KENNAMETAL INC
Form 10-Q
May 09, 2012
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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 MARCH 31, 2012

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 organization)	(I.R.S. Employer Identification No.)
World Headquarters	
1600 Technology Way	
P.O. Box 231	
Latrobe, Pennsylvania	**15650-0231**
(Address of principal executive offices)	(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 [X] 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 [X] 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 [X]	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 [X]

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 April 30, 2012
Capital Stock, par value $1.25 per share	80,045,908

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KENNAMETAL INC.

FORM 10-Q

FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2012

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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 intend, plan, believe and other words of similar 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: economic recession; anticipated benefits resulting from our recently completed restructuring activities; 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; 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; and implementation of environmental remediation matters. 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.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KENNAMETAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	0000000000	0000000000	0000000000	0000000000
	Three Months Ended March 31,		Nine Months Ended March 31,	
(in thousands, except per share amounts)	2012	2011	2012	2011
Sales	$ 696,411	$ 614,830	$ 1,997,030	$ 1,709,756
Cost of goods sold	449,965	384,849	1,267,638	1,091,010
Gross profit	246,446	229,981	729,392	618,746
Operating expense	138,904	138,322	419,459	395,447
Restructuring charges (Note 8)	-	1,046	-	7,697
Amortization of intangibles	4,250	2,836	10,982	8,696
Operating income	103,292	87,777	298,951	206,906
Interest expense	8,003	5,767	18,746	17,294
Other (income) expense, net	(486)	1,413	(1,169)	3,071
Income before income taxes	95,775	80,597	281,374	186,541
Provision for income taxes	19,538	15,394	57,093	41,092
Net income	76,237	65,203	224,281	145,449
Less: Net income attributable to noncontrolling interests	738	520	3,099	2,376
Net income attributable to Kennametal	$ 75,499	$ 64,683	$ 221,182	$ 143,073
PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREOWNERS				
Basic earnings per share	$ 0.94	$ 0.79	$ 2.76	$ 1.74
Diluted earnings per share	$ 0.93	$ 0.77	$ 2.72	$ 1.72
Dividends per share	$ 0.14	$ 0.12	$ 0.40	$ 0.36
Basic weighted average shares outstanding	80,110	82,138	80,179	82,144
Diluted weighted average shares outstanding	81,535	83,495	81,434	83,164

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

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KENNAMETAL INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except per share data)	000000000000 March 31, 2012	000000000000 June 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 125,549	$ 204,565
Accounts receivable, less allowance for doubtful accounts of $18,709 and $20,958	481,821	447,835
Inventories (Note 11)	630,870	519,973
Deferred income taxes	57,380	60,257
Other current assets	51,823	54,955
Total current assets	1,347,443	1,287,585
Property, plant and equipment:		
Land and buildings	383,199	373,971
Machinery and equipment	1,408,431	1,396,306
Less accumulated depreciation	(1,051,971)	(1,073,215)
Property, plant and equipment, net	739,659	697,062
Other assets:		
Investments in affiliated companies	752	829
Goodwill (Note 18)	731,348	511,328
Other intangible assets, less accumulated amortization of $85,700 and $78,712 (Note 18)	254,924	152,279
Deferred income taxes	33,683	29,876
Other	90,765	75,510
Total other assets	1,111,472	769,822
Total assets	$ 3,198,574	$ 2,754,469
LIABILITIES		
Current liabilities:		
Current maturities of long-term debt and capital leases (Note 12)	$ 333,745	$ 307,304
Notes payable to banks	667	3,659
Accounts payable	223,656	222,678
Accrued income taxes	47,677	38,098
Accrued expenses	94,143	102,576
Other current liabilities (Note 8)	154,321	167,206
Total current liabilities	854,209	841,521
Long-term debt and capital leases, less current maturities (Note 12)	306,459	1,919
Deferred income taxes	124,573	83,310
Accrued pension and postretirement benefits	128,536	134,919
Accrued income taxes	3,093	3,094
Other liabilities	36,005	31,065
Total liabilities	1,452,875	1,095,828
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;				
80,027 and 81,129 shares issued		100,035		101,411
Additional paid-in capital		441,638		470,758
Retained earnings		1,172,222		983,374
Accumulated other comprehensive income		5,341		82,529
Total Kennametal Shareowners Equity		1,719,236		1,638,072
Noncontrolling interests		26,463		20,569
Total equity		1,745,699		1,658,641
Total liabilities and equity	$	3,198,574	$	2,754,469

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)

	0000000000	0000000000
Nine months ended March 31 (in thousands)	2012	2011
OPERATING ACTIVITIES		
Net income	$ 224,281	$ 145,449
Adjustments for non-cash items:		
Depreciation	63,163	60,165
Amortization	10,982	8,696
Stock-based compensation expense	17,108	15,727
Restructuring charges	-	2,609
Deferred income tax provision (benefit)	3,827	(2,878)
Other	(11,311)	4,637
Changes in certain assets and liabilities:		
Accounts receivable	(1,478)	(71,692)
Inventories	(85,276)	(74,706)
Accounts payable and accrued liabilities	(56,969)	37,250
Accrued income taxes	2,307	4,378
Other	(2,398)	(4,610)
Net cash flow provided by operating activities	164,236	125,025
INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(60,657)	(33,348)
Disposals of property, plant and equipment	4,397	8,063
Business acquisition, net of cash acquired (Note 5)	(382,562)	-
Purchase of technology license	(10,000)	-
Other	400	2,349
Net cash flow used for investing activities	(448,422)	(22,936)
FINANCING ACTIVITIES		
Net decrease in notes payable	(2,708)	(13,844)
Net increase in short-term revolving and other lines of credit	29,200	-
Term debt borrowings	980,926	365,082
Term debt repayments	(683,573)	(366,653)
Purchase of capital stock	(66,786)	(26,457)
Settlement of interest rate swap agreement (Note 7)	(22,406)	-
Dividend reinvestment and the effect of employee benefit and stock plans	23,072	15,081
Cash dividends paid to shareowners	(32,334)	(29,873)
Other	(8,909)	(1,045)
Net cash flow provided by (used for) financing activities	216,482	(57,709)
Effect of exchange rate changes on cash and cash equivalents	(11,312)	21,683
CASH AND CASH EQUIVALENTS		
Net (decrease) increase in cash and cash equivalents	(79,016)	66,063
Cash and cash equivalents, beginning of period	204,565	118,129
Cash and cash equivalents, end of period	$ 125,549	$ 184,192

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 (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, and oil and gas exploration and production industries. Our end users products include items ranging from airframes to coal mining, engines to oil wells and turbochargers to construction. 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 2011 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2011 was derived from the audited balance sheet included in our 2011 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 adjustments. The results for the nine months ended March 31, 2012 and 2011 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 2012 is to the fiscal year ending June 30, 2012. 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

Adopted

As of January 1, 2012, Kennametal adopted changes to fair value measurements and disclosure. Many of the amendments in this guidance represent clarifications to existing guidance or changes in the measurement guidance for determining fair value. The most significant change in disclosures is an expansion of the information required for Level 3 measurements. Disclosures will be required about the use of a nonfinancial asset measured or disclosed at fair value if its use differs from its highest and best use. In addition, entities must report the level in the fair value hierarchy of assets and liabilities not recorded at fair value but where fair value is disclosed. The adoption of this guidance did not have an impact on our condensed consolidated financial statements.

Issued

In December 2011, the Financial Accounting Standards Board (FASB) deferred the requirement to present reclassifications of other comprehensive income on the face of the income statement. Companies would still be required to adopt the other requirements contained in the accounting guidance on presentation of other comprehensive income. This guidance is effective for Kennametal beginning July 1, 2012.

In June 2011, the FASB issued guidance on presentation of comprehensive income. This guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. An entity can elect to present items of net income and other comprehensive income in one continuous statement or in two separate consecutive statements. Each component of net income and other comprehensive income, together with totals for comprehensive income and its two parts, net income and other comprehensive income, would need to be displayed under either alternative. This guidance is effective for Kennametal beginning July 1, 2012.

In September 2011, the FASB issued additional guidance on testing goodwill for impairment. The guidance permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This guidance is effective for Kennametal beginning July 1, 2012.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

4. SUPPLEMENTAL CASH FLOW DISCLOSURES

Nine months ended March 31 (in thousands)	0000000000 2012	0000000000 2011
Cash paid during the period for:		
Interest	$ 14,603	$ 14,684
Income taxes	44,715	40,741
Supplemental disclosure of non-cash information:		
Contribution of capital stock to employees defined contribution benefit plans	-	948

5. ACQUISITION

On March 1, 2012, the Company acquired all of the shares of Deloro Stellite Holdings 1 Limited (Stellite) pursuant to the terms of the Share Sale and Purchase Agreement dated January 13, 2012. The U.K.-based Stellite is a global manufacturer and provider of alloy-based critical wear solutions for extreme environments involving high temperature, corrosion and abrasion. Stellite employs approximately 1,300 people across seven primary operating facilities globally, including locations in the U.S., Canada, Germany, Italy, India and China. Stellite s proprietary metal alloys, materials expertise, engineering design and fabrication capabilities complement Kennametal s current business in the oil and gas, power generation, transportation and aerospace end markets. This acquisition is in alignment with Kennametal s growth strategy and positions us to further achieve geographic and end market balance.

Kennametal acquired Stellite for a purchase price of approximately $383 million; net of cash acquired, and funded the acquisition through existing credit facilities and operating cash flows. As part of the acquisition of Stellite, Kennametal incurred for both the three and nine months ended March 31, 2012, $5.7 million of acquisition related costs, which are included in operating expense.

Purchase Price Allocation

This acquisition was accounted for under the acquisition method of accounting and accordingly, the purchase price has been allocated to the assets acquired and liabilities assumed based on estimated fair values at the date of the acquisition. The Condensed Consolidated Balance Sheet as of March 31, 2012 reflects the preliminary allocation of the purchase price and is subject to revision when appraisals are finalized, which is expected to occur in the June quarter of 2012.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The preliminary allocation of the total purchase price to the fair values of the assets acquired and liabilities assumed is as follows:

(in thousands)		00000000000 Total
ASSETS		
Current assets:		
Accounts receivable	$	45,484
Inventories		49,618
Other current assets		4,007
Total current assets		99,109
Property and equipment		72,794
Goodwill		235,883
Other intangible assets		102,721
Deferred income taxes		2,478
Other		70
Total assets	$	513,055
LIABILITIES		
Current liabilities:		
Short term debt and current maturities of long-term debt	$	4,685
Accounts payable		43,534
Accrued income taxes		9,530
Other current liabilities		16,045
Total current liabilities		73,794
Long-term debt and capital leases		5,379
Deferred income taxes		46,109
Total liabilities		125,282
Noncontrolling interest		5,211
Net assets acquired	$	382,562

In connection with this acquisition, we identified and valued certain intangible assets, including existing customer relationships, technologies and trademarks, as further discussed in Note 18. The goodwill recorded of $235.9 million is not deductible for tax purposes and is attributable to the operating synergies we expect to gain from the acquisition. These intangible assets are part of the Infrastructure segment.

Stellite realized net sales of $22.5 million and a net loss of $4.7 million during the month ended March 31, 2012 to the Company, including $5.7 million of acquisition related pre-tax costs.

Unaudited Pro Forma Financial Information

The following unaudited pro forma summary of operating results presents the consolidated results of operations as if the Stellite acquisition had occurred on July 1, 2010. These amounts were calculated after the conversion to U.S. GAAP, applying our accounting policies and adjusting Stellite s results to reflect increased depreciation and amortization expense resulting from recording fixed assets and intangible assets at fair value and decreasing interest expense to reflect Kennametal s more favorable borrowing rate, together with the related tax effects. The pro forma results for the three months ended March 31, 2012 excluded $5.7 million of acquisition related pre-tax costs. The pro forma results for the three and nine months ended March 31, 2011 includes $2.0 million and $8.9 million, respectively, of acquisition related expenses. The pro forma results have been presented for comparative purposes only and are not indicative of future results of operations or what would have occurred had the acquisition been made on July 1, 2010.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Unaudited pro forma summary of operating results of the Company, assuming the acquisition had occurred as of July 1, 2010 are as follows:

(in thousands)	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011	Nine Months Ended March 31, 2012	Nine Months Ended March 31, 2011
Pro forma (unaudited):				
Net Sales	$ 733,518	$ 687,121	$ 2,170,532	$ 1,901,888
Net income attributable to Kennametal	$ 83,955	$ 68,819	$ 237,144	$ 145,028
Per share data attributable to Kennametal :				
Basic earnings per share	$ 1.05	$ 0.84	$ 2.96	$ 1.77
Diluted earnings per share	$ 1.03	$ 0.82	$ 2.91	$ 1.74

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 March 31, 2012, 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 (1)	$ -	$ 487	$ -	$ 487
Total assets at fair value	$ -	$ 487	$ -	$ 487
Liabilities:				
Derivatives (1)	$ -	$ 58	$ -	$ 58
Total liabilities at fair value	$ -	$ 58	$ -	$ 58

KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As of June 30, 2011, 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)	september300 Level 1	september300 Level 2	september300 Level 3	september300 Total
Assets:				
Derivatives [1]	$ -	$ 896	$ -	$ 896
Total assets at fair value	$ -	$ 896	$ -	$ 896
Liabilities:				
Derivatives [1]	$ -	$ 3,330	$ -	$ 3,330
Total liabilities at fair value	$ -	$ 3,330	$ -	$ 3,330

(1) 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.

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 use derivative financial instruments to provide predictability to the effects of changes in foreign currency 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)	september30 March 31, 2012	september30 June 30, 2011
Derivatives designated as hedging instruments		
Other current assets - range forward contracts	$ 435	$ 87
Other current liabilities - range forward contracts	(4)	(159)
Other assets - forward starting interest rate swap contracts	-	772
Other liabilities - forward starting interest rate swap contracts	-	(3,169)
Total derivatives designated as hedging instruments	431	(2,469)
Derivatives not designated as hedging instruments		

Other current assets - currency forward contracts	52	37
Other current liabilities - currency forward contracts	(54)	(2)
Total derivatives not designated as hedging instruments	(2)	35
Total derivatives	$ 429	$ (2,434)

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 balance sheet, with the offset to other (income) expense, net. (Gains) losses related to derivatives no