

KENNAMETAL INC  
Form 10-Q  
February 08, 2011

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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, 2010**

Commission file number 1-5318

**KENNAMETAL INC.**

(Exact name of registrant as specified in its charter)

**Pennsylvania**

(State or other jurisdiction of incorporation or organization)

**25-0900168**

(I.R.S. Employer Identification No.)

**World Headquarters  
1600 Technology Way  
P.O. Box 231**

**Latrobe, Pennsylvania**

(Address of principal executive offices)

**15650-0231**

(Zip Code)

Website: **www.kennametal.com**

Registrant's telephone number, including area code: **(724) 539-5000**

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 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  
Capital Stock, par value \$1.25 per share

Outstanding at January 31, 2011  
82,151,690

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FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2010  
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**FORWARD-LOOKING INFORMATION**

This 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, believe and meaning and expression in connection with any discussion of future operating or financial performance or events. Forward-looking statements in this Form 10-Q may concern, among other things, Kennametal's expectations regarding our strategy, goals, plans and projections regarding our financial position, liquidity and capital resources, results of operations, market position, and product development, all of which are based on current estimates that involve inherent risks and uncertainties. Among the factors that could cause the actual results to differ materially from those indicated in the forward-looking statements are risks and uncertainties related to: prolonged economic recession; restructuring and related actions (including associated costs and anticipated benefits); availability and cost of the raw materials we use to manufacture our products; 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; our ability to protect and defend our intellectual property; competition; our ability to retain our management and employees; demands on management resources; successful completion of information systems upgrades, including our enterprise system software; potential claims relating to our products; integrating acquisitions and achieving the expected savings and synergies; business divestitures; global or regional catastrophic events; energy costs; commodity prices; labor relations; demand for and market acceptance of new and existing products; implementation of environmental remediation matters; and implementation of a new segment structure. Should one or more of these risks or uncertainties materialize, or should the assumptions underlying the forward-looking statements prove incorrect, actual outcomes could vary materially from those indicated. These and other risks are more fully described in the Risk Factors Section of our Annual Report on Form 10-K and in our other periodic filings with the Securities and Exchange Commission. We undertake no obligation to release publicly any revisions to forward-looking statements as a result of future events or developments.

**Table of Contents****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,	
	2010	2009	2010	2009
Sales	\$ 565,768	\$ 442,865	\$ 1,094,926	\$ 852,260
Cost of goods sold	365,743	302,777	706,161	594,371
Gross profit	200,025	140,088	388,765	257,889
Operating expense	132,105	117,902	257,125	234,064
Restructuring charges (Note 7)	3,391	3,348	6,651	11,178
Amortization of intangibles	2,912	3,367	5,860	6,707
Operating income	61,617	15,471	119,129	5,940
Interest expense	5,564	5,954	11,527	12,325
Other (income) expense, net	(253)	(1,866)	1,658	(4,818)
Income (loss) from continuing operations before income taxes	56,306	11,383	105,944	(1,567)
Provision (benefit) for income taxes	12,016	5,090	25,698	(39)
Income (loss) from continuing operations	44,290	6,293	80,246	(1,528)
Loss from discontinued operations (Note 8)	-	(56)	-	(1,423)
Net income (loss)	44,290	6,237	80,246	(2,951)
Less: Net income attributable to noncontrolling interests	821	270	1,856	899
Net income (loss) attributable to Kennametal	\$ 43,469	\$ 5,967	\$ 78,390	\$ (3,850)
Amounts attributable to Kennametal Shareowners:				
Income (loss) from continuing operations	\$ 43,469	\$ 6,023	\$ 78,390	\$ (2,427)

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Loss from discontinued operations	-	(56)	-	(1,423)
Net income (loss)	\$ 43,469	\$ 5,967	\$ 78,390	\$ (3,850)
<b>PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREOWNERS</b>				
Basic earnings (loss) per share:				
Continuing operations	\$ 0.53	\$ 0.07	\$ 0.95	\$ (0.03)
Discontinued operations	-	-	-	(0.02)
	\$ 0.53	\$ 0.07	\$ 0.95	\$ (0.05)
Diluted earnings (loss) per share:				
Continuing operations	\$ 0.52	\$ 0.07	\$ 0.94	\$ (0.03)
Discontinued operations	-	-	-	(0.02)
	\$ 0.52	\$ 0.07	\$ 0.94	\$ (0.05)
Dividends per share	\$ 0.12	\$ 0.12	\$ 0.24	\$ 0.24
Basic weighted average shares outstanding	82,186	81,149	82,146	80,461
Diluted weighted average shares outstanding	83,337	81,855	83,012	80,461

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

**Table of Contents****KENNAMETAL INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

(in thousands, except per share data)	December 31, 2010	June 30, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 147,157	\$ 118,129
Accounts receivable, less allowance for doubtful accounts of \$23,664 and \$24,789	340,531	326,699
Inventories (Note 11)	425,957	364,268
Deferred income taxes	63,863	62,083
Other current assets	47,625	44,752
<b>Total current assets</b>	<b>1,025,133</b>	<b>915,931</b>
Property, plant and equipment:		
Land and buildings	359,943	341,748
Machinery and equipment	1,328,627	1,281,872
Less accumulated depreciation	(1,022,791)	(959,085)
<b>Property, plant and equipment, net</b>	<b>665,779</b>	<b>664,535</b>
Other assets:		
Investments in affiliated companies	1,826	2,251
Goodwill (Note 18)	500,790	489,443
Other intangible assets, less accumulated amortization of \$71,213 and \$63,343 (Note 18)	153,917	155,306
Deferred income taxes	11,815	11,827
Other	35,733	28,530
<b>Total other assets</b>	<b>704,081</b>	<b>687,357</b>
<b>Total assets</b>	<b>\$ 2,394,993</b>	<b>\$ 2,267,823</b>
<b>LIABILITIES</b>		
Current liabilities:		
Current maturities of long-term debt and capital leases (Note 12)	\$ 900	\$ 3,539
Notes payable to banks	3,336	19,454
Accounts payable	116,849	125,360
Accrued income taxes	13,265	17,857
Accrued expenses	81,134	73,989
Other current liabilities (Note 7)	154,435	152,806
<b>Total current liabilities</b>	<b>369,919</b>	<b>393,005</b>
Long-term debt and capital leases, less current maturities (Note 12)	312,143	314,675
Deferred income taxes	64,933	63,266
Accrued pension and postretirement benefits	139,679	129,701



Accrued income taxes	5,648	5,193
Other liabilities	26,244	28,540
Total liabilities	918,566	934,380
Commitments and contingencies		
EQUITY (Note 16)		
Kennametal Shareowners Equity:		
Preferred stock, no par value; 5,000 shares authorized; none issued	-	-
Capital stock, \$1.25 par value; 120,000 shares authorized; 82,003 and 81,903 shares issued	102,503	102,379
Additional paid-in capital	503,663	492,454
Retained earnings	851,909	793,448
Accumulated other comprehensive loss	(2,607)	(72,781)
Total Kennametal Shareowners Equity	1,455,468	1,315,500
Noncontrolling interests	20,959	17,943
Total equity	1,476,427	1,333,443
Total liabilities and equity	\$ 2,394,993	\$ 2,267,823

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

**Table of Contents****KENNAMETAL INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW (UNAUDITED)**

Six months ended December 31 (in thousands)	2010	2009 <sup>(1)</sup>
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 80,246	\$ (2,951)
Adjustments for non-cash items:		
Depreciation	39,883	40,770
Amortization	5,860	6,707
Stock-based compensation expense	12,591	8,551
Restructuring charges	1,622	62
Loss on divestitures	-	527
Deferred income tax provision	505	(877)
Other	771	(147)
Changes in certain assets and liabilities, excluding effects of acquisitions and divestitures:		
Accounts receivable	1,600	11,985
Inventories	(45,089)	8,446
Accounts payable and accrued liabilities	(21,163)	(20,572)
Accrued income taxes	(3,993)	(6,300)
Other	(5,432)	7,230
Net cash flow provided by operating activities	67,401	53,431
<b>INVESTING ACTIVITIES</b>		
Purchases of property, plant and equipment	(21,150)	(19,266)
Disposals of property, plant and equipment	7,451	1,659
Proceeds from divestitures (Note 8)	-	27,788
Other	1,138	343
Net cash flow (used for) provided by investing activities	(12,561)	10,524
<b>FINANCING ACTIVITIES</b>		
Net decrease in notes payable	(16,139)	(11,248)
Net decrease in short-term revolving and other lines of credit	-	(18,400)
Term debt borrowings	255,055	254,779
Term debt repayments	(256,564)	(370,261)
Purchase of capital stock	(10,275)	(146)
Net proceeds from equity offering	-	120,696
Dividend reinvestment and the effect of employee benefit and stock plans	10,186	3,789
Cash dividends paid to shareowners	(19,929)	(19,572)
Other	(1,489)	(2,481)
Net cash flow used for financing activities	(39,155)	(42,844)
Effect of exchange rate changes on cash and cash equivalents	13,343	4,901

CASH AND CASH EQUIVALENTS

Net increase in cash and cash equivalents	29,028	26,012
Cash and cash equivalents, beginning of period	118,129	69,823
Cash and cash equivalents, end of period	\$ 147,157	\$ 95,835

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

(1) Amounts presented include cash flows from discontinued operations.

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**KENNAMETAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**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 in our principle products, has helped us to achieve a leading market presence in our primary markets. End users of our products include metalworking manufacturers and suppliers across a diverse array of industries including the aerospace, defense, transportation, machine tool, light machinery and heavy machinery industries, as well as manufacturers, producers and suppliers in a number of other industries including coal mining, highway construction, quarrying, oil and gas exploration and production industries. Our end users' products and services include everything from airframes to coal, engines to oil wells and turbochargers to construction. We operate two global business units 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 2010 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2010 was derived from the audited balance sheet included in our 2010 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, 2010 and 2009 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 2011 is to the fiscal year ending June 30, 2011. When used in this Form 10-Q, unless the context requires otherwise, the terms we, our and us refer to Kennametal Inc. and its consolidated subsidiaries.

**3. NEW ACCOUNTING STANDARDS**

*Issued*

In December 2010, the FASB issued additional guidance on intangible impairment testing for reporting units with zero or negative carrying amounts. This guidance is effective for fiscal years and interim periods beginning after December 15, 2010. Kennametal adopted this guidance on January 1, 2011 and such adoption did not have a material impact on our condensed consolidated financial statements.

In December 2010, the FASB issued additional guidance on disclosures related to business combinations for a public entity that presents comparative financial statements. This guidance also expanded the supplemental pro forma business combination disclosures. This guidance is effective prospectively for business combinations for which the acquisition date is on or after the annual reporting period beginning December 15, 2010. Kennametal adopted this guidance on January 1, 2011 and such adoption did not have a material impact to our condensed consolidated financial statements.

*Adopted*

As of July 1, 2010, Kennametal adopted new guidance on consolidations for enterprises involved with variable interest entities. The guidance modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar) rights should be consolidated and clarifies that the determination of whether a company is required to consolidate a variable interest entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. This guidance requires an ongoing reassessment of whether a company is the

primary beneficiary of a variable interest entity and also requires additional disclosures about a company's involvement in variable interest entities and any significant changes in risk exposure due to that involvement. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

As of July 1, 2010, Kennametal adopted new guidance on accounting for transfers of financial assets. This guidance requires additional disclosure regarding transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

As of July 1, 2010, Kennametal adopted new guidance on revenue recognition for multiple-deliverable revenue arrangements. The guidance allows companies to allocate arrangement consideration in multiple deliverable arrangements in a manner that better reflects the transaction's economics and may result in earlier revenue recognition. In addition, the residual method of allocating arrangement consideration is no longer permitted. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

**Table of Contents****KENNAMETAL INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****4. SUPPLEMENTAL CASH FLOW DISCLOSURES**

Six months ended December 31 (in thousands)	2010	2009
Cash paid during the period for:		
Interest	\$ 12,653	\$ 14,012
Income taxes	30,362	8,016
Supplemental disclosure of non-cash information:		
Contribution of capital stock to employees defined contribution benefit plans	948	2,683

**5. 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, 2010, 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>	\$ -	\$ 4,016	\$ -	\$ 4,016
Total assets at fair value	\$ -	\$ 4,016	\$ -	\$ 4,016
Liabilities:				
Derivatives <sup>(1)</sup>	\$ -	\$ 1,435	\$ -	\$ 1,435
Total liabilities at fair value	\$ -	\$ 1,435	\$ -	\$ 1,435

As of June 30, 2010, 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>	\$ -	\$ 43	\$ -	\$ 43
Total assets at fair value	\$ -	\$ 43	\$ -	\$ 43
Liabilities:				
Derivatives <sup>(1)</sup>	\$ -	\$ 3,453	\$ -	\$ 3,453
Total liabilities at fair value	\$ -	\$ 3,453	\$ -	\$ 3,453

<sup>(1)</sup> Foreign currency derivative and interest rate swap contracts are valued based on observable market spot and forward rates and are classified within Level 2 of the fair value hierarchy.

**Table of Contents****KENNAMETAL INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****6. 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 use derivative financial instruments to provide predictability to the effects of changes in foreign exchange rates on our consolidated results and to achieve our targeted mix of fixed and floating interest rates on outstanding debt. We account for derivative instruments as a hedge of the related asset, liability, firm commitment or anticipated transaction when the derivative is specifically designated as a hedge of such items. Our objective in managing foreign exchange exposures with derivative instruments is to reduce volatility in cash flow, allowing us to focus more of our attention on business operations. With respect to interest rate management, these derivative instruments allow us to achieve our targeted fixed-to-floating interest rate mix as a separate decision from funding arrangements in the bank and public debt markets. 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 in the condensed consolidated balance sheet are as follows:

(in thousands)	December 31, 2010	June 30, 2010
Derivatives designated as hedging instruments		
Other current assets - range forward contracts	\$ 363	\$ 34
Other current liabilities - range forward contracts	(394)	(2)
Other assets - forward starting interest rate swap contracts	2,597	-
Other liabilities - forward starting interest rate swap contracts	(919)	(2,348)
Total derivatives designated as hedging instruments	1,647	(2,316)
Derivatives not designated as hedging instruments		
Other current assets - currency forward contracts	1,056	9
Other current liabilities - currency forward contracts	(122)	(1,103)
Total derivatives not designated as hedging instruments	934	(1,094)
Total derivatives	\$ 2,581	\$ (3,410)

Certain currency forward contracts hedging 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 balance sheet, with the offset to other (income) expense, net. (Gains) losses related to derivatives not designated as hedging instruments have been recognized as follows:

(in thousands)	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
	\$ 865	\$ 9,742	\$ (1,782)	\$ 6,997



Other expense (income), net - currency forward  
contracts