiscal year 2015. We had 252.5 selling days in both fiscal 2015 and fiscal 2014.

Sales of our Service Center Based Distribution segment, which operates primarily in MRO markets, increased \$281.4 million, or 14.3%. Acquisitions within this segment increased sales by \$280.2 million or 14.2%. Unfavorable foreign currency translation decreased sales by \$36.5 million or 1.8%. Excluding the impact of businesses acquired and unfavorable currency translation impact, sales increased \$37.7 million or 1.9%.

Sales of our Fluid Power Businesses segment, which operates primarily in OEM markets, increased \$10.3 million or 2.1%, primarily attributed to strong sales growth at several of our U.S. based Fluid Power businesses which added \$17.1 million or 3.5%, while unfavorable foreign currency translation decreased sales by \$6.8 million or 1.4%.

Sales in our U.S. operations were up \$207.1 million or 10.2%, with acquisitions adding \$175.8 million or 8.7%. Sales from our Canadian operations increased \$67.5 million or 23.2%, with acquisitions adding \$86.4 million or 29.7%. Unfavorable foreign currency translation decreased Canadian sales by \$30.4 million or 10.4%. Excluding the impact of businesses acquired and prior to the impact of currency translation, sales were up \$11.5 million or 3.9% during fiscal year 2015. Consolidated sales from our other country operations, which include Mexico, Australia and New Zealand, were \$17.1 million or 12.4% above fiscal year 2014, with acquisitions adding sales of \$18.0 million or 13.1%. Unfavorable foreign currency translation decreased other country sales by \$12.9 million or 9.4%. Excluding the impact of businesses acquired and prior to the impact of currency translation, sales were up \$12.0 million or 8.7% during fiscal 2015.

The sales product mix for fiscal 2015 was 73.2% industrial products and 26.8% fluid power products compared to 70.7% industrial and 29.3% fluid power in fiscal year 2014. These changes in product mix related entirely to the

product mix of recent acquisitions being primarily industrial products.

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Our gross profit margin was 28.0% in fiscal 2015 versus 27.9% in fiscal 2014. The increased margins were attributable to the impact of relatively higher gross margins from acquired operations.

Selling, distribution and administrative expenses (SD&A) consist 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, facility related expenses and expenses incurred with acquiring businesses. SD&A increased \$62.6 million or 12.0% during fiscal 2015 compared to fiscal 2014, and as a percent of sales increased to 21.3% in fiscal 2015 from 21.2% in fiscal 2014. The acquired businesses added an incremental \$69.4 million of SD&A expenses, which included an additional \$13.4 million associated with acquired identifiable intangibles amortization. Excluding the \$11.0 million decline in SD&A from foreign currency translation, the remaining SD&A amounts were similar to fiscal 2014. The increase in SD&A as a percentage of sales was driven by additional intangible asset amortization from businesses acquired.

Operating income increased \$20.3 million, or 12.3%, to \$184.6 million during fiscal 2015 from \$164.4 million during fiscal 2014, and as a percent of sales, remained stable at 6.7%. The increase in operating income dollars was primarily attributable to our acquired businesses.

Operating income as a percentage of sales for the Service Center Based Distribution segment increased to 6.2% in fiscal 2015 from 6.0% in fiscal 2014. This increase was primarily attributable to an increase in gross profit as a percentage of sales, as a result of acquisitions in fiscal 2015 which operated at higher gross profit margins, representing an increase of 0.1%, along with a decrease in SD&A as a percentage of sales of 0.1%.

Operating income as a percentage of sales for the Fluid Power Businesses segment increased to 9.8% in fiscal 2015 from 9.2% in fiscal 2014. This increase was primarily attributable to the leveraging of organic sales growth in our U.S. based Fluid Power Businesses, without a commensurate increase in SD&A expenses.

Segment operating income was impacted by changes in the amounts and levels of expenses allocated to the segments. The expense allocations included corporate charges for working capital, logistics support and other items and impact segment gross profit and operating expense.

Interest expense, net, increased to \$7.9 million in fiscal 2015 entirely due to acquisition related borrowing.

Other expense (income), net, represented certain non-operating items of income and expense. This was \$0.9 million of expense in fiscal 2015 compared to \$2.2 million of income in fiscal 2014. Fiscal 2015 expense primarily consisted of foreign currency transaction losses of \$1.3 million offset by unrealized gains on investments held by non-qualified deferred compensation trusts of \$0.4 million. Fiscal 2014 consisted primarily of unrealized gains on investments held by non-qualified deferred compensation trusts of \$1.7 million as well as \$1.3 million of income associated with the elimination of the one-month Canadian and Mexican reporting lags (see note 1 in Item 8 under the caption "Financial Statements and Supplementary Data"), offset by foreign currency transaction losses of \$0.8 million.

Income tax expense as a percent of income before taxes was 34.3% for fiscal 2015 and 32.1% for fiscal 2014. This increase in the effective rate was due to recording of valuation allowances against certain deferred tax assets for foreign jurisdictions in fiscal 2015 as well as the non-recurrence of a one-time favorable tax benefit in fiscal 2014 in accounting for undistributed earnings of non-U.S. subsidiaries. All undistributed earnings of our foreign subsidiaries were considered to be permanently reinvested at June 30, 2015 and 2014.

As a result of the factors addressed above, net income for fiscal 2015 increased \$2.7 million or 2.4% from the prior year. Net income per share increased at a slightly higher rate of 4.9% due to lower weighted-average shares outstanding in fiscal 2015.

At June 30, 2015, we had a total of 565 operating facilities in the United States, Puerto Rico, Canada, Mexico, Australia and New Zealand, versus 538 at June 30, 2014.

The number of Company employees was 5,839 at June 30, 2015 and 5,472 at June 30, 2014.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of capital is cash flow from operations, supplemented as necessary by bank borrowings or other sources of debt. At June 30, 2016 we had total debt obligations outstanding of \$328.3 million compared to \$321.0 million at June 30, 2015. Management expects that our existing cash, cash equivalents, funds available under the revolving credit and uncommitted shelf facilities, cash provided from operations, and the use of operating leases will

be sufficient to finance normal working capital needs in each of the countries we operate in, payment of dividends, acquisitions, investments in properties, facilities and equipment, and the purchase of additional Company common

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stock. Management also believes that additional long-term debt and line of credit financing could be obtained based on the Company's credit standing and financial strength.

The Company holds significant cash and cash equivalent balances outside of the United States of America. The following table shows the Company's total cash as of June 30, 2016 by geographic location; all amounts are in thousands.

Country	Amount
United States	\$10,828
Canada	36,981
Other Countries	12,052
Total	\$59,861

To the extent cash in foreign countries is distributed to the U.S., it could become subject to U.S. income taxes. Foreign tax credits may be available to offset all or a portion of such taxes. At June 30, 2016, all foreign earnings are considered permanently reinvested.

The Company's working capital at June 30, 2016 was \$507.2 million compared to \$535.9 million at June 30, 2015. The current ratio was 2.8 to 1 at June 30, 2016 compared to 2.7 to 1 at June 30, 2015.

Net Cash Flows

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

	Year Ended June 30,		
	2016	2015	2014
Net Cash Provided by (Used in):			
Operating Activities	\$160,992	\$154,538	\$110,110
Investing Activities	(75,031)	(173,621)	(203,637)
Financing Activities	(91,985)	24,689	92,142
Exchange Rate Effect	(3,585)	(7,325)	(590)
Decrease in Cash and Cash Equivalents	\$(9,609)	\$(1,719)	\$(1,975)

The increase in cash provided by operating activities during fiscal 2016 is due primarily to decreased working capital needs due to lower receivables levels resulting from lower sales levels as compared to the prior period, partially offset by lower operating results.

Net cash used in investing activities in fiscal 2016 included \$13.1 million for capital expenditures and \$62.5 million used for acquisitions. Net cash used in investing activities in fiscal 2015 included \$14.9 million for capital expenditures and \$160.6 million used for acquisitions. Net cash used in investing activities in fiscal 2014 included \$20.2 million for capital expenditures, \$10.0 million of which was used for the purchase of our headquarters facility, and \$184.3 million for acquisitions.

Net cash used in financing activities in fiscal 2016 included \$98.7 million of long-term debt repayments and \$19.0 million of net repayments under the revolving credit facility, offset by \$125.0 million of cash from borrowings under the new credit facility. Further uses of cash were \$43.3 million for dividend payments, \$37.5 million used to repurchase 951,100 shares of treasury stock, and \$18.9 million of acquisition holdback payments.

Net cash provided by financing activities in fiscal 2015 included \$170.0 million from borrowings under long-term debt facilities used for the financing of acquisitions, offset by \$17.0 million of net repayments under our revolving credit facility and \$2.7 million of long-term debt repayments. Further uses of cash were \$42.7 million for dividend payments, \$76.5 million used to repurchase 1,740,100 shares of treasury stock and \$7.7 million of acquisition holdback payments.

Net cash provided by financing activities in fiscal 2014 included \$100.0 million from borrowings under long-term debt facilities as well as \$69.0 million in net borrowings under our revolving credit facility, both of which were utilized for the financing of acquisitions. These sources of cash were offset by \$40.4 million for dividend payments and \$36.7 million used to repurchase 759,900 shares of treasury stock.

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The increase in dividends over the last three fiscal years is the result of regular increases in our dividend payout rates. We paid dividends of \$1.10, \$1.04 and \$0.96 per share in fiscal 2016, 2015 and 2014, respectively.

Capital Expenditures

We expect capital expenditures for fiscal 2017 to be in the \$17.0 million to \$19.0 million range, primarily consisting of capital associated with additional information technology equipment and infrastructure investments. Depreciation for fiscal 2017 is expected to be in the range of \$16.0 million to \$17.0 million.

ERP Project

In fiscal 2011 Applied commenced its ERP (SAP) project to transform the Company's technology platforms and enhance its business information and technology systems for future growth. We have deployed our solution in our Western Canadian operating locations and our traditional U.S. Service Center Based Distribution businesses, excluding recent acquisitions. In fiscal 2014, the Company initiated the conversion to SAP of its related financial and accounting systems, including the receivables, payables, treasury, inventory, fixed assets, general ledger and consolidation systems. All of these underlying financial and accounting systems, except for the consolidation process/system, were transitioned to SAP during fiscal 2015. At the beginning of fiscal 2016 the Company converted to a new consolidation process and system. During the third quarter of fiscal 2016, the Company determined that operations in Eastern Canada will be transitioned onto SAP throughout fiscal 2017 and 2018. The Company will continue to evaluate and consider an appropriate deployment schedule for other operations not on SAP.

Share Repurchases

The Board of Directors has authorized the repurchase of shares of the Company's stock. These purchases may be made in open market and negotiated transactions, from time to time, depending upon market conditions.

At June 30, 2016, we had authorization to purchase an additional 296,200 shares.

In fiscal 2016, 2015 and 2014, we repurchased 951,100, 1,740,100 and 759,900 shares of the Company's common stock, respectively, at an average price per share of \$39.39, \$43.97, and \$48.34, respectively.

Borrowing Arrangements

In December 2015, the Company entered into a new five-year credit facility with a group of banks expiring in December 2020. This agreement provides for a \$125.0 million unsecured term loan and a \$250.0 million unsecured revolving credit facility. Fees on this facility range from 0.09% to 0.175% per year based upon the Company's leverage ratio at each quarter end. Borrowings under this agreement carry variable interest rates tied to either LIBOR or prime at the Company's discretion. At June 30, 2016, the Company had \$123.4 million outstanding under the term loan and \$33.0 million outstanding under the revolver. Unused lines under this facility, net of outstanding letters of credit of \$2.7 million to secure certain insurance obligations, totaled \$214.3 million at June 30, 2016 and are available to fund future acquisitions or other capital and operating requirements. The interest rate on the term loan as of June 30, 2016 was 1.50%. The weighted-average interest rate on the revolving credit facility outstanding as of June 30, 2016 was 1.44%.

The new credit facility replaced the Company's previous term loan and revolving credit facility agreements. The Company had \$96.9 million outstanding at June 30, 2015 under the previous term loan agreement, which carried a variable interest rate tied to LIBOR and was 1.19% at June 30, 2015. At June 30, 2015, the Company had \$52.0 million outstanding under the previous revolving credit facility. Unused lines under this facility, net of outstanding letters of credit of \$3.8 million to secure certain insurance obligations, totaled \$94.2 million at June 30, 2015 and were available to fund future acquisitions or other capital and operating requirements. The weighted-average interest rate on the revolving credit facility outstanding as of June 30, 2015 was 1.15%.

Additionally, the Company had letters of credit outstanding with a separate bank, not associated with the revolving credit agreement, in the amount of \$2.7 million as of June 30, 2016 and \$1.8 million as of June 30, 2015, in order to secure certain insurance obligations.

In April 2014 the Company assumed \$2.4 million of debt as a part of the acquisition of our headquarters facility. The 1.5% fixed interest rate note is held by the State of Ohio Development Services Agency and matures in May 2024. We had \$1.9 million and \$2.1 million outstanding under this note at June 30, 2016 and 2015, respectively.

At June 30, 2016, the Company had borrowings outstanding under its unsecured shelf facility agreement with Prudential Investment Management of \$170.0 million. The "Series C" notes have a principal amount of \$120.0 million

and carry a fixed interest rate of 3.19%; the principal is due in equal payments in July 2020, 2021, and 2022. The "Series D" notes have a principal amount of \$50.0 million and carry a fixed interest rate of 3.21%; the principal

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is due in equal payments in October 2019 and 2023. As of June 30, 2016, \$50.0 million in additional financing was available under this facility.

The revolving credit facility and unsecured shelf facility contain restrictive covenants regarding liquidity, net worth, financial ratios, and other covenants. At June 30, 2016, the most restrictive of these covenants required that the Company have net indebtedness less than 3.25 times consolidated income before interest, taxes, depreciation and amortization. At June 30, 2016, the Company's indebtedness was less than two times consolidated income before interest, taxes, depreciation and amortization. The Company was in compliance with all covenants at June 30, 2016.

Accounts Receivable Analysis

The following table is included to aid in analysis of accounts receivable and the associated provision for losses on accounts receivable (all dollar amounts are in thousands):

June 30,	2016	2015		
Accounts receivable, gross	\$358,891	\$386,926		
Allowance for doubtful accounts	11,034	10,621		
Accounts receivable, net	\$347,857	\$376,305		
Allowance for doubtful accounts, % of gross receivables	3.1	% 2.7	%	
Year Ended June 30,	2016	2015		
Provision for losses on accounts receivable	\$4,303	\$2,597		
Provision as a % of net sales	0.17	% 0.09	%	

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

On a consolidated basis, DSO was 49.4 at June 30, 2016 versus 50.0 at June 30, 2015. Accounts receivable decreased 7.6% this year, compared to an decrease of 8.4% in sales in the twelve months ended June 30, 2016. Acquisitions added \$8.0 million, or 2.1%, of accounts receivable in fiscal 2016. We primarily attribute the decrease in DSO to the improved timing of collections within our traditional U.S. Service Center Based Distribution businesses.

Approximately 2.7% of our accounts receivable balances are more than 90 days past due at June 30, 2016 compared to 4.2% at June 30, 2015. This improvement relates to our U.S. Service Center Based Distribution businesses. On an overall basis, our provision for losses from uncollected receivables represents 0.17% of our sales in the year ended June 30, 2016. Historically, this percentage is around 0.10% to 0.15%. The increase in the provision as a percentage of sales for fiscal 2016 relates to \$2.4 million of expense for reserves added in the twelve months ended June 30, 2016 for our operations focused on upstream oil and gas customers due to the recent downturn in the energy markets. Management believes the overall receivables aging and provision for losses on uncollected receivables are at reasonable levels, and that past due balances will continue to decline in fiscal 2017.

Inventory Analysis

Inventories are valued at the average cost method, using the last-in, first-out (LIFO) method for U.S. inventories and the average cost method for foreign inventories. Management uses an inventory turnover ratio to monitor and evaluate inventory. Management calculates this ratio on an annual as well as a quarterly basis and uses inventory valued at average costs. The annualized inventory turnover (using average costs) for the period ended June 30, 2016 was 3.6 versus 3.7 at June 30, 2015. By actively managing our inventory levels, we were able to maintain our inventory turnover in a period of declining sales. We believe our inventory turnover ratio in fiscal 2017 will be slightly better than our fiscal 2016 levels.

Table of Contents**CONTRACTUAL OBLIGATIONS**

The following table shows the approximate value of the Company's contractual obligations and other commitments to make future payments as of June 30, 2016 (in thousands):

	Total	Period Less Than 1 yr	Period 2-3 yrs	Period 4-5 yrs	Period Over 5 yrs	Other
Operating leases	\$80,500	\$27,500	\$35,500	\$12,200	\$5,300	—
Planned funding of post-retirement obligations	21,400	900	3,500	6,100	10,900	—
Unrecognized income tax benefit liabilities, including interest and penalties	3,500					3,500
Long-term debt obligations	328,400	3,400	11,400	207,900	105,700	—
Interest on long-term debt obligations (1)	34,900	7,300	14,300	10,100	3,200	—
Acquisition holdback payments	14,000	7,700	6,300	—	—	—
Total Contractual Cash Obligations	\$482,700	\$46,800	\$71,000	\$236,300	\$125,100	\$3,500

(1) Amounts represent estimated contractual interest payments on outstanding long-term debt obligations. Rates in effect as of June 30, 2016 are used for variable rate debt.

Purchase orders for inventory and other goods and services are not included in our estimates as we are unable to aggregate the amount of such purchase orders that represent enforceable and legally binding agreements specifying all significant terms. The previous table includes the gross liability for unrecognized income tax benefits including interest and penalties in the "Other" column as the Company is unable to make a reasonable estimate regarding the timing of cash settlements, if any, with the respective taxing authorities.

SUBSEQUENT EVENTS

We have evaluated events and transactions occurring subsequent to June 30, 2016 through the date the financial statements were issued.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates at a specific point in time that affect the amounts reported in the consolidated financial statements and disclosed in the accompanying notes. The Business and Accounting Policies note to the consolidated financial statements describes the significant accounting policies and methods used in preparation of the consolidated financial statements. Estimates are used for, but not limited to, determining the net carrying value of trade accounts receivable, inventories, recording self-insurance liabilities and other accrued liabilities. Estimates are also used in establishing opening balances in relation to purchase accounting. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the consolidated financial statements.

LIFO Inventory Valuation and Methodology

Inventories are valued at the average cost method, using the last-in, first-out (LIFO) method for U.S. inventories, and the average cost method for foreign inventories. We adopted the link chain dollar value LIFO method for accounting for U.S. inventories in fiscal 1974. Approximately 22.8% of our domestic inventory dollars relate to LIFO layers added in the 1970s. The excess of average cost over LIFO cost is \$147.2 million as reflected in our consolidated balance sheet at June 30, 2016. The Company maintains five LIFO pools based on the following product groupings: bearings, power transmission products, rubber products, fluid power products and other products.

LIFO layers and/or liquidations are determined consistently year-to-year. See the Inventories note to the consolidated financial statements in Item 8 under the caption "Financial Statements and Supplementary Data, for further information.

Allowances for Slow-Moving and Obsolete Inventories

We evaluate the recoverability of our slow-moving or obsolete inventories at least quarterly. We estimate the recoverable cost of such inventory by product type while considering factors such as its age, historic and current

demand trends, the physical condition of the inventory, as well as assumptions regarding future demand. Our ability to recover our cost for slow moving or obsolete inventory can be affected by such factors as general market conditions, future customer demand and relationships with suppliers. A significant portion of the products we hold

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in inventory have long shelf lives, are not highly susceptible to obsolescence and are eligible for return under various supplier return programs.

As of June 30, 2016 and 2015, the Company's reserve for slow-moving or obsolete inventories was \$25.1 million and \$17.7 million, respectively, recorded in inventories in the consolidated balance sheets. The increase is due to \$3.6 million added to the reserve related to closing locations for restructuring activities within the Service Center Based Distribution segment along with with additional reserves for slow-moving inventory due to lower sales levels.

Allowances for Doubtful Accounts

We evaluate the collectibility of trade accounts receivable based on a combination of factors. Initially, we estimate an allowance for doubtful accounts as a percentage of net sales based on historical bad debt experience. This initial estimate is adjusted based on recent trends of certain customers and industries estimated to be a greater credit risk, trends within the entire customer pool and changes in the overall aging of accounts receivable. While we have a large customer base that is geographically dispersed, a general economic downturn in any of the industry segments in which we operate could result in higher than expected defaults, and therefore, the need to revise estimates for bad debts.

Accounts are written off against the allowance when it becomes evident that collection will not occur.

As of June 30, 2016 and 2015, our allowance for doubtful accounts was 3.1% and 2.7% of gross receivables, respectively. Our provision for losses on accounts receivable was \$4.3 million, \$2.6 million and \$4.0 million in fiscal 2016, 2015 and 2014, respectively.

Goodwill and Intangibles

Goodwill is recognized as the amount by which the cost of an acquired entity exceeds the net amount assigned to assets acquired and liabilities assumed. Goodwill for acquired businesses is accounted for using the acquisition method of accounting which requires that the assets acquired and liabilities assumed be recorded at the date of the acquisition at their respective estimated fair values. The judgments made in determining the estimated fair value assigned to each class of assets acquired, as well as the estimated life of each asset, can materially impact the net income of the periods subsequent to the acquisition through depreciation and amortization, and in certain instances through impairment charges, if the asset becomes impaired in the future. As part of acquisition accounting, we also recognize acquired identifiable intangible assets such as customer relationships, vendor relationships, trade names, and non-competition agreements apart from goodwill. Finite-lived identifiable intangibles are evaluated for impairment when changes in conditions indicate carrying value may not be recoverable.

We evaluate goodwill for impairment at the reporting unit level annually as of January 1, and whenever an event occurs or circumstances change that would indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Events or circumstances that may result in an impairment review include changes in macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, other relevant entity-specific events, specific events affecting the reporting unit or sustained decrease in share price. Each year, the Company may elect to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If impairment is indicated in the qualitative assessment, or, if management elects to initially perform a quantitative assessment of goodwill, the impairment test uses a two-step approach. Step one compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not impaired, and the second step of goodwill impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss (if any). Step two compares the implied fair value of the reporting unit goodwill with the carrying amount of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination, meaning, the reporting unit's fair value is allocated to all the assets and liabilities of the reporting unit (including unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit is the price paid to acquire the reporting unit. If the carrying amount of a reporting unit's goodwill exceeds the implied fair value of its goodwill, an impairment loss is recognized in an amount equal to the excess.

Goodwill on our consolidated financial statements relates to both the Service Center Based Distribution segment and the Fluid Power Businesses segment. The Company has seven (7) reporting units for which an annual goodwill impairment assessment was performed as of January 1, 2016. The Company concluded that five (5) of the reporting

units' fair value substantially exceeded their carrying amounts. The carrying value for two (2) reporting units (Canada service center and Australia/New Zealand service center) exceeded the fair value, indicating there may be goodwill impairment. The fair values of the reporting units in accordance with step one of the goodwill impairment test were determined using the Income and Market approaches. The Income approach employs the discounted cash

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flow method reflecting projected cash flows expected to be generated by market participants and then adjusted for time value of money factors. The Market approach utilized an analysis of comparable publicly traded companies. Step two of the goodwill impairment test for the Canada service center reporting unit was completed in the third quarter of fiscal 2016. The analysis resulted in a goodwill impairment of \$56.0 million for the Canada service center reporting unit. The non-cash impairment charge was the result of the overall decline in the industrial economy in Canada coupled with the substantial and sustained decline in the oil and gas sector during calendar year 2015. This led to reduced spending by customers and reduced revenue expectations. The uncertainty regarding the oil and gas industries and overall industrial economy in Canada also led the reporting unit to reduce expectations. The remaining goodwill for the Canada service center reporting unit at June 30, 2016 is \$31.2 million.

Step two of the goodwill impairment test for the Australia/New Zealand reporting unit was completed in the third quarter of fiscal 2016. The analysis concluded that all of the Australia/New Zealand reporting unit's goodwill was impaired, and therefore the Company recorded a non-cash impairment expense of \$8.8 million in the third quarter of fiscal 2016. The impairment charge was primarily the result of the decline in the mining and extraction industries in Australia, reduced spending by customers, and the effects of reduced revenue expectations.

The techniques used in the Company's impairment test have incorporated a number of assumptions that the Company believes to be reasonable and to reflect known market conditions at the measurement date. Assumptions in estimating future cash flows are subject to a degree of judgment. The Company makes all efforts to forecast future cash flows as accurately as possible with the information available at the measurement date. The Company evaluates the appropriateness of its assumptions and overall forecasts by comparing projected results of upcoming years with actual results of preceding years. Key Level 3 based assumptions relate to pricing trends, inventory costs, customer demand, and revenue growth. A number of benchmarks from independent industry and other economic publications were also used. Changes in future results, assumptions, and estimates after the measurement date may lead to an outcome where additional impairment charges would be required in future periods. Specifically, actual results may vary from the Company's forecasts and such variations may be material and unfavorable, thereby triggering the need for future impairment tests where the conclusions may differ in reflection of prevailing market conditions. Further, continued adverse market conditions could result in the recognition of additional impairment if the Company determines that the fair values of its reporting units have fallen below their carrying values.

Self-Insurance Liabilities

We maintain business insurance programs with significant self-insured retention covering workers' compensation, business, automobile, general product liability and other claims. We accrue estimated losses using actuarial calculations, models and assumptions based on historical loss experience. We also maintain a partially self-insured health benefits plan, which provides medical benefits to U.S. based employees electing coverage. We maintain a reserve for all unpaid medical claims including those incurred but not reported based on historical experience and other assumptions. Although management believes that the estimated liabilities for self-insurance are adequate, the estimates described above may not be indicative of current and future losses. In addition, the actuarial calculations used to estimate self-insurance liabilities are based on numerous assumptions, some of which are subjective. Self-insurance liabilities totaled \$9.0 million and \$8.6 million as of June 30, 2016 and 2015, respectively, and were recorded in compensation and related benefits and other current liabilities in the consolidated balance sheets. We will continue to adjust our estimated liabilities for self-insurance, as deemed necessary, in the event that future loss experience differs from historical loss patterns.

Income Taxes

Deferred income taxes are recorded for estimated future tax effects of differences between the bases of assets and liabilities for financial reporting and income tax purposes, giving consideration to enacted tax laws. As of June 30, 2016, the Company had recognized \$0.5 million of net deferred tax assets. Valuation allowances are provided against deferred tax assets where it is considered more-likely-than-not that the Company will not realize the benefit of such assets. The remaining net deferred tax asset is the amount management believes is more-likely-than-not of being realized. The realization of these deferred tax assets can be impacted by changes to tax laws, statutory rates and future taxable income levels.

Income taxes on undistributed earnings of non-U.S. subsidiaries are not accrued for the portion of such earnings that management considers to be permanently reinvested. At June 30, 2016, management considered all undistributed earnings of non-U.S. subsidiaries to be permanently reinvested. Undistributed earnings of non-U.S. subsidiaries totaled \$141.5 million for which no provision for U.S. income tax had been made.

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CAUTIONARY STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT

This Form 10-K, including Management's Discussion and Analysis, contains statements that are forward-looking based on management's current expectations about the future. Forward-looking statements are often identified by qualifiers, such as "guidance", "expect", "believe", "plan", "intend", "will", "should", "could", "would", "anticipate", "estimate", "may", "optimistic" and derivative or similar words or expressions. Similarly, descriptions of objectives, strategies, plans, or goals are also forward-looking statements. These statements may discuss, among other things, expected growth, future sales, future cash flows, future capital expenditures, future performance, and the anticipation and expectations of the Company and its management as to future occurrences and trends. The Company intends that the forward-looking statements be subject to the safe harbors established in the Private Securities Litigation Reform Act of 1995 and by the Securities and Exchange Commission in its rules, regulations and releases.

Readers are cautioned not to place undue reliance on any forward-looking statements. All forward-looking statements are based on current expectations regarding important risk factors, many of which are outside the Company's control. Accordingly, actual results may differ materially from those expressed in the forward-looking statements, and the making of those statements should not be regarded as a representation by the Company or any other person that the results expressed in the statements will be achieved. In addition, the Company assumes no obligation publicly to update or revise any forward-looking statements, whether because of new information or events, or otherwise, except as may be required by law.

Important risk factors include, but are not limited to, the following: risks relating to the operations levels of our customers and the economic factors that affect them; changes in the prices for products and services relative to the cost of providing them; reduction in supplier inventory purchase incentives; loss of key supplier authorizations, lack of product availability, or changes in supplier distribution programs; the cost of products and energy and other operating costs; changes in customer preferences for products and services of the nature and brands sold by us; changes in customer procurement policies and practices; competitive pressures; our reliance on information systems; 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; our ability to retain and attract qualified sales and customer service personnel and other skilled executives, managers and professionals; our ability to identify and complete acquisitions, integrate them effectively, and realize their anticipated benefits; the variability, timing and nature 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; our ability to maintain effective internal control over financial reporting; 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, both enacted and under consideration, including with respect to federal tax policy (e.g., 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, power outages, telecommunication outages, terrorist acts, earthquakes, extreme weather events, other natural disasters, 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 and other risk factors more fully throughout our Form 10-K, as well as other of our filings with the Securities and Exchange Commission.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Our market risk is impacted by changes in foreign currency exchange rates as well as changes in interest 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. We do not currently have any outstanding derivative instruments.

Foreign Currency Exchange Rate Risk

Because we operate throughout North America, Australia and New Zealand and approximately 16.0% of our fiscal year 2016 net sales were generated outside the United States, foreign currency exchange rates can impact our financial position, results of operations and competitive position. The financial statements of foreign subsidiaries are translated into their U.S. dollar equivalents at end-of-period exchange rates for assets and liabilities, while income and expenses are translated at average monthly exchange rates. Translation gains and losses are components of other comprehensive income (loss) as reported in the statements of consolidated comprehensive income. Transaction gains and losses arising from fluctuations in currency exchange rates on transactions denominated in currencies other than the functional currency are recognized in the statements of consolidated income as a component of other expense (income), net. Applied does not currently hedge the net investments in our foreign operations.

During the course of the fiscal year, the Canadian, Australian, and Mexican currency exchange rates decreased in relation to the U.S. dollar by 5.0%, 3.1%, and 15.6%, respectively, and the New Zealand currency exchange rate increased in relation to the U.S. dollar by 3.7%. In the twelve months ended June 30, 2016, we experienced net foreign currency translation losses totaling \$24.4 million, which were included in other comprehensive income (loss). We utilize a sensitivity analysis to measure the potential impact on earnings based on a hypothetical 10% change in foreign currency rates. Excluding the non-cash impairment charge recorded in fiscal 2016, a 10% strengthening or weakening of the U.S. dollar relative to foreign currencies that affect the Company from the levels experienced during the year ended June 30, 2016 would not have a material impact on net income for the year ended June 30, 2016.

Interest Rate Risk

Our primary exposure to interest rate risk results from our outstanding debt obligations with variable interest rates. The levels of fees and interest charged on our various debt facilities are based upon leverage levels and market interest rates.

Our variable interest rate debt facilities outstanding include our five-year credit facility, which provides for a revolving credit facility with a capacity of up to \$250.0 million in borrowings and \$33.0 million outstanding at June 30, 2016, and a \$125.0 million term loan, of which \$123.4 million was outstanding at June 30, 2016. Fixed interest rate debt facilities include \$170.0 million outstanding under our unsecured shelf facility agreement, as well as \$1.9 million of assumed debt from the purchase of our headquarters facility. We had total average variable interest rate bank borrowings of \$195.4 million during fiscal 2016. The impact of a hypothetical 1.0% increase in the interest rates on our average variable interest rate bank borrowings would have resulted in a \$2.0 million increase in interest expense. Changes in market interest rates would also impact interest rates on these facilities.

We monitor depository institutions that hold our cash and cash equivalents, primarily for safety of principal and secondarily for maximizing yield on those funds. We diversify our cash and cash equivalents among counterparties to minimize exposure to any of these entities.

For more information relating to borrowing and interest rates, see the "Liquidity and Capital Resources" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 and note 5 to the consolidated financial statements in Item 8. That information is also incorporated here by reference. In addition, see Item 1A, "Risk Factors," for additional risk factors relating to our business.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Applied Industrial Technologies, Inc. and subsidiaries (the "Company") as of June 30, 2016 and 2015, and the related statements of consolidated income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2016. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at June 30, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2016, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of June 30, 2016, based on the criteria established in "Internal Control-Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated August 24, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
Cleveland, Ohio

August 24, 2016

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STATEMENTS OF CONSOLIDATED INCOME

(In thousands, except per share amounts)

Year Ended June 30,	2016	2015	2014	
Net Sales	\$2,519,428	\$2,751,561	\$2,459,878	
Cost of Sales	1,812,006	1,981,747	1,772,952	
Gross Profit	707,422	769,814	686,926	
Selling, Distribution and Administrative, including depreciation	553,827	585,195	522,568	
Goodwill Impairment	64,794	—	—	
Operating Income	88,801	184,619	164,358	
Interest Expense	9,004	8,121	900	
Interest Income	(241) (252) (651)
Other Expense (Income), net	1,060	879	(2,153)
Income Before Income Taxes	78,978	175,871	166,262	
Income Tax Expense	49,401	60,387	53,441	
Net Income	\$29,577	\$115,484	\$112,821	
Net Income Per Share — Basic	\$0.75	\$2.82	\$2.69	
Net Income Per Share — Diluted	\$0.75	\$2.80	\$2.67	

See notes to consolidated financial statements.

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STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

(In thousands)

Year Ended June 30,	2016	2015	2014
Net income per the statements of consolidated income	\$29,577	\$115,484	\$112,821
Other comprehensive (loss) income, before tax:			
Foreign currency translation adjustments	(24,441)	(58,233)	629
Postemployment benefits:			
Actuarial (loss) gain on remeasurement	(1,998)	(776)	1,402
Reclassification of actuarial losses and prior service cost into SD&A expense and included in net periodic pension costs	518	286	382
Unrealized (loss) gain on investment securities available for sale	(52)	(38)	112
Total other comprehensive (loss) income, before tax	(25,973)	(58,761)	2,525
Income tax (benefit) expense related to items of other comprehensive income (loss)	(598)	(205)	719
Other comprehensive (loss) income, net of tax	(25,375)	(58,556)	1,806
Comprehensive income	\$4,202	\$56,928	\$114,627

See notes to consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS

(In thousands)

June 30,	2016	2015
Assets		
Current assets		
Cash and cash equivalents	\$59,861	\$69,470
Accounts receivable, less allowances of \$11,034 and \$10,621	347,857	376,305
Inventories	338,221	362,419
Other current assets	35,687	37,816
Total current assets	781,626	846,010
Property — at cost		
Land	14,214	12,950
Buildings	97,521	89,325
Equipment, including computers and software	157,496	166,515
Total property — at cost	269,231	268,790
Less accumulated depreciation	161,466	164,343
Property — net	107,765	104,447
Identifiable intangibles, net	191,240	198,828
Goodwill	202,700	254,406
Deferred tax assets	12,277	10,980
Other assets	16,921	17,885
Total Assets	\$1,312,529	\$1,432,556
Liabilities		
Current liabilities		
Accounts payable	\$148,543	\$179,825
Current portion of long-term debt	3,352	3,349
Compensation and related benefits	57,187	63,780
Other current liabilities	65,306	63,118
Total current liabilities	274,388	310,072
Long-term debt	324,982	317,646
Post-employment benefits	21,322	19,627
Other liabilities	33,921	43,883
Total Liabilities	654,613	691,228
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; 39,057 and 39,905 shares outstanding, respectively	10,000	10,000
Additional paid-in capital	162,529	160,072
Retained earnings	944,821	969,548
Treasury shares — at cost (15,156 and 14,308 shares), respectively	(373,888)	(338,121)
Accumulated other comprehensive loss	(85,546)	(60,171)
Total Shareholders' Equity	657,916	741,328
Total Liabilities and Shareholders' Equity	\$1,312,529	\$1,432,556

See notes to consolidated financial statements.

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STATEMENTS OF CONSOLIDATED CASH FLOWS

(In thousands)

Year Ended June 30,	2016	2015	2014
Cash Flows from Operating Activities			
Net income	\$29,577	\$115,484	\$112,821
Adjustments to reconcile net income to net cash provided by operating activities:			
Goodwill impairment	64,794	—	—
Depreciation and amortization of property	15,966	16,578	13,977
Amortization of intangibles	25,580	25,797	14,023
Amortization of stock appreciation rights and options	1,543	1,610	1,808
Deferred income taxes	(6,581)	(4,961)	(8,209)
Provision for losses on accounts receivable	4,303	2,597	3,970
Unrealized foreign exchange transaction losses (gains)	61	(727)	204
Other share-based compensation expense	2,524	2,851	2,703
Shares issued for deferred compensation plans	—	45	161
Loss (gain) on sale of property	337	(1,291)	(53)
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	26,414	13,129	(29,089)
Inventories	25,081	(15,704)	(29,171)
Other operating assets	2,964	797	17,966
Accounts payable	(28,644)	1,040	21,369
Other operating liabilities	(2,927)	(2,707)	(12,370)
Cash provided by Operating Activities	160,992	154,538	110,110
Cash Flows from Investing Activities			
Property purchases	(13,130)	(14,933)	(20,190)
Proceeds from property sales	603	1,932	877
Net cash paid for acquisition of businesses, net of cash acquired	(62,504)	(160,620)	(184,324)
Cash used in Investing Activities	(75,031)	(173,621)	(203,637)
Cash Flows from Financing Activities			
Net (repayments) borrowings under revolving credit facility, classified as long term	(19,000)	(17,000)	69,000
Borrowings under long-term debt facilities	125,000	170,000	100,000
Long-term debt repayments	(98,662)	(2,717)	(647)
Deferred financing costs	(719)	—	—
Purchases of treasury shares	(37,465)	(76,515)	(36,732)
Dividends paid	(43,330)	(42,663)	(40,410)
Excess tax benefits from share-based compensation	208	1,042	2,674
Acquisition holdback payments	(18,913)	(7,693)	(1,839)
Exercise of stock appreciation rights and options	896	235	96
Cash provided by (used in) Financing Activities	(91,985)	24,689	92,142
Effect of exchange rate changes on cash	(3,585)	(7,325)	(590)
Decrease in cash and cash equivalents	(9,609)	(1,719)	(1,975)
Cash and cash equivalents at beginning of year	69,470	71,189	73,164
Cash and Cash Equivalents at End of Year	\$59,861	\$69,470	\$71,189
Supplemental Cash Flow Information			
Cash paid during the year for:			
Income taxes	\$54,749	\$69,272	\$51,548
Interest	9,497	5,851	1,026

See notes to consolidated financial statements.

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STATEMENTS OF CONSOLIDATED SHAREHOLDERS' EQUITY

(In thousands)

For the Years Ended June 30, 2016, 2015 and 2014	Shares of Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Shares- at Cost	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at July 1, 2013	42,169	\$ 10,000	\$ 153,893	\$ 824,362	\$(225,219)	\$(3,421)	\$ 759,615
Net income				112,821			112,821
Other comprehensive income (loss)						1,806	1,806
Cash dividends — \$0.96 per share				(40,410)			(40,410)
Purchases of common stock for treasury	(760)				(36,732)		(36,732)
Treasury shares issued for:							
Exercise of stock appreciation rights and options	76		849		324		1,173
Performance share awards	36		(1,062)		(21)		(1,083)
Restricted stock units	31		(1,110)		(247)		(1,357)
Deferred compensation plans	3		98		63		161
Compensation expense — stock appreciation rights and options			1,808				1,808
Other share-based compensation expense			2,703				2,703
Other	8		(180)	3	(20)		(197)
Balance at June 30, 2014	41,563	10,000	156,999	896,776	(261,852)	(1,615)	800,308
Net income				115,484			115,484
Other comprehensive income (loss)						(58,556)	(58,556)
Cash dividends — \$1.04 per share				(42,663)			(42,663)
Purchases of common stock for treasury	(1,740)				(76,515)		(76,515)
Treasury shares issued for:							
Exercise of stock appreciation rights and options	34		552		415		967
Performance share awards	12		(425)		52		(373)
Restricted stock units	36		(1,312)		76		(1,236)
Deferred compensation plans	1		24		21		45
Compensation expense — stock appreciation rights and options			1,610				1,610
Other share-based compensation expense			2,851				2,851

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Other	(1)	(227)	(49)	(318)	(594)
Balance at June 30, 2015	39,905	10,000	160,072	969,548	(338,121)	(60,171)	741,328	
Net income				29,577					29,577	
Other comprehensive income (loss)							(25,375	)	(25,375)
Cash dividends — \$1.10 per share				(54,266	)				(54,266)
Purchases of common stock for treasury	(951	)					(37,465	)	(37,465)
Treasury shares issued for:										
Exercise of stock appreciation rights and options	64		(391	)			1,000		609	
Performance share awards	8		(308	)			116		(192)
Restricted stock units	15		(530	)			232		(298)
Compensation expense — stock appreciation rights and options			1,543						1,543	
Other share-based compensation expense			2,524						2,524	
Other	16		(381	)	(38	)	350		(69)
Balance at June 30, 2016	39,057	\$ 10,000	\$ 162,529	\$ 944,821	\$(373,888)	\$ (85,546)	\$ 657,916		

See notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share amounts)

NOTE 1: BUSINESS AND ACCOUNTING POLICIES

Business

Applied Industrial Technologies, Inc. and subsidiaries (the “Company” or “Applied”) is a leading industrial distributor serving Maintenance Repair & Operations (MRO) and Original Equipment Manufacturer (OEM) customers in virtually every industry. In addition, Applied provides engineering, design and systems integration for industrial and fluid power applications, as well as customized mechanical, fabricated rubber and fluid power shop services. Although the Company does not generally manufacture the products it sells, it does assemble and repair certain products and systems.

Consolidation

The consolidated financial statements include the accounts of Applied Industrial Technologies, Inc. and its subsidiaries. Intercompany transactions and balances have been eliminated in consolidation. For the year ended June 30, 2013 the financial results of the Company’s Canadian and Mexican subsidiaries were included in the consolidated financial statements for the twelve months ended May 31. During fiscal 2014, the Company eliminated the one month reporting lag for both the Canadian and Mexican subsidiaries in the first and third quarters respectively. See the “Change in Accounting Principle” section below for additional information related to the elimination of the reporting lag.

Foreign Currency

The financial statements of the Company’s Canadian, Mexican, Australian and New Zealand subsidiaries are measured using local currencies as their functional currencies. Assets and liabilities are translated into U.S. dollars at current exchange rates, while income and expenses are translated at average exchange rates. Translation gains and losses are reported in other comprehensive (loss) income in the statements of consolidated comprehensive income. Gains and losses resulting from transactions denominated in foreign currencies are included in the statements of consolidated income as a component of other expense (income), net.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

Cash and Cash Equivalents

The Company considers all short-term, highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents are carried at cost, which approximates fair value.

Marketable Securities

The primary marketable security investments of the Company include money market and mutual funds held in a rabbi trust for a non-qualified deferred compensation plan. These are included in other assets in the consolidated balance sheets, are classified as trading securities, and reported at fair value based on quoted market prices. Changes in the fair value of the investments during the period are recorded in other expense (income), net in the statements of consolidated income.

Concentration of Credit Risk

The Company has a broad customer base representing many diverse industries across North America, Australia and New Zealand. As such, the Company does not believe that a significant concentration of credit risk exists in its accounts receivable. The Company’s cash and cash equivalents consist of deposits with commercial banks and regulated non-bank subsidiaries. While Applied monitors the creditworthiness of these institutions, a crisis in the financial systems could limit access to funds and/or result in the loss of principal. The terms of these deposits and investments provide that all monies are available to the Company upon demand.

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Allowances for Doubtful Accounts

The Company evaluates the collectibility of trade accounts receivable based on a combination of factors. Initially, the Company estimates an allowance for doubtful accounts as a percentage of net sales based on historical bad debt experience. This initial estimate is adjusted based on recent trends of customers and industries estimated to be greater credit risks, trends within the entire customer pool, and changes in the overall aging of accounts receivable. Accounts are written off against the allowance when it becomes evident collection will not occur. While the Company has a large customer base that is geographically dispersed, a general economic downturn in any of the industry segments in which the Company operates could result in higher than expected defaults, and therefore, the need to revise estimates for bad debts.

Inventories

Inventories are valued at the average cost method, using the last-in, first-out (LIFO) method for U.S. inventories and the average cost method for foreign inventories. The Company adopted the link chain dollar value LIFO method of accounting for U.S. inventories in fiscal 1974. At June 30, 2016, approximately 22.8% of the Company's domestic inventory dollars relate to LIFO layers added in the 1970s. The Company maintains five LIFO pools based on the following product groupings: bearings, power transmission products, rubber products, fluid power products and other products. LIFO layers and/or liquidations are determined consistently year-to-year.

The Company evaluates the recoverability of its slow moving or obsolete inventories at least quarterly. The Company estimates the recoverable cost of such inventory by product type while considering factors such as its age, historic and current demand trends, the physical condition of the inventory, as well as assumptions regarding future demand. The Company's ability to recover its cost for slow moving or obsolete inventory can be affected by such factors as general market conditions, future customer demand, and relationships with suppliers. Historically, the Company's inventories have demonstrated long shelf lives, are not highly susceptible to obsolescence, and, in certain instances, can be eligible for return under supplier return programs.

Supplier Purchasing Programs

The Company enters into agreements with certain suppliers providing inventory purchase incentives. The Company's inventory purchase incentive arrangements are unique to each supplier and are generally annual programs ending at either the Company's fiscal year end or the supplier's year end; however, program length and ending dates can vary. Incentives are received in the form of cash or credits against purchases upon attainment of specified purchase volumes and are received either monthly, quarterly or annually. The incentives are generally a specified percentage of the Company's net purchases based upon achieving specific purchasing volume levels. These percentages can increase or decrease based on changes in the volume of purchases. The Company accrues for the receipt of these inventory purchase incentives based upon cumulative purchases of inventory. The percentage level utilized is based upon the estimated total volume of purchases expected during the life of the program. Supplier programs are analyzed each quarter to determine the appropriateness of the amount of purchase incentives accrued. Upon program completion, differences between estimates and actual incentives subsequently received have not been material. Benefits under these supplier purchasing programs are recognized under the Company's LIFO inventory accounting method as a reduction of cost of sales when the inventories representing these purchases are recorded as cost of sales. Accrued incentives expected to be settled as a credit against future purchases are reported on the consolidated balance sheet as an offset to amounts due to the related supplier.

Property and Related Depreciation and Amortization

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets and is included in selling, distribution and administrative expenses in the accompanying statements of consolidated income. Buildings, building improvements and leasehold improvements are depreciated over ten to thirty years or the life of the lease if a shorter period, and equipment is depreciated over three to ten years. The Company capitalizes internal use software development costs in accordance with guidance on accounting for costs of computer software developed or obtained for internal use. Amortization of software begins when it is ready for its intended use, and is computed on a straight-line basis over the estimated useful life of the software, generally not to exceed twelve years. Capitalized software and hardware costs are classified as property on the consolidated balance sheets. The carrying values of property and equipment are reviewed for impairment when

events or changes in circumstances indicate that the recorded value cannot be recovered from undiscounted future cash flows. Impairment losses, if any, would be measured based upon the difference between the carrying amount and the fair value of the assets.

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Goodwill and Intangible Assets

Goodwill is recognized as the excess cost of an acquired entity over the net amount assigned to assets acquired and liabilities assumed. Goodwill is not amortized. Goodwill is reviewed for impairment annually as of January 1 or whenever changes in conditions indicate an evaluation should be completed. These conditions could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit. The Company utilizes discounted cash flow models and market multiples for comparable businesses to determine the fair value of reporting units. Evaluating impairment requires significant judgment by management, including estimated future operating results, estimated future cash flows, the long-term rate of growth of the business, and determination of an appropriate discount rate. While the Company uses available information to prepare the estimates and evaluations, actual results could differ significantly.

The Company recognizes acquired identifiable intangible assets such as customer relationships, trade names, vendor relationships, and non-competition agreements apart from goodwill. Customer relationship identifiable intangibles are amortized using the sum-of-the-years-digits method over estimated useful lives consistent with assumptions used in the determination of their value. Amortization of all other finite-lived identifiable intangible assets is computed using the straight-line method over the estimated period of benefit. Amortization of identifiable intangible assets is included in selling, distribution and administrative expenses in the accompanying statements of consolidated income.

Identifiable intangible assets with finite lives are reviewed for impairment when changes in conditions indicate carrying value may not be recoverable. Identifiable intangible assets with indefinite lives are reviewed for impairment on an annual basis or whenever changes in conditions indicate an evaluation should be completed. The Company does not currently have any indefinite lived identifiable intangible assets.

Self-Insurance Liabilities

The Company maintains business insurance programs with significant self-insured retention covering workers' compensation, business, automobile, general product liability and other claims. The Company accrues estimated losses including those incurred but not reported using actuarial calculations, models and assumptions based on historical loss experience. The Company also maintains a self-insured health benefits plan which provides medical benefits to U.S. based employees electing coverage under the plan. The Company estimates its reserve for all unpaid medical claims, including those incurred but not reported, based on historical experience, adjusted as necessary based upon management's reasoned judgment.

Revenue Recognition

Sales are recognized when there is evidence of an arrangement, the sales price is fixed, collectibility is reasonably assured and the product's title and risk of loss is transferred to the customer. Typically, these conditions are met when the product is shipped to the customer. The Company charges shipping and handling fees when products are shipped or delivered to a customer, and includes such amounts in net sales. The Company reports its sales net of actual sales returns and the amount of reserves established for anticipated sales returns based on historical rates. Sales tax collected from customers is excluded from net sales in the accompanying statements of consolidated income.

Shipping and Handling Costs

The Company records freight payments to third parties in cost of sales and internal delivery costs in selling, distribution and administrative expenses in the accompanying statements of consolidated income. Internal delivery costs in selling, distribution and administrative expenses were approximately \$21,480, \$24,430 and \$16,230 for the fiscal years ended June 30, 2016, 2015 and 2014, respectively.

Income Taxes

Income taxes are determined based upon income and expenses recorded for financial reporting purposes. Deferred income taxes are recorded for estimated future tax effects of differences between the bases of assets and liabilities for financial reporting and income tax purposes, giving consideration to enacted tax laws. Uncertain tax positions meeting a more-likely-than-not recognition threshold are recognized in accordance with the Income Taxes topic of the ASC (Accounting Standards Codification). The Company recognizes accrued interest and penalties related to unrecognized income tax benefits in the provision for income taxes.

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Share-Based Compensation

Share-based compensation represents the cost related to share-based awards granted to employees under the 2015 Long-Term Performance Plan, the 2011 Long-Term Performance Plan, or the 2007 Long-Term Performance Plan. The Company measures share-based compensation cost at the grant date, based on the estimated fair value of the award and recognizes the cost over the requisite service period. Non-qualified stock appreciation rights (SARs) and stock options are granted with an exercise price equal to the closing market price of the Company's common stock at the date of grant and the fair values are determined using a Black-Scholes option pricing model, which incorporates assumptions regarding the expected volatility, the expected option life, the risk-free interest rate and the expected dividend yield. SARs and stock option awards generally vest over four years of continuous service and have ten-year contractual terms. The fair value of restricted stock awards, restricted stock units (RSUs), and performance shares are based on the closing market price of Company common stock on the grant date.

Treasury Shares

Shares of common stock repurchased by the Company are recorded at cost as treasury shares and result in a reduction of shareholders' equity in the consolidated balance sheets. The Company uses the weighted-average cost method for determining the cost of shares reissued. The difference between the cost of the shares and the reissuance price is added to or deducted from additional paid-in capital.

Changes in Accounting Principle

Deferred Income Taxes

In November 2015, the FASB issued its final standard on the simplification of the presentation of deferred income taxes. The standard, issued as Accounting Standards Update ("ASU") 2015-17, requires that deferred tax liabilities and assets be classified as non-current in the consolidated balance sheet. This update is effective for financial statement periods beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company early adopted ASU 2015-17 in the second quarter of fiscal 2016. The Company applied the new standard retrospectively to the prior period presented in the consolidated balance sheets; the impact of this change in accounting principle on balances previously reported as of June 30, 2015 was as follows:

Balance Sheet Line Item	Amount as of June 30, 2015		Change
	As Previously Reported	As Revised	
Other current assets	\$51,111	\$37,816	\$(13,295)
Deferred tax assets	\$97	\$10,980	\$10,883
Other liabilities	\$46,295	\$43,883	\$(2,412)

Alignment of Canadian Subsidiary Reporting

Effective July 1, 2013, the Company aligned the consolidation of the Company's Canadian subsidiary in the consolidated financial statements, which previously included the results on a one month reporting lag. The Company believes that this change in accounting principle is preferable as it provides contemporaneous reporting within our consolidated financial statements. In accordance with applicable accounting literature, the elimination of a one month reporting lag of a subsidiary is treated as a change in accounting principle and requires retrospective application. The Company determined that the effect of this change is not material to the financial statements for all periods presented and therefore, the Company has not presented retrospective application of this change. The net impact of the lag elimination was \$1,200 of income for the month of June 2013 and has been included within other expense (income), net on the statement of consolidated income for the year ended June 30, 2014. The statement of consolidated income for the year ended June 30, 2014 reflects the same results, had the financial statements been retrospectively adjusted, with the exception of net income which would have decreased by \$1,200.

Alignment of Mexican Subsidiary Reporting

Effective January 1, 2014, the Company aligned the consolidation of the Company's Mexican subsidiary in the consolidated financial statements, which previously included the results on a one month reporting lag. The Company believes that this change in accounting principle is preferable as it provides contemporaneous reporting within our

consolidated financial statements. In accordance with applicable accounting literature, the elimination of a one month reporting lag of a subsidiary is treated as a change in accounting principle and requires retrospective application. The Company determined that the effect of this change is not material to the financial statements for all periods presented and therefore, the Company has not presented retrospective application of this change. The net impact of the lag elimination was \$200 of income for the month of December 2013 and has been included within other expense (income), net on the statement of consolidated income for year ended June 30, 2014.

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Net sales, operating income and net income for the year ended June 30, 2014 would have decreased by \$1,100, \$100 and \$250 had the financial statements been retrospectively adjusted.

Other Recently Adopted Accounting Guidance

In June 2014, the FASB issued its final standard on accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. The standard, issued as ASU 2014-12, clarifies that a performance target that affects vesting and that can be achieved after the requisite service period, should be treated as a performance condition. The update is effective for financial statement periods beginning after December 15, 2015, with early adoption permitted. The Company adopted ASU 2014-12 in the first quarter of fiscal 2016. The adoption of this update did not have an impact on the financial statements of the Company.

New Accounting Pronouncements

In May 2014, the FASB issued its final standard on the recognition of revenue from contracts with customers.

The standard, issued as ASU 2014-09, outlines a single comprehensive model for entities to use in the accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry specific guidance. The core principle of this model is that "an entity recognizes revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services." In August 2015, the FASB issued ASU 2015-14 to delay the effective date of ASU 2014-09 by one year. In accordance with the delay, the update is effective for financial statement periods beginning after December 15, 2017. Early adoption is permitted, but not before financial statement periods beginning after December 15, 2016. In March 2016 the FASB issued ASU 2016-08 and ASU 2016-10, and in May 2016 the FASB issued ASU 2016-12, which clarify the guidance in ASU 2014-09 but do not change the core principle of the revenue recognition model. The Company has not determined the collective impact of these pronouncements on its financial statements and related disclosures or the method of adoption.

In April 2015, the FASB issued its final standard on simplifying the presentation of debt issue costs. This standard, issued as ASU 2015-03, requires that all costs incurred to issue debt be presented in the balance sheet as a direct reduction from the carrying value of the debt, similar to the presentation of debt discounts. This update is effective for financial statement periods beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. The impact of the adoption of this guidance will result in the reclassification of the unamortized debt issuance costs on the consolidated balance sheets, which were \$504 and \$394 at June 30, 2016 and 2015, respectively, recorded in other current assets and other assets in the consolidated balance sheets.

In July 2015, the FASB issued its final standard on simplifying the measurement of inventory. This standard, issued as ASU 2015-11, specifies that an entity should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new standard does not apply to inventory that is measured using LIFO; therefore, it is not applicable to the Company's U.S. inventory values, but does apply to the Company's foreign inventories which are valued using the average cost method. The update is effective for financial statement periods beginning after December 15, 2016, with earlier application permitted. The Company has not yet determined the impact of this pronouncement on its financial statements and related disclosures.

In September 2015, the FASB issued its final standard on simplifying the accounting for measurement-period adjustments for business combinations. This standard, issued as ASU 2015-16, requires that an entity that is the acquirer in a business combination that identifies adjustments to provisional amounts during the measurement period recognize those adjustments in the reporting period in which the amounts are determined. This update further requires that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The update is effective for financial statement periods beginning after December 15, 2015, and should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update, with early adoption permitted. When adjustments to provisional amounts occur in the future, the Company will make the adjustments in the appropriate period and include the required disclosures.

In January 2016, the FASB issued its final standard on financial instruments. This standard, issued as ASU 2016-01, enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information and addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The update is effective for financial statement periods beginning after December 15, 2017, with earlier application permitted for only certain aspects of the standard; earlier application of the remaining

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aspects is not permitted. The Company has not yet determined the impact of this pronouncement on its financial statements and related disclosures.

In February 2016, the FASB issued its final standard on accounting for leases. This standard, issued as ASU 2016-02, requires that an entity that is a lessee recognize lease assets and lease liabilities on the balance sheet for all leases and disclose key information about leasing arrangements. The core principle of this update is that a "lessee should recognize the assets and liabilities that arise from leases." This update is effective for financial statement periods beginning after December 15, 2018, with earlier application permitted. The Company has not yet determined the impact of this pronouncement on its financial statements and related disclosures.

In March 2016, the FASB issued its final standard on simplifying the accounting for share-based payment awards. This standard, issued as ASU 2016-09, simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification on the statement of cash flows, and accounting for forfeitures. This update is effective for financial statement periods beginning after December 15, 2016, with early adoption permitted. The Company has not yet determined the impact of this pronouncement on its financial statements and related disclosures or the method of adoption.

In June 2016, the FASB issued its final standard on measurement of credit losses on financial instruments. This standard, issued as ASU 2016-13, requires that an entity measure impairment of certain financial instruments, including trade receivables, based on expected losses rather than incurred losses. This update is effective for financial statement periods beginning after December 15, 2019, with early adoption permitted for financial statement periods beginning after December 15, 2018. The Company has not yet determined the impact of this pronouncement on its financial statements and related disclosures.

NOTE 2: BUSINESS COMBINATIONS

The operating results of all acquired entities are included within the consolidated operating results of the Company from the date of each respective acquisition.

Fiscal 2016 Acquisitions

On June 14, 2016, the Company acquired 100% of the outstanding stock of Seals Unlimited ("Seals"), a distributor of sealing, fastener, and hose products located in Burlington, Ontario. On January 4, 2016, the Company acquired substantially all of the net assets of HUB Industrial Supply ("HUB"), a distributor of consumable industrial products operating from three locations - Lake City, FL, Indianapolis, IN, and Las Vegas, NV. On August 3, 2015, the Company acquired substantially all of the net assets of Atlantic Fasteners Co., Inc. ("Atlantic Fasteners"), a distributor of C-Class consumables including industrial fasteners and related industrial supplies located in Agawam, MA. Seals, HUB, and Atlantic Fasteners are all included in the Service Center Based Distribution segment. On October 1, 2015, the Company acquired substantially all of the net assets of S.G. Morris Co. ("SGM"). SGM, headquartered in Cleveland, OH, is a distributor of hydraulic components throughout Ohio, Western Pennsylvania and West Virginia and is included in the Fluid Power Businesses Segment. The total combined consideration for these acquisitions was approximately \$66,250, net tangible assets acquired were \$22,650, and intangibles including goodwill were \$43,600 based upon preliminary estimated fair values at the acquisition dates, which are subject to adjustment. The total combined consideration includes \$3,750 of acquisition holdback payments, included in other current liabilities and other liabilities on the condensed consolidated balance sheets, which will be paid plus interest at various times through October 2018. The Company funded the amounts paid for the acquisitions at closing using available cash and borrowings under the revolving credit facility at variable interest rates. The acquisition prices and the results of operations for the acquired entities are not material in relation to the Company's consolidated financial statements.

Knox Acquisition

On July 1, 2014, the Company acquired 100% of the outstanding stock of Knox Oil Field Supply Inc. ("Knox"), headquartered in San Angelo, Texas, for total consideration of \$132,000, including cash paid of \$118,000 at closing. The primary reason for the acquisition of Knox was to complement and expand the Company's capabilities to serve the upstream oil and gas industry in the United States. As a distributor of oilfield supplies and related services, this business is included in the Service Center Based Distribution Segment. The Company funded the acquisition by drawing \$120,000 from the previously uncommitted shelf facility with Prudential Investment Management at a fixed interest rate of 3.19% with an average seven year life. The remaining \$14,000 purchase price was to be paid as

acquisition holdback payments on the first three anniversaries of the acquisition with interest at a fixed rate of 1.50% per annum; \$7,100 was paid on the first anniversary in the first quarter of fiscal 2016.

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The following table summarizes the consideration transferred, assets acquired, and liabilities assumed in connection with the acquisition of Knox based on their estimated fair values at the acquisition date:

	Knox Acquisition 2015
Accounts receivable	\$ 19,100
Inventories	18,800
Property	3,900
Identifiable intangible assets	58,500
Goodwill	63,200
Total assets acquired	163,500
Accounts payable and accrued liabilities	7,200
Deferred income taxes	24,300
Net assets acquired	\$ 132,000
Purchase price	\$ 132,800
Reconciliation of fair value transferred:	
Working Capital Adjustments	(800)
Total Consideration	\$ 132,000

None of the goodwill acquired is expected to be deductible for income tax purposes. The goodwill recognized was attributable primarily to expected synergies and other benefits that the Company believed would result from the acquisition of Knox.

Reliance Acquisition

On May 1, 2014, the Company acquired 100% of the outstanding stock of Reliance Industrial Products (“Reliance”), headquartered in Nisku, Alberta, Canada, with operations in Western Canada and the Western United States, for a total purchase price in the amount of \$188,500. The primary reasons for the acquisition were to provide the Company enhanced capabilities to serve the upstream oil and gas industry in the United States and Canada. A distributor of fluid conveyance and oilfield supplies, this business is included in the Service Center Based Distribution Segment. The Company funded the acquisition by using available cash in Canada in the amount of \$31,900, existing revolving credit facilities of \$36,600 and a new \$100,000 five-year term loan facility, with the remainder of \$20,000 to be paid in equal amounts as acquisition holdback payments on the first two anniversaries of the acquisition, plus interest at 2% per annum; \$8,300 was paid during fiscal 2016.

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The following table summarizes the consideration transferred, assets acquired, and liabilities assumed in connection with the acquisition of Reliance based on their estimated fair values at the acquisition date:

	Reliance Acquisition 2014
Accounts receivable	\$ 20,600
Inventories	22,900
Other current assets	6,000
Property	12,900
Identifiable intangible assets	73,200
Goodwill	79,500
Total assets acquired	215,100
Accounts payable and accrued liabilities	15,800
Deferred income taxes	19,500
Net assets acquired	\$ 179,800
Purchase price	\$ 188,500
Reconciliation of fair value transferred:	
Cash acquired	(1,400)
Working capital adjustments	(8,200)
Debt assumed	900
Total Consideration	\$ 179,800

None of the goodwill acquired is expected to be deductible for income tax purposes. The goodwill recognized was attributable primarily to expected synergies and other benefits that the Company believed would result from the acquisition of Reliance.

The Company incurred \$1,448 in third party costs during fiscal 2014 pertaining to the acquisition of Reliance. These expenses are included in selling, distribution and administration expense in the statement of consolidated income for the year ended June 30, 2014.

Knox and Reliance Pro Forma Results (Unaudited)

The following unaudited pro forma consolidated results of operations have been prepared as if the Reliance acquisition (including the related acquisition costs) had occurred at the beginning of fiscal 2013 and the Knox acquisition (including the related acquisition costs) had occurred at the beginning of fiscal 2014:

Pro forma, year ended June 30:	2014	2013
Sales	\$2,687,903	\$2,600,453
Operating income	\$184,164	\$187,419
Net income	\$121,158	\$128,779
Diluted net income per share	\$2.86	\$3.03

These pro forma amounts have been calculated after applying the Company's accounting policies and adjusting the results to reflect additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant, and equipment, and amortizable intangible assets had been applied as of July 1, 2013. In addition, pro forma adjustments have been made for the interest expense that would have been incurred as a result of the indebtedness used to finance the acquisitions. The pro forma net income amounts also incorporate an adjustment to the recorded income tax expense for the income tax effect of the pro forma adjustments described above. These pro forma results of operations do not include any anticipated synergies or other effects of the planned integration of Reliance and Knox; accordingly, such pro forma adjustments do not purport to be indicative of the results of operations that actually would have resulted had the acquisitions occurred as of the date indicated or that may result in the future.

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Other Fiscal 2015 Acquisitions

Other acquisitions during fiscal 2015 included the acquisition of substantially all of the net assets of Rodamientos y Derivados del Norte S.A. de C.V., a Mexican distributor of bearings and power transmission products and related products, and Great Southern Bearings / Northam Bearings, a Western Australia distributor of bearings and power transmission products on July 1, 2014 as well as Ira Pump and Supply Inc., ("Ira Pump") a Texas distributor of oilfield pumps and supplies on November 3, 2014. These companies are included in the Service Center Based Distribution Segment. The total combined consideration for these acquisitions was approximately \$54,900. Net tangible assets acquired were \$21,000 and intangibles including goodwill were \$33,900, based upon estimated fair values at the acquisition date. The Company funded these acquisitions from borrowings under our existing debt facilities. Total acquisition holdback payments of \$6,900 are being paid at various times through July 2017. The results of operations for the Mexican, Australian, and Ira Pump acquisitions are not material for any period presented.

Other Fiscal 2014 Acquisitions

In December 2013, the Company acquired substantially all of the net assets of Texas Oilpatch Services Corporation, a Texas distributor of bearings, oil seals, power transmission products, and related replacement parts to the oilfield industry. The acquired business is included in the Service Center Based Distribution segment. The purchase price for this acquisition was \$17,000, tangible assets acquired were \$3,863 and intangibles, including goodwill was \$13,137. The purchase price included \$2,550 of acquisition holdback payments which were paid into an escrow account controlled by a third party. The acquisition price and the results of operations of the acquired entity are not material in relation to the Company's consolidated financial statements.

Holdback Liabilities for Acquisitions

Acquisition holdback payments of approximately \$7,700, \$3,800 and \$2,500 will be made in fiscal 2017, 2018 and 2019, respectively. The related liabilities for these payments are recorded in the consolidated balance sheets in other current liabilities for the amounts due in fiscal year 2017 and other liabilities for the amounts due in fiscal years 2018 through 2019.

NOTE 3: INVENTORIES

Inventories consist of the following:

June 30,	2016	2015
U.S. inventories at average cost	\$380,000	\$397,524
Foreign inventories at average cost	105,465	116,674
	485,465	514,198
Less: Excess of average cost over LIFO cost for U.S. inventories	147,244	151,779
Inventories on consolidated balance sheets	\$338,221	\$362,419

In fiscal 2016, reductions in U.S. inventories, primarily in the bearings pool, resulted in liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years. The overall impact of LIFO layer liquidations increased gross profit by \$2,100 in fiscal 2016. There were no LIFO layer liquidations in fiscal 2015 or 2014.

NOTE 4: GOODWILL AND INTANGIBLES

The changes in the carrying amount of goodwill for both the Service Center Based Distribution Segment and the Fluid Power Businesses segment for the years ended June 30, 2016 and 2015 are as follows:

	Service Center Based Distribution	Fluid Power Businesses	Total
Balance at July 1, 2014	\$ 192,565	\$ 929	\$ 193,494
Goodwill acquired during the year	77,728	—	77,728
Other, primarily currency translation	(16,816)	) —	(16,816)
Balance at June 30, 2015	253,477	929	254,406
Goodwill acquired during the year	18,683	3,285	21,968
Impairment	(64,794)	) —	(64,794)
Other, primarily currency translation	(8,880)) —	(8,880)

Balance at June 30, 2016	\$ 198,486	\$ 4,214	\$202,700
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The Company has seven (7) reporting units for which an annual goodwill impairment assessment was performed as of January 1, 2016. The Company concluded that five (5) of the reporting units' fair value substantially exceeded their carrying amounts. The carrying value for two (2) reporting units (Canada service center and Australia/New Zealand service center) exceeded the fair value, indicating there may be goodwill impairment. The fair values of the reporting units in accordance with step one of the goodwill impairment test were determined using the Income and Market approaches. The Income approach employs the discounted cash flow method reflecting projected cash flows expected to be generated by market participants and then adjusted for time value of money factors. The Market approach utilized an analysis of comparable publicly traded companies.

Step two of the goodwill impairment test compares the fair value of the reporting unit goodwill with the carrying amount of goodwill. The implied fair value of goodwill is determined in the same manner as in a business combination. The fair value of the reporting unit from step one is allocated to all of the assets and liabilities of the reporting unit, including unrecognized intangible assets, as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

Step two of the goodwill impairment test for the Canada service center reporting unit was completed in the third quarter of fiscal 2016. The analysis resulted in a goodwill impairment of \$56,022 for the Canada service center reporting unit. The non-cash impairment charge is the result of the overall decline in the industrial economy in Canada coupled with the substantial and sustained decline in the oil and gas sector during calendar year 2015. This has led to reduced spending by customers and reduced revenue expectations. The uncertainty regarding the oil and gas industries and overall industrial economy in Canada has also led the reporting unit to reduce expectations. The remaining goodwill for the Canada service center reporting unit at June 30, 2016 is \$31,242. Because the carrying value of the Canada service center reporting unit approximated fair value of the reporting unit after the impairment was recorded, a future decline in the estimated cash flows could result in an additional impairment loss. A future decline in the estimated cash flows could result from a significant decline in capital spending by oil and gas producers and related businesses.

Step two of the goodwill impairment test for the Australia/New Zealand reporting unit was completed in the third quarter of fiscal 2016. The analysis concluded that all of the Australia/New Zealand reporting unit's goodwill was impaired, and therefore the Company recorded a non-cash impairment expense of \$8,772 in the third quarter of fiscal 2016. The impairment charge is primarily the result of the decline in the mining and extraction industries in Australia, reduced spending by customers, and the effects of reduced revenue expectations.

The techniques used in the Company's impairment test have incorporated a number of assumptions that the Company believes to be reasonable and to reflect known market conditions at the measurement date. Assumptions in estimating future cash flows are subject to a degree of judgment. The Company makes all efforts to forecast future cash flows as accurately as possible with the information available at the measurement date. The Company evaluates the appropriateness of its assumptions and overall forecasts by comparing projected results of upcoming years with actual results of preceding years. Key Level 3 based assumptions relate to pricing trends, inventory costs, customer demand, and revenue growth. A number of benchmarks from independent industry and other economic publications were also used. Changes in future results, assumptions, and estimates after the measurement date may lead to an outcome where additional impairment charges would be required in future periods. Specifically, actual results may vary from the Company's forecasts and such variations may be material and unfavorable, thereby triggering the need for future impairment tests where the conclusions may differ in reflection of prevailing market conditions. Further, continued adverse market conditions could result in the recognition of additional impairment if the Company determines that the fair values of its reporting units have fallen below their carrying values.

Accumulated goodwill impairment losses subsequent to fiscal year 2002 totaled \$36,605 related to the Fluid Power Businesses segment at June 30, 2016, 2015, and 2014, and totaled \$64,794 related to the Service Center Based Distribution segment at June 30, 2016.

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

June 30, 2016	Amount	Accumulated Amortization	Net Book Value
Finite-Lived Intangibles:			
Customer relationships	\$ 239,132	\$ 84,566	\$ 154,566
Trade names	44,430	16,099	28,331
Vendor relationships	14,042	8,003	6,039
Non-competition agreements	4,700	2,396	2,304
Total Intangibles	\$ 302,304	\$ 111,064	\$ 191,240

June 30, 2015	Amount	Accumulated Amortization	Net Book Value
Finite-Lived Intangibles:			
Customer relationships	\$ 225,332	\$ 65,789	\$ 159,543
Trade names	42,689	13,187	29,502
Vendor relationships	14,465	7,258	7,207
Non-competition agreements	4,578	2,002	2,576
Total Intangibles	\$ 287,064	\$ 88,236	\$ 198,828

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

During 2016, the Company acquired identifiable intangible assets with an acquisition cost allocation and weighted-average life as follows:

	Acquisition Cost	Weighted-Average Life
Customer relationships	\$ 17,996	15.0 years
Trade names	2,889	15.0 years
Non-competition agreements	765	5.0 years
Total Intangibles Acquired	\$ 21,650	14.7 years

Amortization of identifiable intangibles totaled \$25,580, \$25,797 and \$14,023 in fiscal 2016, 2015 and 2014, respectively, and is included in selling, distribution and administrative expenses in the statements of consolidated income. Future amortization expense based on the Company's identifiable intangible assets as of June 30, 2016 is estimated to be \$25,000 for 2017, \$22,700 for 2018, \$21,000 for 2019, \$19,200 for 2020 and \$17,600 for 2021.

NOTE 5: DEBT**Revolving Credit Facility & Term Loan**

In December 2015, the Company entered into a new five-year credit facility with a group of banks expiring in December 2020. This agreement provides for a \$125,000 unsecured term loan and a \$250,000 unsecured revolving credit facility. Fees on this facility range from 0.09% to 0.175% per year based upon the Company's leverage ratio at each quarter end. Borrowings under this agreement carry variable interest rates tied to either LIBOR or prime at the Company's discretion. At June 30, 2016, the Company had \$123,438 outstanding under the term loan and \$33,000 outstanding under the revolver. Unused lines under this facility, net of outstanding letters of credit of \$2,707 to secure certain insurance obligations, totaled \$214,293 at June 30, 2016 and are available to fund future acquisitions or other capital and operating requirements. The interest rate on the term loan as of June 30, 2016 was 1.50%. The weighted-average interest rate on the revolving credit facility outstanding as of June 30, 2016 was 1.44%. The new credit facility replaced the Company's previous term loan and revolving credit facility agreements. The Company had \$96,875 outstanding at June 30, 2015 under the previous term loan agreement, which carried a variable interest rate tied to LIBOR and was 1.19% at June 30, 2015. At June 30, 2015, the Company had \$52,000 outstanding under the previous revolving credit facility. Unused lines under this facility, net of outstanding letters of credit of

\$3,764 to secure certain insurance obligations, totaled \$94,236 at June 30, 2015 and were available to

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fund future acquisitions or other capital and operating requirements. The weighted-average interest rate on the revolving credit facility outstanding as of June 30, 2015 was 1.15%.

Additionally, the Company had letters of credit outstanding with a separate bank, not associated with the revolving credit agreement, in the amount of \$2,698 as of June 30, 2016 and \$1,841 as of June 30, 2015, in order to secure certain insurance obligations.

Other Long-Term Borrowings

In April 2014 the Company assumed \$2,359 of debt as a part of the headquarters facility acquisition. The 1.5% fixed interest rate note is held by the State of Ohio Development Services Agency, maturing in May 2024. At June 30, 2016 and 2015, \$1,896 and \$2,120 was outstanding, respectively.

At June 30, 2016 and June 30, 2015, the Company had borrowings outstanding under its unsecured shelf facility agreement with Prudential Investment Management of \$170,000. The "Series C" notes have a principal amount of \$120,000 and carry a fixed interest rate of 3.19%, and are due in equal principal payments in July 2020, 2021, and 2022. The "Series D" notes have a principal amount of \$50,000 and carry a fixed interest rate of 3.21%, and are due in equal principal payments in October 2019 and 2023. As of June 30, 2016, \$50,000 in additional financing was available under this facility.

The table below summarizes the aggregate maturities of amounts outstanding under long-term borrowing arrangements for each of the next five years:

Fiscal Year	Aggregate Maturity
2017	\$ 3,352
2018	4,918
2019	6,484
2020	33,050
2021	174,804
Thereafter	105,726

Covenants

The revolving credit facility, the term loan agreement, and the unsecured shelf facility contain restrictive covenants regarding liquidity, net worth, financial ratios, and other covenants. At June 30, 2016, the most restrictive of these covenants required that the Company have net indebtedness less than 3.25 times consolidated income before, interest, taxes, depreciation and amortization. The Company was in compliance with all covenants at June 30, 2016.

NOTE 6: FAIR VALUE MEASUREMENTS

Marketable securities measured at fair value at June 30, 2016 and June 30, 2015 totaled \$9,097 and \$9,330, respectively. The majority of these marketable securities are held in a rabbi trust for a non-qualified deferred compensation plan. The marketable securities are included in other assets on the consolidated balance sheets and their fair values were valued using quoted market prices (Level 1 in the fair value hierarchy).

As of June 30, 2016, the carrying value of the Company's fixed interest rate debt outstanding under its unsecured shelf facility agreement with Prudential Investment Management approximates fair value (Level 2 in the fair value hierarchy).

The revolving credit facility and the term loan contain variable interest rates and their carrying values approximate fair value (Level 2 in the fair value hierarchy).

NOTE 7: INCOME TAXES**Income Before Income Taxes**

The components of income before income taxes are as follows:

Year Ended June 30,	2016	2015	2014
U.S.	\$ 139,960	\$ 152,618	\$ 147,980
Foreign	(60,982)	23,253	18,282
Income before income taxes	\$ 78,978	\$ 175,871	\$ 166,262

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Provision

The provision (benefit) for income taxes consists of:

Year Ended June 30,	2016	2015	2014
Current:			
Federal	\$45,226	\$52,861	\$50,455
State and local	6,349	6,884	6,576
Foreign	4,407	5,603	4,619
Total current	55,982	65,348	61,650
Deferred:			
Federal	397	(3,799)	(5,328)
State and local	(30)	(153)	(267)
Foreign	(6,948)	(1,009)	(2,614)
Total deferred	(6,581)	(4,961)	(8,209)
Total	\$49,401	\$60,387	\$53,441

The exercise of non-qualified stock appreciation rights and options during fiscal 2016, 2015 and 2014 resulted in \$212, \$352 and \$1,462, respectively, of income tax benefits to the Company derived from the difference between the market and option price of the shares at the date of exercise and the fair value of the options on the grant date. Vesting of stock awards and other stock compensation in fiscal 2016, 2015 and 2014 resulted in \$(4), \$690 and \$1,211, respectively, of incremental income tax (expense), benefits over the amounts previously reported for financial reporting purposes. These tax (expenses) benefits were recorded in additional paid-in capital.

Effective Tax Rates

The following reconciles the U.S. federal statutory income tax rate to the Company's effective income tax rate:

Year Ended June 30,	2016	2015	2014
Statutory income tax rate	35.0 %	35.0 %	35.0 %
Effects of:			
State and local taxes	5.2 %	2.5 %	2.4 %
Goodwill impairment	27.1 %	— %	— %
U.S. tax on foreign income, net	— %	— %	(1.6)%
Foreign income taxes	(3.0)%	(2.5)%	(2.6)%
Deductible dividend	(0.9)%	(0.5)%	(0.5)%
Valuation allowance	0.5 %	0.5 %	— %
Other, net	(1.3)%	(0.7)%	(0.6)%
Effective income tax rate	62.6 %	34.3 %	32.1 %

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Consolidated Balance Sheets

Significant components of the Company's deferred tax assets and liabilities are as follows:

June 30,	2016	2015
Deferred tax assets:		
Compensation liabilities not currently deductible	\$25,992	\$28,902
Other expenses and reserves not currently deductible	11,650	9,115
Goodwill and intangibles	6,366	7,363
Foreign tax credit (expiring in years 2025-2026)	849	1,155
Net operating loss carryforwards (expiring in years 2017-2036)	4,960	860
Other	83	289
Total deferred tax assets	49,900	47,684
Less: Valuation allowance	(1,347)	(917)
Deferred tax assets, net of valuation allowance	48,553	46,767
Deferred tax liabilities:		
Inventories	(4,785)	(5,499)
Goodwill and intangibles	(33,353)	(38,707)
Depreciation and differences in property bases	(9,892)	(9,328)
Total deferred tax liabilities	(48,030)	(53,534)
Net deferred tax assets (liabilities)	\$523	\$(6,767)
Net deferred tax assets (liabilities) are classified as follows:		
Deferred tax assets	\$12,277	\$10,980
Other liabilities	(11,754)	(17,747)
Net deferred tax assets (liabilities)	\$523	\$(6,767)

Valuation allowances are provided against deferred tax assets where it is considered more-likely-than-not that the Company will not realize the benefit of such assets. The remaining net deferred tax asset is the amount management believes is more-likely-than-not of being realized. The realization of these deferred tax assets can be impacted by changes to tax laws, statutory rates and future income levels.

U.S. federal income taxes are provided on the portion of non-U.S. subsidiaries' income that is not considered to be permanently reinvested outside the U.S. and may be remitted to the U.S. At June 30, 2016, all undistributed earnings of non-U.S. subsidiaries are considered to be permanently reinvested and totaled approximately \$141,482, for which no U.S. tax has been provided. Determination of the net amount of the unrecognized tax liability with respect to the distribution of these earnings is not practicable; however, foreign tax credits would be available to partially reduce U.S. income taxes in the event of a distribution.

In 2014, the Company recognized a tax benefit of \$2,804 related to U.S. tax on foreign income which reduced the Company's effective tax rate by approximately 1.6%. This tax benefit was due to the reversal of taxes previously accrued on a portion of the undistributed earnings of non-US subsidiaries applicable to a change in the permanent reinvestment assertion. In 2015, \$17,793 of cash was distributed by one of the Company's non-U.S. subsidiaries as a non-taxable return of capital.

Unrecognized Income Tax Benefits

The Company and its subsidiaries file income tax returns in U.S. federal, various state, local and foreign jurisdictions. The following table sets forth the changes in the amount of unrecognized tax benefits for the years ended June 30, 2016, 2015 and 2014:

Year Ended June 30,	2016	2015	2014
Unrecognized Income Tax Benefits at beginning of the year	\$2,604	\$2,364	\$2,655
Current year tax positions	539	472	730
Expirations of statutes of limitations	(132)	(160)	(1,007)
Settlements	(96)	(72)	(14)
Unrecognized Income Tax Benefits at end of year	\$2,915	\$2,604	\$2,364

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Included in the balance of unrecognized income tax benefits at June 30, 2016, 2015 and 2014 are \$2,691, \$2,377 and \$2,104, respectively, of income tax benefits that, if recognized, would affect the effective income tax rate.

During 2016, 2015 and 2014, the Company recognized \$127 and \$49 and \$16 of expense, respectively, for interest and penalties related to unrecognized income tax benefits in its statements of consolidated income. The Company had a liability for penalties and interest of \$625 and \$497 as of June 30, 2016 and 2015, respectively. The Company does not anticipate a significant change to the total amount of unrecognized income tax benefits within the next twelve months.

The Company is subject to U.S. federal income tax examinations for the tax years 2014 through 2016 and to state and local income tax examinations for the tax years 2010 through 2016. In addition, the Company is subject to foreign income tax examinations for the tax years 2009 through 2016.

The Company's unrecognized income tax benefits are included in other liabilities in the consolidated balance sheets since payment of cash is not expected within one year.

NOTE 8: SHAREHOLDERS' EQUITY**Treasury Shares**

At June 30, 2016, 596 shares of the Company's common stock held as treasury shares were restricted as collateral under escrow arrangements relating to change in control and director and officer indemnification agreements.

Accumulated Other Comprehensive Income (Loss)

Changes in the accumulated other comprehensive income (loss) for the years ended June 30, 2016 and 2015, is comprised of the following:

	Foreign currency translation adjustment	Unrealized gain (loss) on securities available for sale	Postemployment benefits	Total accumulated other comprehensive income (loss)
Balance at July 1, 2013	\$ 360	\$ (52)	\$ (3,729)	\$ (3,421)
Other comprehensive income (loss)	629	73	871	1,573
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	233	233
Net current-period other comprehensive income (loss), net of taxes	629	73	1,104	1,806
Balance at June 30, 2014	\$ 989	\$ 21	\$ (2,625)	\$ (1,615)
Other comprehensive income (loss)	(58,233)	(25)	(472)	(58,730)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	174	174
Net current-period other comprehensive income (loss), net of taxes	(58,233)	(25)	(298)	(58,556)
Balance at June 30, 2015	\$ (57,244)	\$ (4)	\$ (2,923)	\$ (60,171)
Other comprehensive income (loss)	(24,441)	(34)	(1,215)	(25,690)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	315	315
Net current-period other comprehensive income (loss), net of taxes	(24,441)	(34)	(900)	(25,375)
Balance at June 30, 2016	\$ (81,685)	\$ (38)	\$ (3,823)	\$ (85,546)

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Other Comprehensive (Loss) Income

Details of other comprehensive (loss) income are as follows:

Year Ended June 30,	2016			2015			2014		
	Pre-Tax Amount	Tax (Benefit) Expense	Net Amount	Pre-Tax Amount	Tax (Benefit) Expense	Net Amount	Pre-Tax Amount	Tax Expense	Net Amount
Foreign currency translation adjustments	\$(24,441)	\$ —	\$(24,441)	\$(58,233)	\$ —	\$(58,233)	\$ 629	\$ —	\$ 629
Postemployment benefits:									
Actuarial (loss) gain on rereasurement	(1,998)	(783)	(1,215)	(776)	(304)	(472)	1,402	531	871
Reclassification of actuarial losses and prior service cost into SD&A expense and included in net periodic pension costs	518	203	315	286	112	174	382	149	233
Unrealized (loss) gain on investment securities available for sale	(52)	(18)	(34)	(38)	(13)	(25)	112	39	73
Other comprehensive (loss) income	\$(25,973)	\$(598)	\$(25,375)	\$(58,761)	\$(205)	\$(58,556)	\$2,525	\$ 719	\$ 1,806

Net Income Per Share

Basic net income per share is based on the weighted-average number of common shares outstanding. Diluted net income per share includes the dilutive effect of potential common shares outstanding. Under the two-class method of computing net income per share, non-vested share-based payment awards that contain rights to receive non-forfeitable dividends are considered participating securities. The Company's participating securities include RSUs and restricted stock awards. The Company calculated basic and diluted net income per share under both the treasury stock method and the two-class method. For the years presented there were no material differences in the net income per share amounts calculated using the two methods. Accordingly, the treasury stock method is disclosed below.

The following table presents amounts used in computing net income per share and the effect on the weighted-average number of shares of dilutive potential common shares:

Year Ended June 30,	2016	2015	2014
Net Income	\$29,577	\$115,484	\$112,821
Average Shares Outstanding:			
Weighted-average common shares outstanding for basic computation	39,254	40,892	41,942
Dilutive effect of potential common shares	212	295	389
Weighted-average common shares outstanding for dilutive computation	39,466	41,187	42,331
Net Income Per Share — Basic	\$0.75	\$2.82	\$2.69
Net Income Per Share — Diluted	\$0.75	\$2.80	\$2.67

Stock appreciation rights and options relating to 775, 435 and 289 shares of common stock were outstanding at June 30, 2016, 2015 and 2014, respectively, but were not included in the computation of diluted earnings per share for the fiscal years then ended as they were anti-dilutive.

NOTE 9: SHARE-BASED COMPENSATION

Share-Based Incentive Plans

Following approval by the Company's shareholders in October 2015, the 2015 Long-Term Performance Plan (the "2015 Plan") replaced the 2011 Long-Term Performance Plan. The 2015 Plan, which expires in 2020, provides for granting of SARs, stock options, stock awards, cash awards, and such other awards or combination thereof as the Executive Organization and Compensation Committee or, in the case of director awards, the Corporate Governance Committee of the Board of Directors (together referred to as the Committee) may determine to officers, other key

employees and members of the Board of Directors. Grants are generally made at regularly scheduled committee

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meetings. Compensation costs charged to expense under award programs paid (or to be paid) with shares (including SARs, stock options, performance shares, restricted stock, and RSUs) are summarized in the table below:

Year Ended June 30,	2016	2015	2014
SARs and options	\$1,543	\$1,610	\$1,808
Performance shares	446	836	309
Restricted stock and RSUs	2,078	2,015	2,394
Total compensation costs under award programs	\$4,067	\$4,461	\$4,511

Such amounts are included in selling, distribution and administrative expense in the accompanying statements of consolidated income. The total income tax benefit recognized in the statements of consolidated income for share-based compensation plans was \$1,595, \$1,749 and \$1,768 for fiscal years 2016, 2015 and 2014, respectively. It has been the practice of the Company to issue shares from treasury to satisfy requirements of awards paid with shares. The aggregate unrecognized compensation cost for share-based award programs with the potential to be paid at June 30, 2016 are summarized in the table below:

June 30, (Shares in thousands)	2016	Average Expected Period of Expected Recognition (Years)
SARs and options	\$2,193	2.6
Performance shares	3,933	1.7
Restricted stock and RSUs	2,133	2.0
Total unrecognized compensation costs under award programs	\$8,259	2.0

Cost of these programs will be recognized as expense over the weighted-average remaining vesting period of 2.0 years. The aggregate number of shares of common stock which may be awarded under the 2015 Plan is 2,500; shares available for future grants at June 30, 2016 were 2,449.

Stock Appreciation Rights and Stock Options

The weighted-average assumptions used for SARs and stock option grants issued in fiscal 2016, 2015 and 2014 are:

	2016	2015	2014
Expected life, in years	4.4	4.7	4.6
Risk free interest rate	1.3 %	1.4 %	1.3 %
Dividend yield	2.5 %	2.5 %	2.5 %
Volatility	26.0 %	29.0 %	31.8 %
Per share fair value of SARs and stock options granted during the year	\$6.79	\$9.53	\$11.02

The expected life is based upon historical exercise experience of the officers, other key employees and members of the Board of Directors. The risk free interest rate is based upon U.S. Treasury zero-coupon bonds with remaining terms equal to the expected life of the SARs and stock options. The assumed dividend yield has been estimated based upon the Company's historical results and expectations for changes in dividends and stock prices. The volatility assumption is calculated based upon historical daily price observations of the Company's common stock for a period equal to the expected life.

SARs are redeemable solely in Company common stock. The exercise price of stock option awards may be settled by the holder with cash or by tendering Company common stock.

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A summary of SARs and stock options activity is presented below:

Year Ended June 30, 2016 (Shares in thousands)	Shares	Weighted-Average Exercise Price
Outstanding, beginning of year	1,116	\$ 35.86
Granted	297	39.08
Exercised	(171)	27.95
Forfeited	(6)	44.15
Outstanding, end of year	1,236	\$ 37.69
Exercisable at end of year	728	\$ 34.09
Expected to vest at end of year	480	\$ 42.87

The weighted-average remaining contractual terms for SARs and stock options outstanding, exercisable, and expected to vest at June 30, 2016 were 6.3, 4.8, and 8.5 years, respectively. The aggregate intrinsic values of SARs and stock options outstanding, exercisable, and expected to vest at June 30, 2016 were \$10,491, \$8,546, and \$1,827, respectively. The aggregate intrinsic value of the SARs and stock options exercised during fiscal 2016, 2015, and 2014 was \$2,422, \$1,601, and \$5,241, respectively.