

KENNAMETAL INC  
Form 10-Q  
February 08, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2015  
Commission file number 1-5318  
KENNAMETAL INC.  
(Exact name of registrant as specified in its charter)

Pennsylvania 25-0900168  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

600 Grant Street  
Suite 5100 15219-2706  
Pittsburgh, Pennsylvania  
(Address of principal executive offices) (Zip Code)  
Website: www.kennametal.com

Registrant's telephone number, including area code: (412) 248-8000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

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

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

Large accelerated filer  Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

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

Title of Each Class	Outstanding at January 29, 2016
Capital Stock, par value \$1.25 per share	79,672,229



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**FORWARD-LOOKING INFORMATION**

This Quarterly Report on Form 10-Q contains “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are statements that do not relate strictly to historical or current facts. You can identify forward-looking statements by the fact they use words such as “should,” “anticipate,” “estimate,” “approximate,” “expect,” “may,” “will,” “project,” “intend,” “plan” and other words of similar meaning and expression in connection with any discussion of future operating or financial performance or events. We have also included forward looking statements in this Quarterly Report on Form 10-Q concerning, among other things, our strategy, goals, plans and projections regarding our financial position, liquidity and capital resources, results of operations, market position and product development. These statements are based on current estimates that involve inherent risks and uncertainties. Should one or more of these risks or uncertainties materialize, or should the assumptions underlying the forward-looking statements prove incorrect, our actual results could vary materially from our current expectations. There are a number of factors that could cause our actual results to differ from those indicated in the forward-looking statements. They include: economic recession; our ability to achieve all anticipated benefits of restructuring initiatives; our foreign operations and international markets, such as currency exchange rates, different regulatory environments, trade barriers, exchange controls, and social and political instability; changes in the regulatory environment in which we operate, including environmental, health and safety regulations; potential for future goodwill and other intangible asset impairment charges; our ability to protect and defend our intellectual property; continuity of information technology infrastructure; competition; our ability to retain our management and employees; demands on management resources; availability and cost of the raw materials we use to manufacture our products; product liability claims; integrating acquisitions and achieving the expected savings and synergies; global or regional catastrophic events; demand for and market acceptance of our products; business divestitures; energy costs; commodity prices; labor relations; and implementation of environmental remediation matters. We provide additional information about many of the specific risks we face in the “Risk Factors” Section of our Annual Report on Form 10-K. We can give no assurance that any goal or plan set forth in forward-looking statements can be achieved and readers are cautioned not to place undue reliance on such statements, which speak only as of the date made. We undertake no obligation to release publicly any revisions to forward-looking statements as a result of future events or developments.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## KENNAMETAL INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Sales	\$524,021	\$675,631	\$1,079,376	\$1,370,572
Cost of goods sold	383,215	476,173	787,345	953,015
Gross profit	140,806	199,458	292,031	417,557
Operating expense	123,580	137,459	252,824	285,947
Restructuring and asset impairment charges (Notes 8 and 18)	112,237	388,839	121,357	390,402
Loss on divestiture (Note 5)	133,307	—	133,307	—
Amortization of intangibles	5,638	6,931	11,886	13,959
Operating loss	(233,956 )	(333,771 )	(227,343 )	(272,751 )
Interest expense	6,803	7,960	13,782	16,170
Other (income) expense, net	(732 )	2,223	353	409
Loss before income taxes	(240,027 )	(343,954 )	(241,478 )	(289,330 )
(Benefit) provision for income taxes	(71,216 )	43,751	(66,964 )	58,248
Net loss	(168,811 )	(387,705 )	(174,514 )	(347,578 )
Less: Net income attributable to noncontrolling interests	416	597	939	1,236
Net loss attributable to Kennametal	\$(169,227 )	\$(388,302 )	\$(175,453 )	\$(348,814 )
<b>PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREHOLDERS</b>				
Basic loss per share	\$(2.12 )	\$(4.89 )	\$(2.20 )	\$(4.40 )
Diluted loss per share	\$(2.12 )	\$(4.89 )	\$(2.20 )	\$(4.40 )
Dividends per share	\$0.20	\$0.18	\$0.40	\$0.36
Basic weighted average shares outstanding	79,840	79,343	79,784	79,229
Diluted weighted average shares outstanding	79,840	79,343	79,784	79,229

The accompanying notes are an integral part of these condensed consolidated financial statements.

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## KENNAMETAL INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2015	2014	2015	2014
Net loss	\$(168,811 )	\$(387,705 )	\$(174,514 )	\$(347,578 )
Other comprehensive loss, net of tax				
Unrealized gain on derivatives designated and qualified as cash flow hedges	277	1,206	802	2,713
Reclassification of unrealized (gain) loss on expired derivatives designated and qualified as cash flow hedges	(418 )	(35 )	(2,184 )	329
Unrecognized net pension and other postretirement benefit gain	1,450	1,924	2,449	5,565
Reclassification of net pension and other postretirement benefit loss	1,203	735	2,422	1,489
Foreign currency translation adjustments	(23,639 )	(30,209 )	(42,488 )	(81,722 )
Reclassification of foreign currency translation adjustment loss realized upon sale	17,028	—	17,028	—
Total other comprehensive loss, net of tax	(4,099 )	(26,379 )	(21,971 )	(71,626 )
Total comprehensive loss	(172,910 )	(414,084 )	(196,485 )	(419,204 )
Less: comprehensive loss attributable to noncontrolling interests	(111 )	(184 )	(128 )	(1,037 )
Comprehensive loss attributable to Kennametal Shareholders	\$(172,799 )	\$(413,900 )	\$(196,357 )	\$(418,167 )

The accompanying notes are an integral part of these condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except per share data)	December 31, 2015	June 30, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 138,978	\$ 105,494
Accounts receivable, less allowance for doubtful accounts of \$11,406 and \$13,560, respectively	333,402	445,373
Inventories (Note 11)	477,499	575,531
Deferred income taxes	55,722	72,449
Other current assets	57,391	59,699
Total current assets	1,062,992	1,258,546
Property, plant and equipment:		
Land and buildings	350,046	401,207
Machinery and equipment	1,509,418	1,573,597
Less accumulated depreciation	(1,139,935 )	(1,158,979 )
Property, plant and equipment, net	719,529	815,825
Other assets:		
Investments in affiliated companies	2	361
Goodwill (Note 18)	297,975	417,389
Other intangible assets, less accumulated amortization of \$104,964 and \$153,370, respectively (Note 18)	216,027	286,669
Deferred income taxes	72,927	24,091
Other	70,800	46,648
Total other assets	657,731	775,158
Total assets	\$2,440,252	\$2,849,529
<b>LIABILITIES</b>		
Current liabilities:		
Current maturities of long-term debt and capital leases	\$5,444	\$8,129
Notes payable to banks	498	7,573
Accounts payable	151,597	187,381
Accrued income taxes	29,572	25,237
Accrued expenses	53,748	75,746
Other current liabilities	154,124	178,678
Total current liabilities	394,983	482,744
Long-term debt and capital leases, less current maturities (Note 12)	700,711	735,885
Deferred income taxes	15,310	59,744
Accrued pension and postretirement benefits	147,766	163,029
Accrued income taxes	2,274	3,002
Other liabilities	24,931	29,690
Total liabilities	1,285,975	1,474,094
Commitments and contingencies		
<b>EQUITY (Note 16)</b>		
Kennametal Shareholders' Equity:		
Preferred stock, no par value; 5,000 shares authorized; none issued	—	—
	99,588	99,219

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Capital stock, \$1.25 par value; 120,000 shares authorized; 79,670 and 79,375 shares issued, respectively

Additional paid-in capital	426,703	419,829
Retained earnings	862,984	1,070,282
Accumulated other comprehensive loss	(264,427 )	(243,523 )
Total Kennametal Shareholders' Equity	1,124,848	1,345,807
Noncontrolling interests	29,429	29,628
Total equity	1,154,277	1,375,435
Total liabilities and equity	\$2,440,252	\$2,849,529

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## KENNAMETAL INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW (UNAUDITED)

	Six Months Ended	
	December 31,	
(in thousands)	2015	2014
<b>OPERATING ACTIVITIES</b>		
Net loss	\$(174,514 )	\$(347,578 )
Adjustments for non-cash items:		
Depreciation	50,429	53,341
Amortization	11,886	13,959
Stock-based compensation expense	10,811	13,475
Restructuring and asset impairment charges (Notes 8 and 18)	111,327	383,489
Deferred income tax provision	(78,742 )	(13,824 )
Loss on divestiture (Note 5)	133,307	—
Other	(345 )	8,938
Changes in certain assets and liabilities:		
Accounts receivable	69,832	54,928
Inventories	46,565	4,727
Accounts payable and accrued liabilities	(44,142 )	(74,969 )
Accrued income taxes	(12,390 )	45,596
Accrued pension and postretirement benefits	(18,176 )	(7,089 )
Other	(1,304 )	329
Net cash flow provided by operating activities	104,544	135,322
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(61,175 )	(54,672 )
Disposals of property, plant and equipment	4,402	978
Proceeds from divestiture (Note 5)	61,100	—
Other	814	(126 )
Net cash flow provided by (used for) investing activities	5,141	(53,820 )
<b>FINANCING ACTIVITIES</b>		
Net (decrease) increase in notes payable	(6,990 )	15,241
Net increase in short-term revolving and other lines of credit	—	8,500
Term debt borrowings	26,173	50,727
Term debt repayments	(63,726 )	(154,547 )
Purchase of capital stock	(167 )	(168 )
Dividend reinvestment and the effect of employee benefit and stock plans	1,473	7,891
Cash dividends paid to Shareholders	(31,845 )	(28,451 )
Other	(290 )	(4,786 )
Net cash flow used for financing activities	(75,372 )	(105,593 )
Effect of exchange rate changes on cash and cash equivalents	(829 )	(7,571 )
<b>CASH AND CASH EQUIVALENTS</b>		
Net increase (decrease) in cash and cash equivalents	33,484	(31,662 )
Cash and cash equivalents, beginning of period	105,494	177,929
Cash and cash equivalents, end of period	\$138,978	\$146,267

The accompanying notes are an integral part of these condensed consolidated financial statements.



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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1.ORGANIZATION

Kennametal Inc. was incorporated in Pennsylvania in 1943. Kennametal Inc. and its subsidiaries (collectively, Kennametal or the Company) are a leading global manufacturer and supplier of tooling, engineered components and advanced materials consumed in production processes. We believe that our reputation for manufacturing excellence, as well as our technological expertise and innovation we deliver in our products and services, helps us to achieve a leading position in our primary markets. End users of our products include metalworking and machinery manufacturers and suppliers across a diverse array of industries, including the aerospace, defense, transportation, machine tool, light machinery and heavy machinery, as well as producers and suppliers in a number of equipment-intensive industries such as coal mining, road construction and quarrying, as well as oil and gas exploration, refining, production and supply. Our end users' applications range from airframes to mining operations, engines to oil wells and turbochargers to processing. We operate two global business segments consisting of Industrial and Infrastructure.

2.BASIS OF PRESENTATION

The condensed consolidated financial statements, which include our accounts and those of our majority-owned subsidiaries, should be read in conjunction with our 2015 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2015 was derived from the audited balance sheet included in our 2015 Annual Report on Form 10-K. These interim statements are unaudited; however, we believe that all adjustments necessary for a fair statement of the results of the interim periods were made and all adjustments are normal recurring adjustments. The results for the six months ended December 31, 2015 and 2014 are not necessarily indicative of the results to be expected for a full fiscal year. Unless otherwise specified, any reference to a "year" is to a fiscal year ended June 30. For example, a reference to 2016 is to the fiscal year ending June 30, 2016. When used in this Form 10-Q, unless the context requires otherwise, the terms "we," "our" and "us" refer to Kennametal Inc. and its subsidiaries.

3.NEW ACCOUNTING STANDARDS

Adopted

In April 2014, the Financial Accounting Standards Board (FASB) issued new guidance on reporting discontinued operations and disclosures of disposals of components of an entity. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Additionally, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income and expenses of discontinued operations. The new guidance also requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. This guidance was effective for Kennametal beginning July 1, 2015. The transaction outlined in Note 5 was evaluated under this guidance.

Issued

In November 2015, the FASB issued new guidance on balance sheet classification of deferred taxes. The amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position, as opposed to the current practice of separating deferred income tax liabilities and assets into current and noncurrent amounts on the balance sheet. This standard is effective for Kennametal beginning July 1, 2017. We are in the process of assessing the impact the adoption of this ASU will have on our condensed consolidated financial statements.

## 4. SUPPLEMENTAL CASH FLOW DISCLOSURES

(in thousands)	Six Months Ended	
	December 31,	
Cash paid during the period for:	2015	2014
Interest	\$13,076	\$16,334
Income taxes	25,735	24,894
Supplemental disclosure of non-cash information:		
Changes in accounts payable related to purchases of property, plant and equipment	16,400	6,470

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

## 5. DIVESTITURE

During the three months ended December 31, 2015, Kennametal completed its transaction to sell all of the outstanding capital stock of: Kennametal Extrude Hone LLC and its wholly owned subsidiaries, Kennametal Stellite S.r.l. (Bellusco, Italy), Kennametal Stellite S.p.A. (Milan, Italy), Kennametal Stellite GmbH (Koblenz, Germany); and all of the assets of the businesses of: Tricon (manufacturing operations in Birmingham, Alabama; Chicago, Illinois; and Elko, Nevada), Landis (manufacturing operation in Waynesboro, Pennsylvania); and all of the assets located at the Biel, Switzerland manufacturing facility ("non-core businesses") to Madison Industries for an aggregate price of \$61.1 million cash, net of cash sold and working capital settlements. A portion of the transaction proceeds were used to pay down revolver debt with the remaining balance being held as cash on hand.

The net book value of these non-core businesses immediately prior to the transaction was \$182.5 million, which includes the impact of cumulative translation adjustments. We recognized a pre-tax loss on the sale of \$133.3 million during the three months ended December 31, 2015 which included the impact of working capital adjustments and deal costs. Charges of \$126.0 million and \$7.3 million were recorded in the Infrastructure and Industrial segments, respectively. The pre-tax income attributable to the non-core businesses was assessed and determined to be immaterial for disclosure for the periods presented.

## 6. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy consists of three levels to prioritize the inputs used in valuations, as defined below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3: Inputs that are unobservable.

As of December 31, 2015, the fair values of the Company's financial assets and financial liabilities measured at fair value on a recurring basis are categorized as follows:

(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Derivatives <sup>(1)</sup>	\$—	\$799	\$—	\$799
Total assets at fair value	\$—	\$799	\$—	\$799
Liabilities:				
Derivatives <sup>(1)</sup>	\$—	\$75	\$—	\$75
Contingent consideration	—	—	8,600	8,600
Total liabilities at fair value	\$—	\$75	\$8,600	\$8,675



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## KENNAMETAL INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As of June 30, 2015, the fair value of the Company's financial assets and financial liabilities measured at fair value on a recurring basis are categorized as follows:

(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Derivatives <sup>(1)</sup>	\$—	\$2,678	\$—	\$2,678
Total assets at fair value	\$—	\$2,678	\$—	\$2,678
Liabilities:				
Derivatives <sup>(1)</sup>	\$—	\$44	\$—	\$44
Contingent consideration	—	—	10,000	10,000
Total liabilities at fair value	\$—	\$44	\$10,000	\$10,044

<sup>(1)</sup> Currency derivatives are valued based on observable market spot and forward rates and are classified within Level 2 of the fair value hierarchy.

There have been no changes in classification and transfers between levels in the fair value hierarchy in the current period. The fair value of contingent consideration payable that was classified as Level 3 relates to our probability assessments of expected future milestone targets, primarily associated with product delivery, related to a previous acquisition. The contingent consideration is to be paid over the next 12 months and is recorded in other current liabilities in our condensed consolidated balance sheet. The Company reassessed this contingent consideration and determined that an adjustment of \$1.4 million to reduce the fair value of the remaining contingent consideration was necessary during the six months ended December 31, 2015 due to a return of inventory to the seller during the period. No other changes in the expected outcome have occurred during the six months ended December 31, 2015.

## 7. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

As part of our financial risk management program, we use certain derivative financial instruments. We do not enter into derivative transactions for speculative purposes and, therefore, hold no derivative instruments for trading purposes. We account for derivative instruments as a hedge of the related asset, liability, firm commitment or anticipated transaction, when the derivative is specifically designated and qualifies as a hedge of such items. Our objective in managing foreign exchange exposures with derivative instruments is to reduce volatility in cash flow. We measure hedge effectiveness by assessing the changes in the fair value or expected future cash flows of the hedged item. The ineffective portions are recorded in other (income) expense, net.

The fair value of derivatives designated and not designated as hedging instruments in the condensed consolidated balance sheet are as follows:

(in thousands)	December 31, 2015	June 30, 2015
Derivatives designated as hedging instruments		
Other current assets - range forward contracts	\$762	\$2,626
Other assets - range forward contracts	21	—
Total derivatives designated as hedging instruments	783	2,626
Derivatives not designated as hedging instruments		
Other current assets - currency forward contracts	16	52
Other current liabilities - currency forward contracts	(75)	(44)
Total derivatives not designated as hedging instruments	(59)	8
Total derivatives	\$724	\$2,634





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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Certain currency forward contracts that hedge significant cross-border intercompany loans are considered as other derivatives and therefore do not qualify for hedge accounting. These contracts are recorded at fair value in the condensed consolidated balance sheet, with the offset to other (income) expense, net. Gains related to derivatives not designated as hedging instruments have been recognized as follows: