FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 1995

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

ROUTE 981 AT WESTMORELAND COUNTY AIRPORT
P.O. BOX 231
LATROBE, PENNSYLVANIA 15650
(Address of registrant's principal executive offices)

Registrant's telephone number, including area code: (412) 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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| TITLE OF EACH CLASS | OUTSTANDING AT JANUARY 31, 1996 |
|---|---|
| Capital Stock, par value $1.25 per share | 26,634,279 |

KENNAMETAL INC.
FORM 10-Q
FOR QUARTER ENDED DECEMBER 31, 1995

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
KENNAMETAL INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands)

| | December 31, 1995 | June 30, 1995 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and equivalents | $ 17,303 | $ 10,827 |
| Accounts receivable, less allowance for doubtful accounts of $13,016 and $12,106 | 162,857 | 175,405 |
| Inventories | 212,345 | 200,680 |
| Deferred income taxes | 22,262 | 22,362 |
| Total current assets | 414,767 | 409,274 |
| Property, Plant and Equipment: | | |
| Land and buildings | 151,271 | 151,905 |
| Machinery and equipment | 384,068 | 365,275 |
| Less accumulated depreciation | (271,620) | (256,838) |
| Net property, plant and equipment | 263,719 | 260,342 |
| Other Assets: | | |
| Investments in affiliated companies | 7,813 | 6,873 |
| Intangible assets, less accumulated amortization of $19,894 and $19,009 | 32,040 | 32,253 |
| Deferred income taxes | 45,668 | 56,629 |
| Other | 19,803 | 16,238 |
| Total other assets | 105,324 | 111,993 |
| Total assets | $783,810 | $781,609 |
| LIABILITIES | | |
| Current Liabilities: | | |
| Current maturities of term debt and capital leases | $ 16,137 | $ 17,475 |
| Notes payable to banks | 69,615 | 53,555 |
| Accounts payable | 52,082 | 60,211 |
| Accrued vacation pay | 17,810 | 18,424 |
| Other | 56,959 | 75,537 |
| Total current liabilities | 212,603 | 225,202 |
| Term Debt and Capital Leases, Less Current Maturities | 76,296 | 78,700 |
| Deferred Income Taxes | 21,301 | 20,998 |
| Other Liabilities | 51,055 | 51,615 |
| Total liabilities | 361,255 | 376,515 |
| Minority Interest in Consolidated Subsidiaries | 14,318 | 13,209 |
| SHAREHOLDERS' EQUITY | | |
| Shareholders' Equity: | | |
| Preferred stock, 5,000 shares authorized; none issued | - | - |
| Capital stock, $1.25 par value; 70,000 and 30,000 shares authorized; 29,370 shares issued | 36,712 | 36,712 |
| Additional paid-in capital | 86,517 | 85,768 |
| Retained earnings | 317,372 | 297,838 |
| Treasury shares, at cost; 2,735 and 2,793 shares held | (36,312) | (36,737) |
| Cumulative translation adjustments | 3,948 | 8,304 |
| Total shareholders' equity | 408,237 | 391,885 |
| Total liabilities and shareholders' equity | $783,810 | $781,609 |

See accompanying notes to condensed consolidated financial statements.

KENNAMETAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share data)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 1995 | 1994 | 1995 | 1994 |
| OPERATIONS: | | | | |
| Net sales | $259,174 | $230,335 | $514,077 | $449,173 |
| Cost of goods sold | 151,370 | 135,714 | 299,831 | 263,765 |
| Gross profit | 107,804 | 94,621 | 214,246 | 185,408 |
| Research and development expenses | 4,977 | 4,363 | 9,941 | 8,782 |
| Selling, marketing and distribution expenses | 60,632 | 52,336 | 120,007 | 103,104 |
| General and administrative expenses | 15,982 | 13,565 | 31,674 | 26,442 |
| Amortization of intangibles | 398 | 755 | 782 | 1,528 |
| Operating Income | 25,815 | 23,602 | 51,842 | 45,552 |
| Interest expense | 3,173 | 2,992 | 6,112 | 6,466 |
| Other income (expense) | 934 | (137) | 685 | (45) |
| Income before taxes | 23,576 | 20,473 | 46,415 | 39,041 |
| Provision for income taxes | 9,700 | 8,600 | 18,900 | 16,500 |
| Net income | $ 13,876 | $ 11,873 | $ 27,515 | $ 22,541 |
| PER SHARE DATA: | | | | |
| Earnings per share | $0.52 | $0.45 | $1.03 | $0.85 |
| Dividends per share | $0.15 | $0.15 | $0.30 | $0.30 |
| Weighted average shares outstanding | 26,629 | 26,487 | 26,612 | 26,433 |

See accompanying notes to condensed consolidated financial statements.

KENNAMETAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

| | Six Months Ended December 31, 1995 | 1994 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $27,515 | $22,541 |
| Adjustments for noncash items: | | |
| Depreciation and amortization | 19,940 | 19,683 |
| Other | 8,045 | 1,803 |
| Changes in certain assets and liabilities: | | |
| Accounts receivable | 10,109 | (2,243) |
| Inventories | (13,658) | (13,131) |
| Accounts payable and accrued liabilities | (16,152) | (24,783) |
| Other | (7,796) | 2,816 |
| Net cash flow from operating activities | 28,003 | 6,686 |
| INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (27,440) | (16,877) |
| Disposals of property, plant and equipment | 2,607 | 681 |
| Other | (3,134) | 100 |
| Net cash flow used for investing activities | (27,967) | (16,096) |
| FINANCING ACTIVITIES: | | |
| Increase in short-term debt | 16,306 | 8,259 |
| Increase in term debt | 2,191 | 3,190 |
| Reduction in term debt | (5,047) | (4,071) |
| Dividend reinvestment and employee stock plans | 1,174 | 2,969 |
| Cash dividends paid to shareholders | (7,981) | (7,924) |
| Net cash flow from financing activities | 6,643 | 2,423 |
| Effect of exchange rate changes on cash | (203) | 323 |
| CASH AND EQUIVALENTS: | | |
| Net increase (decrease) in cash and equivalents | 6,476 | (6,664) |
| Cash and equivalents, beginning | 10,827 | 17,190 |
| Cash and equivalents, ending | $17,303 | $10,526 |
| SUPPLEMENTAL DISCLOSURES: | | |
| Interest paid | $ 6,236 | $ 6,516 |
| Income taxes paid | 20,209 | 14,665 |

See accompanying notes to condensed consolidated financial statements.

KENNAMETAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. The condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's 1995 Annual Report. The condensed consolidated balance sheet as of June 30, 1995 has been derived from the audited balance sheet included in the Company's 1995 Annual Report. These interim statements are unaudited; however, management believes that all adjustments necessary for a fair presentation have been made and all adjustments are normal, recurring adjustments. The results for the six months ended December 31, 1995 are not necessarily indicative of the results to be expected for the full fiscal year.

2. Inventories are stated at lower of cost or market. Cost is determined using the last-in, first-out (LIFO) method for a significant portion of domestic inventories and the first-in, first-out (FIFO) method or average cost for other inventories. The Company used the LIFO method of valuing its inventories for approximately 55 percent of total inventories at December 31, 1995. Because inventory valuations under the LIFO method are based on an annual determination of quantities and costs as of June 30 of each year, the interim LIFO valuations are based on management's projections of expected year-end inventory levels and costs. Therefore, the interim financial results are subject to any final year-end LIFO inventory adjustments.

3. The major classes of inventory as of the balance sheet dates were as follows (in thousands):

| | December 31, 1995 | June 30, 1995 |
|---|---|---|
| Finished goods | $161,019 | $147,231 |
| Work in process and powder blends | 66,527 | 65,231 |
| Raw materials and supplies | 24,377 | 24,629 |
| Inventory at current cost | 251,923 | 237,091 |
| Less LIFO valuation | (39,578) | (36,411) |
| Total inventories | $212,345 | $200,680 |

4. The Company has been involved in various environmental cleanup and remediation activities at several of its manufacturing facilities. In addition, the Company has been named as a potentially responsible party at four Superfund sites in the United States. However, it is management's opinion, based on its evaluations and discussions with outside counsel and independent consultants, that the ultimate resolution of these environmental matters will not have a material adverse effect on the results of operations, financial position or cash flows of the Company.

The Company maintains a Corporate Environmental, Health and Safety (EH&S) Department to facilitate compliance with environmental regulations and to monitor and oversee remediation activities. In addition, the Company has established an EH&S administrator at each of its domestic manufacturing facilities. The Company's financial management team periodically meets with members of the Corporate EH&S Department and the Corporate Legal Department to review and evaluate the status of environmental projects and contingencies. On a quarterly and annual basis, management establishes or adjusts financial provisions and reserves for environmental contingencies in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Contingencies."

5. Prior to its acquisition by the Company, a non-U.S. subsidiary recorded sales of approximately $60 million in calendar 1993 under contracts with a certain customer to provide various equipment, know-how and training for a manufacturing facility. Upon the acquisition by the Company, the subsidiary decided to complete performance under the contracts with this customer but to not enter into any such contracts in the future.

Pursuant to a United States embargo effective June 6, 1995, the subsidiary suspended performance under the contracts pending issuance by the U.S. government of definitive embargo regulations. Other than finalizing the transfer of know-how and training to commence production, performance was substantially completed prior to the suspension. The estimated costs to complete performance are not material and were accrued in the consolidated financial statements. The customer disputed the suspension and advised that it might file suit to require completion of performance as well as for compensation for alleged damages. However, the subsidiary reinstituted performance following the issuance of definitive embargo regulations in September of 1995.

Management believes that the ultimate resolution of this matter will not have a material adverse impact on the financial position of the Company.

6. On January 29, 1996, the Company's Board of Directors approved a plan to build a manufacturing facility in Shanghai, China at a cost of approximately $20 million. The Company will own 100 percent of the plant, which will manufacture tools made of cemented carbides and other hard materials for metalcutting applications. Construction is expected to begin during fiscal 1996, with manufacturing planned to begin in January 1998. The Board of Directors also approved a capital expenditure to begin a pilot project to manufacture solid carbide drills in Pennsylvania.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

There were no material changes in financial position, liquidity or capital resources between June 30, 1995 and December 31, 1995. The ratio of current assets to current liabilities was 2.0 as of December 31, 1995 and 1.8 as of June 30, 1995. The debt to capital ratio (i.e., total debt divided by the sum of total debt and shareholders' equity) was 28 percent as of December 31, 1995, unchanged from June 30, 1995.

Capital expenditures are estimated to be $60-70 million in fiscal year 1996. Expenditures are being made to modernize facilities, upgrade machinery and equipment, and acquire new information technology. Capital expenditures are being financed with cash from operations and borrowings under existing revolving credit agreements with banks.

### RESULTS OF OPERATIONS

SALES AND EARNINGS

During the quarter ended December 31, 1995, consolidated sales were $259 million, up 13 percent from $230 million in the same quarter last year. Net income was $13.9 million, or $0.52 per share, as compared with net income of $11.9 million, or $0.45 per share in the same quarter last year.

During the six month period ended December 31, 1995, consolidated sales were $514 million, up 14 percent from $449 million last year. Net income was $27.5 million, or $1.03 per share, compared to $22.5 million, or $0.85 per share last year.

For the quarter and six months ended December 31, 1995, earnings increased primarily because of higher sales volume in North America and Europe, and the continued expansion of catalog sales. Earnings were also impacted by higher manufacturing costs and operating expenses related to implementation of new information technology.

The following table presents the Company's sales by product class and geographic area (in thousands):

| | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|---|---|---|---|---|---|---|
| | 1995 | 1994 | % Change | 1995 | 1994 | % Change |
| By Product Class: | | | | | | |
| Metalworking | $225,092 | $197,637 | 13.9% | $442,039 | $381,218 | 16.0% |
| Mining and construction | 26,189 | 25,407 | 3.1 | 56,429 | 53,774 | 4.9 |
| Metallurgical | 7,893 | 7,291 | 8.3 | 15,609 | 14,181 | 10.1 |
| Net sales | $259,174 | $230,335 | 12.5% | $514,077 | $449,173 | 14.4% |
| By Geographic Area: | | | | | | |
| Within the United States | $157,420 | $141,330 | 11.4% | $312,360 | $281,899 | 10.8% |
| International | 101,754 | 89,005 | 14.3 | 201,717 | 167,274 | 20.6 |
| Net sales | $259,174 | $230,335 | 12.5% | $514,077 | $449,173 | 14.4% |

METALWORKING PRODUCTS

During the December 1995 quarter, worldwide sales of metalworking products increased 14 percent from last year.

In the United States, direct sales of metalcutting inserts and toolholding devices increased 4 percent. Total sales of industrial supply products increased 28 percent as a result of increased sales through mail order catalogs and full service supply programs.

International sales of metalworking products increased 17 percent from the previous year primarily because of higher sales volume in Europe, the impact of favorable foreign currency translation effects, and newly-consolidated subsidiaries in Japan and China. Excluding the currency translation effect, international metalworking sales increased an estimated 12 percent.

For the six month period, worldwide sales of metalworking products increased 16 percent from the prior year because of increased sales of metalworking products in the United States and Europe, modest price increases, newly-consolidated subsidiaries in Japan and China, and favorable foreign currency translation effects. Excluding foreign currency translation effects, international sales of metalworking products increased 15 percent from last year.

MINING AND CONSTRUCTION PRODUCTS

During the December 1995 quarter, sales of mining and construction tools increased 3 percent from the previous year primarily because of additional domestic demand for mining and construction tools. International sales of highway construction and mining tools increased slightly because of increased demand in the United Kingdom and as a result of the start-up of a joint venture in China.

For the six month period, sales of mining and construction tools increased 5 percent from the prior year primarily because of increased domestic demand for highway construction and mining tools and the start-up of a joint venture in China.

METALLURGICAL PRODUCTS

During the December 1995 quarter, sales of metallurgical products increased 8 percent from the previous year primarily because of increased international demand for carbide powders.

For the six month period, sales of metallurgical products rose 10 percent primarily because of increased international demand for carbide powders.

GROSS PROFIT

As a percentage of sales, gross profit for the December 1995 quarter was 41.6 percent as compared with 41.1 percent in the prior year. The gross profit benefited from higher sales volumes, modest price increases and favorable currency effects of international sales of products manufactured in the United States. These benefits were offset by higher raw material costs, costs associated with the implementation of focused factories, and reduced manufacturing efficiencies due to lower production volumes.

For the six month period, the gross profit was 41.7 percent, up from 41.3 percent last year. The gross profit was favorable affected by higher sales volumes, modest price increases, and favorable foreign currency effects. However, these benefits were partially offset by higher raw material costs, costs associated with the implementation of focused factories, and reduced manufacturing efficiencies due to lower production volumes.

OPERATING EXPENSES

For the quarter ended December 31, 1995, operating expenses as a percentage of sales were 31.5 percent compared to 30.5 percent last year. Operating expenses increased 16 percent primarily because of costs related to implementation of new client server information systems, costs necessary to support the higher sales levels, increased spending on research and development, marketing, and catalog branch openings.

For the six month period, operating expenses as a percentage of sales were 31.4 percent compared to 30.8 percent last year. Operating expenses increased primarily because of costs related to implementation of new client server information systems, costs necessary to support the higher sales levels, increased research and development, marketing and catalog branch openings.

INCOME TAXES

The effective tax rate for the December 1995 quarter was 41.1 percent compared to an effective tax rate of 42.0 percent in the prior year.

For the six month period, the effective tax rate was 40.7 percent compared to 42.3 percent in the prior year. The decrease in the effective tax rate for the six month period is the result of lower estimated non-U.S. taxes and additional benefits derived from the utilization of the foreign sales corporation.

OUTLOOK

In looking to the third quarter ending March 31, 1996, management expects consolidated sales to increase from the $268 million achieved in the same quarter last year. Sales of metalworking products in the United States should continue to benefit from full service supply programs and catalog sales as a result of additional branch openings. International sales are expected to increase due to additional demand and as the Asia-Pacific economy continues to expand. Sales of mining and construction tools should continue to increase from international demand for highway construction and mining tools and emerging opportunities in China and Russia.

The foregoing are "forward-looking statements" as defined in Section 21E of the Securities Exchange Act of 1934. Actual results can differ from those in the forward-looking statements to the extent that the economic conditions in the United States and Europe are not sustained.

# PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 4 to the condensed consolidated financial statements, contained in Part I, Item 1 of this Form 10-Q, is incorporated by reference herein and supplements the information previously reported in Part I, Item 3 of the Company's Form 10-K for the year ended June 30, 1995, which is also incorporated by reference herein.

It is management's opinion, based on its evaluation and discussions with outside counsel, that the Company has viable defenses to these cases and that, in any event, the ultimate resolutions of these matters will not have a materially adverse effect on the results of operations, financial position or cash flows of the Company.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The information set forth in Part II, Item 4 of the Company's September 30, 1995 Form 10-Q is incorporated by reference herein.

## ITEM 5. OTHER INFORMATION

On January 29, 1996, the Company issued a press release announcing that it received approval to make capital investments in China and Pennsylvania.

The Company's Board of Directors approved a plan to build a manufacturing facility in Shanghai, China at a cost of approximately $20 million. The Company will own 100 percent of the plant, which will manufacture tools made of cemented carbides and other hard materials for metalcutting applications. Construction is expected to begin during fiscal 1996, with manufacturing planned to begin in January 1998.

The Board of Directors also approved a capital expenditure to begin a pilot project to manufacture solid carbide drills in Pennsylvania.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

| (a) Exhibits | REFERENCE |
|---|---|
| (27) Financial Data Schedule for six months ended December 31, 1995 | Filed herewith |
| (99) Additional Exhibits Press Release Dated January 29, 1996 | Filed herewith |

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 1995.

# SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KENNAMETAL INC.

Date: February 12, 1996     By:  /s/ RICHARD J. ORWIG

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Richard J. Orwig<br>
Vice President<br>
Chief Financial and Administrative Officer

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This schedule contains summary financial information extracted from the December 31, 1995 Condensed Consolidated Financial Statements (unaudited) and is qualified in its entirety by reference to such financial statements.

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JUN-30-1996
JUL-01-1995
DEC-31-1995
17,303
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175,873
13,016
212,345
414,767
535,339
271,620
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18,900
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27,515
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1.03

KENNAMETAL INC.
Corporate Public Relations
Latrobe, PA 15650
412-539-4618

CONTACT: Charles T. Glazer

FOR IMMEDIATE RELEASE

# KENNAMETAL DECLARES QUARTERLY DIVIDEND

## Board Also Approves Capital Investments in China and Pennsylvania

Latrobe, Pa. -- January 29, 1996 -- The Board of Directors of Kennametal Inc. (NYSE: KMT) today declared a quarterly cash dividend of 15 cents per share payable February 23, 1996 to shareholders of record as of February 9, 1996. This action continues the dividend at the rate paid in the preceding five quarters.

The Board also approved a plan to build a manufacturing facility in Shanghai, China at a cost of approximately $20 million. Kennametal will own 100 percent of the plant, which will manufacture tools made of cemented carbides and other hard materials for metalcutting applications.

"There are tremendous growth opportunities for Kennametal in China and throughout the Asia/Pacific region," said Robert L. McGeehan, president and chief executive officer. "Although we already have several sales offices in China and two successful joint ventures in mining tools, by building this plant in Shanghai, we will increase our presence significantly in one of the world's fastest-growing markets."

Kennametal is in negotiations with building contractors and will begin construction of the facility in the spring. The project will proceed in three phases, with the first phase being a 40,000 square-foot facility to house manufacturing, sales, engineering, administration, training and warehousing. Phase One is scheduled to be completed and manufacturing is scheduled to begin by January 1998.

"Our market research strongly supports this move," said H. Patrick Mahanes, vice president and chief operating officer. "The opportunities for making and selling our products in China should contribute long term to our sustained, worldwide growth."

Mahanes added that talks have gone well with Chinese authorities and that Kennametal's plans have been well received in Shanghai.

Kennametal's Board also approved a capital expenditure to begin a pilot project at its Chestnut Ridge plant, located just outside Latrobe, Pennsylvania. This project to manufacture solid carbide drills will utilize Kennametal technology combined with technology it gained in its acquisition of Hertel, a former competitor headquartered in Fuerth, Germany.

"This is another example of the strength of our acquisition of Hertel," said McGeehan. "This project unites two great, leading-edge technologies."

Mahanes added, "This investment will allow us to participate in the growing carbide drill market worldwide. Because this is a pilot project, we cannot discuss at this time what the impact will be on our production numbers or if any new jobs will result. We will announce further plans in the future after we evaluate the project's start-up."

The Chestnut Ridge project is scheduled to begin immediately.

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