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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, 2017**

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.)

**600 Grant Street**

**Suite 5100**

**Pittsburgh, Pennsylvania**

(Address of principal executive offices)

**15219-2706**

(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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 28, 2017 |
|---|-------------------------------|
| Capital Stock, par value \$1.25 per share | 80,554,198                    |

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**KENNAMETAL INC.**  
**FORM 10-Q**  
**FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2017**

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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,” “believe” 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 and security 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.

## 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 March 31, |            | Nine Months Ended March 31, |              |
|---|------------------------------|------------|-----------------------------|--------------|
|   | 2017                         | 2016       | 2017                        | 2016         |
| Sales   | \$ 528,630                   | \$ 497,837 | \$ 1,493,343                | \$ 1,577,212 |
| Cost of goods sold  | 342,365                      | 340,484    | 1,015,926                   | 1,127,828    |
| Gross profit  | 186,265                      | 157,353    | 477,417                     | 449,384      |
| Operating expense   | 116,939                      | 121,004    | 347,808                     | 373,827      |
| Restructuring and asset impairment charges (Notes 8 and 18) | 7,169                        | 7,142      | 44,230                      | 128,498      |
| Loss on divestiture (Note 5)                                | —                            | (2,557)    | —                           | 130,750      |
| Amortization of intangibles                                 | 4,245                        | 4,429      | 12,665                      | 16,315       |
| Operating income (loss)                                     | 57,912                       | 27,335     | 72,714                      | (200,006)    |
| Interest expense  | 7,331                        | 7,113      | 21,475                      | 20,895       |
| Other expense (income), net                                 | 1,626                        | (1,938)    | 2,470                       | (1,582)      |
| Income (loss) before income taxes                           | 48,955                       | 22,160     | 48,769                      | (219,319)    |
| Provision (benefit) for income taxes                        | 9,301                        | 5,465      | 22,401                      | (61,499)     |
| Net income (loss)   | 39,654                       | 16,695     | 26,368                      | (157,820)    |
| Less: Net income attributable to noncontrolling interests   | 764                          | 695        | 1,873                       | 1,634        |
| Net income (loss) attributable to Kennametal                | \$ 38,890                    | \$ 16,000  | \$ 24,495                   | \$ (159,454) |
| PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREHOLDERS      |                              |            |                             |              |
| Basic earnings (loss) per share                             | \$ 0.48                      | \$ 0.20    | \$ 0.31                     | \$ (2.00)    |
| Diluted earnings (loss) per share                           | \$ 0.48                      | \$ 0.20    | \$ 0.30                     | \$ (2.00)    |
| Dividends per share   | \$ 0.20                      | \$ 0.20    | \$ 0.60                     | \$ 0.60      |
| Basic weighted average shares outstanding                   | 80,398                       | 79,871     | 80,219                      | 79,814       |
| Diluted weighted average shares outstanding                 | 81,381                       | 80,224     | 80,965                      | 79,814       |

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

[Table of Contents](#)**KENNAMETAL INC.  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

| (in thousands)   | Three Months Ended March 31, |           | Nine Months Ended March 31, |              |
|--|------------------------------|-----------|-----------------------------|--------------|
|  | 2017                         | 2016      | 2017                        | 2016         |
| Net income (loss)  | \$ 39,654                    | \$ 16,695 | \$ 26,368                   | \$ (157,820) |
| Other comprehensive income (loss), net of tax  |                              |           |                             |              |
| Unrealized (loss) gain on derivatives designated and qualified as cash flow hedges                             | (866)                        | (637)     | 614                         | 165          |
| Reclassification of unrealized loss (gain) on expired derivatives designated and qualified as cash flow hedges | 389                          | 238       | 1,158                       | (1,946)      |
| Unrecognized net pension and other postretirement benefit (loss) gain  | (725)                        | (888)     | 3,376                       | 1,561        |
| Reclassification of net pension and other postretirement benefit loss  | 1,804                        | 1,219     | 5,434                       | 3,641        |
| Foreign currency translation adjustments   | 13,785                       | 17,783    | (26,480)                    | (24,705)     |
| Reclassification of foreign currency translation adjustment (gain) loss realized upon sale                     | —                            | (1,940)   | —                           | 15,088       |
| Total other comprehensive income (loss), net of tax  | 14,387                       | 15,775    | (15,898)                    | (6,196)      |
| Total comprehensive income (loss)  | 54,041                       | 32,470    | 10,470                      | (164,016)    |
| Less: comprehensive income attributable to noncontrolling interests  | 1,734                        | 1,222     | 2,203                       | 1,094        |
| Comprehensive income (loss) attributable to Kennametal Shareholders  | \$ 52,307                    | \$ 31,248 | \$ 8,267                    | \$ (165,110) |

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)   | March 31,<br>2017 | June 30,<br>2016 |
|---|-------------------|------------------|
| <b>ASSETS</b>   |                   |                  |
| Current assets:   |                   |                  |
| Cash and cash equivalents   | \$ 100,817        | \$ 161,579       |
| Accounts receivable, less allowance for doubtful accounts of \$12,562 and \$12,724, respectively          | 376,956           | 370,916          |
| Inventories (Note 11)   | 490,212           | 458,830          |
| Deferred income taxes (Note 3)  | —                 | 26,713           |
| Other current assets  | 75,061            | 57,303           |
| Total current assets  | 1,043,046         | 1,075,341        |
| Property, plant and equipment:  |                   |                  |
| Land and buildings  | 351,909           | 353,789          |
| Machinery and equipment   | 1,541,177         | 1,511,462        |
| Less accumulated depreciation   | (1,164,311)       | (1,134,611)      |
| Property, plant and equipment, net  | 728,775           | 730,640          |
| Other assets:   |                   |                  |
| Goodwill (Note 18)  | 294,315           | 298,487          |
| Other intangible assets, less accumulated amortization of \$124,163 and \$114,093, respectively (Note 18) | 193,069           | 207,208          |
| Deferred income taxes (Note 3)  | 34,481            | 14,459           |
| Other   | 41,053            | 36,648           |
| Total other assets  | 562,918           | 556,802          |
| Total assets  | \$ 2,334,739      | \$ 2,362,783     |
| <b>LIABILITIES</b>  |                   |                  |
| Current liabilities:  |                   |                  |
| Current maturities of long-term debt and capital leases   | \$ 253            | \$ 732           |
| Notes payable to banks  | 1,338             | 1,163            |
| Accounts payable  | 190,841           | 182,039          |
| Accrued income taxes  | 17,732            | 16,602           |
| Accrued expenses  | 76,026            | 74,470           |
| Other current liabilities   | 140,609           | 152,269          |
| Total current liabilities   | 426,799           | 427,275          |
| Long-term debt and capital leases, less current maturities (Notes 3 and 12)                               | 694,631           | 693,548          |
| Deferred income taxes (Note 3)  | 13,690            | 17,126           |
| Accrued pension and postretirement benefits   | 190,434           | 201,473          |
| Accrued income taxes  | 2,837             | 3,100            |
| Other liabilities   | 26,777            | 24,460           |
| Total liabilities   | 1,355,168         | 1,366,982        |
| <b>EQUITY (Note 16)</b>   |                   |                  |
| Kennametal Shareholders' Equity:  |                   |                  |
| Preferred stock, no par value; 5,000 shares authorized; none issued                                       | —                 | —                |
| Capital stock, \$1.25 par value; 120,000 shares authorized; 80,252 and 79,694 shares issued, respectively | 100,315           | 99,618           |
| Additional paid-in capital  | 457,305           | 436,617          |
| Retained earnings   | 757,079           | 780,597          |
| Accumulated other comprehensive loss  | (368,737)         | (352,509)        |
| Total Kennametal Shareholders' Equity   | 945,962           | 964,323          |
| Noncontrolling interests  | 33,609            | 31,478           |
| Total equity  | 979,571           | 995,801          |
| Total liabilities and equity  | \$ 2,334,739      | \$ 2,362,783     |

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)**

| (in thousands)   | Nine Months Ended March 31, |              |
|--|-----------------------------|--------------|
|  | 2017                        | 2016         |
| <b>OPERATING ACTIVITIES</b>  |                             |              |
| Net income (loss)  | \$ 26,368                   | \$ (157,820) |
| Adjustments for non-cash items:  |                             |              |
| Depreciation   | 68,369                      | 73,297       |
| Amortization   | 12,665                      | 16,315       |
| Stock-based compensation expense   | 17,285                      | 14,705       |
| Restructuring and asset impairment charges (Note 8 and 18)               | 1,224                       | 111,922      |
| Deferred income tax provision  | 1,300                       | (85,426)     |
| Loss on divestiture (Note 5)   | —                           | 130,750      |
| Other  | (2,711)                     | 239          |
| Changes in certain assets and liabilities:                               |                             |              |
| Accounts receivable  | (12,736)                    | 44,125       |
| Inventories  | (38,110)                    | 47,778       |
| Accounts payable and accrued liabilities                                 | 25,789                      | (16,244)     |
| Accrued income taxes   | 1,087                       | (12,989)     |
| Accrued pension and postretirement benefits                              | (18,799)                    | (22,901)     |
| Other  | (1,710)                     | 1,663        |
| Net cash flow provided by operating activities                           | 80,021                      | 145,414      |
| <b>INVESTING ACTIVITIES</b>  |                             |              |
| Purchases of property, plant and equipment                               | (94,095)                    | (83,285)     |
| Disposals of property, plant and equipment                               | 3,852                       | 5,102        |
| Proceeds from divestiture (Note 5)                                       | —                           | 61,100       |
| Other  | 111                         | 835          |
| Net cash flow used for investing activities                              | (90,132)                    | (16,248)     |
| <b>FINANCING ACTIVITIES</b>  |                             |              |
| Net increase (decrease) in notes payable                                 | 333                         | (4,088)      |
| Term debt borrowings   | 25,298                      | 50,070       |
| Term debt repayments   | (25,830)                    | (94,337)     |
| Purchase of capital stock  | (188)                       | (231)        |
| Dividend reinvestment and the effect of employee benefit and stock plans | 7,057                       | 1,713        |
| Cash dividends paid to Shareholders                                      | (48,013)                    | (47,780)     |
| Other  | (6,439)                     | (55)         |
| Net cash flow used for financing activities                              | (47,782)                    | (94,708)     |
| Effect of exchange rate changes on cash and cash equivalents             | (2,869)                     | (3,388)      |
| <b>CASH AND CASH EQUIVALENTS</b>   |                             |              |
| Net (decrease) increase in cash and cash equivalents                     | (60,762)                    | 31,070       |
| Cash and cash equivalents, beginning of period                           | 161,579                     | 105,494      |
| Cash and cash equivalents, end of period                                 | \$ 100,817                  | \$ 136,564   |

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

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#### 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.

In order to take advantage of the growth opportunities of our WIDIA brand, we implemented a new operating structure at the beginning of fiscal 2017. A key attribute of the new structure is the establishment of the Widia operating segment. In order to better leverage the opportunities in this business, in addition to being more agile and competitive in the marketplace, we are placing higher levels of focus, determination and leadership in this business. The Industrial and Widia segments in 2017 were formed from the 2016 Industrial segment. We now have three global reportable operating segments: Industrial, Widia, 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 2016 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2016 was derived from the audited balance sheet included in our 2016 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 nine months ended March 31, 2017 and 2016 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 2017 is to the fiscal year ending June 30, 2017. 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 January 2017, the FASB issued guidance to simplify the test for goodwill impairment by removing step two of the test. Step two measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. The new guidance requires an entity to perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, including goodwill. This standard is effective for Kennametal beginning July 1, 2020; however, early adoption is permitted for goodwill impairment tests performed on testing dates after January 1, 2017. The Company has chosen to early adopt this guidance and does not expect the adoption of the guidance to have a material impact on our condensed consolidated financial position, results of operations and cash flows.

In November 2015, the Financial Accounting Standards Board (FASB) issued guidance on balance sheet classification of deferred taxes. The amendments in this guidance require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position, in comparison to the previous practice of separating deferred income tax liabilities and assets into current and noncurrent amounts on the balance sheet. We adopted this guidance July 1, 2016 on a prospective basis. Therefore, prior period balance sheets were not retrospectively adjusted. Current deferred tax assets of \$26.7 million and current deferred tax liabilities of \$0.6 million are reported in the June 30, 2016 balance sheet.

In April 2015, the FASB issued guidance on the presentation of debt issuance costs. The guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance was effective for Kennametal beginning July 1, 2016 and was retrospectively applied to all periods presented. Debt issuance costs of \$5.0 million and \$6.0 million are reported as direct reductions of the carrying amounts of debt liabilities in the balance sheet as of March 31, 2017 and June 30, 2016, respectively.



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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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In April 2015, the FASB issued guidance on accounting for fees paid in a cloud computing arrangement. The amendments in this update provide guidance to customers about treatment of costs as either capitalized and amortized as an intangible asset or expensed as incurred as a service contract. The amendments provide clarification that costs in arrangements that include software license should be capitalized and amortized, and costs in arrangements that do not include a software license should be expensed as incurred. This standard was effective for Kennametal beginning July 1, 2016 and was applied prospectively. The adoption of this guidance did not have a material impact on our condensed consolidated financial position, results of operations and cash flows.

*Issued*

In March 2017, the FASB issued guidance on the presentation of net periodic pension cost and net periodic postretirement benefit cost. The guidance requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. This guidance is effective for Kennametal beginning July 1, 2018. We are in the process of assessing the impact the adoption of this guidance will have on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers: Topic 606." This ASU replaces nearly all existing U.S. GAAP guidance on revenue recognition. The standard prescribes a five-step model for recognizing revenue, the application of which will require significant judgment. It also requires additional disclosures. We will adopt this standard on July 1, 2018. We have commenced our assessment of the new standard and developed a project plan to guide the implementation. Currently, we are analyzing the standard's impact on our customer arrangements and evaluating the new standard against our historical accounting policies and practices, including the timing of revenue recognition. We have not yet determined the impact of adoption on our condensed consolidated financial statements.

4. SUPPLEMENTAL CASH FLOW DISCLOSURES

| (in thousands)  | Nine Months Ended March 31, |           |
|---|-----------------------------|-----------|
|   | 2017                        | 2016      |
| <b>Cash paid during the period for:</b>   |                             |           |
| Interest  | \$ 20,725                   | \$ 20,056 |
| Income taxes  | 20,013                      | 38,429    |
| <b>Supplemental disclosure of non-cash information:</b>                           |                             |           |
| Changes in accounts payable related to purchases of property, plant and equipment | 15,404                      | 16,400    |

5. DIVESTITURE

During the nine months ended March 31, 2016, Kennametal completed the sale 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, net. A portion of the transaction proceeds were used to pay down revolver debt and the remaining balance was held as cash on hand.

The net book value of these non-core businesses was \$191.9 million, which included a refinement to estimated working capital adjustment. 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 estimated working capital adjustments, deal costs and transaction costs. We recorded a pre-tax net gain on divestiture during the three months ended March 31, 2016 of approximately \$2.6 million, which consisted primarily of the write-off of the currency translation adjustments of a legal entity liquidated in the March quarter, partially offset by a refinement to our estimated working capital adjustment. The pre-tax net loss on divestiture during the nine months ended March 31, 2016 was \$130.8 million, of which \$127.2 million and \$3.6 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.

[Table of Contents](#)**KENNAMETAL INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)****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, 2017, the fair values of the Company's financial assets and financial liabilities are categorized as follows:

| (in thousands)                         | Level 1     | Level 2         | Level 3     | Total           |
|--|-------------|-----------------|-------------|-----------------|
| <b>Assets:</b>                         |             |                 |             |                 |
| Derivatives <sup>(1)</sup>             | \$ —        | \$ 1,421        | \$ —        | \$ 1,421        |
| <b>Total assets at fair value</b>      | <b>\$ —</b> | <b>\$ 1,421</b> | <b>\$ —</b> | <b>\$ 1,421</b> |
| <b>Liabilities:</b>                    |             |                 |             |                 |
| Derivatives <sup>(1)</sup>             | \$ —        | \$ 1,352        | \$ —        | \$ 1,352        |
| <b>Total liabilities at fair value</b> | <b>\$ —</b> | <b>\$ 1,352</b> | <b>\$ —</b> | <b>\$ 1,352</b> |

As of June 30, 2016, the fair values of the Company's financial assets and financial liabilities are categorized as follows:

| (in thousands)                         | Level 1     | Level 2       | Level 3         | Total           |
|--|-------------|---------------|-----------------|-----------------|
| <b>Assets:</b>                         |             |               |                 |                 |
| Derivatives <sup>(1)</sup>             | \$ —        | \$ 334        | \$ —            | \$ 334          |
| <b>Total assets at fair value</b>      | <b>\$ —</b> | <b>\$ 334</b> | <b>\$ —</b>     | <b>\$ 334</b>   |
| <b>Liabilities:</b>                    |             |               |                 |                 |
| Derivatives <sup>(1)</sup>             | \$ —        | \$ 763        | \$ —            | \$ 763          |
| Contingent consideration               | —           | —             | 6,600           | 6,600           |
| <b>Total liabilities at fair value</b> | <b>\$ —</b> | <b>\$ 763</b> | <b>\$ 6,600</b> | <b>\$ 7,363</b> |

<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 at June 30, 2016 related to our probability assessments of expected future milestone targets, primarily associated with product delivery, related to a previous acquisition. During the the nine months ended March 31, 2017, the Company paid the remaining \$6.6 million in conjunction with achieved milestone targets. The payment is recorded in the financing activities section of our condensed consolidated statement of cash flow for the nine months ended March 31, 2017 under the caption "other." The contingent consideration was recorded in other current liabilities in our condensed consolidated balance sheet at June 30, 2016. No other changes in the expected outcome have occurred during the nine months ended March 31, 2017.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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 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)   | March 31,<br>2017 | June 30,<br>2016 |
|--|-------------------|------------------|
| <b>Derivatives designated as hedging instruments</b>           |                   |                  |
| Other current assets - range forward contracts                 | \$ 901            | \$ 323           |
| Other assets - range forward contracts                         | 40                | —                |
| <b>Total derivatives designated as hedging instruments</b>     | <b>941</b>        | <b>323</b>       |
| <b>Derivatives not designated as hedging instruments</b>       |                   |                  |
| Other current assets - currency forward contracts              | 480               | 11               |
| Other current liabilities - currency forward contracts         | (1,352)           | (763)            |
| <b>Total derivatives not designated as hedging instruments</b> | <b>(872)</b>      | <b>(752)</b>     |
| <b>Total derivatives</b>                                       | <b>\$ 69</b>      | <b>\$ (429)</b>  |

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 expense (income), net.

Gains related to derivatives not designated as hedging instruments have been recognized as follows:

| (in thousands)   | Three Months Ended March 31, |          | Nine Months Ended March 31, |          |
|--|------------------------------|----------|-----------------------------|----------|
|  | 2017                         | 2016     | 2017                        | 2016     |
| Other expense (income), net - currency forward contracts | \$ 538                       | \$ (182) | \$ 161                      | \$ (116) |

**CASH FLOW HEDGES**

Range forward contracts (a transaction where both a put option is purchased and a call option is sold) are designated as cash flow hedges and hedge anticipated cash flows from cross-border intercompany sales of products and services. Gains and losses realized on these contracts at maturity are recorded in accumulated other comprehensive loss and are recognized as a component of other expense, net when the underlying sale of products or services is recognized into earnings. The notional amount of the contracts translated into U.S. dollars at March 31, 2017 and June 30, 2016, was \$66.2 million and \$53.3 million, respectively. The time value component of the fair value of range forward contracts is excluded from the assessment of hedge effectiveness. Assuming the market rates remain constant with the rates at March 31, 2017, we expect to recognize into earnings in the next 12 months \$0.6 million of income on outstanding derivatives.

The following represents gains and losses related to cash flow hedges:

| (in thousands)   | Three Months Ended March 31, |          | Nine Months Ended March 31, |          |
|--|------------------------------|----------|-----------------------------|----------|
|  | 2017                         | 2016     | 2017                        | 2016     |
| (Losses) gains recognized in other comprehensive loss, net                                     | \$ (866)                     | \$ (914) | \$ 615                      | \$ (637) |
| Losses reclassified from accumulated other comprehensive loss into other expense (income), net | \$ 390                       | \$ 629   | \$ 1,158                    | \$ 293   |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

No portion of the gains or losses recognized in earnings was due to ineffectiveness and no amounts were excluded from our effectiveness testing for the nine months ended March 31, 2017 and 2016.

**NET INVESTMENT HEDGES**

During the three months ended March 31, 2017, we designated certain foreign currency-denominated intercompany loans payable with total aggregate principal amounts of €63.0 million as net investment hedges to hedge the foreign exchange exposure of our net investment in Euro-based subsidiaries. The remeasurements of these non-derivatives designated as net investment hedges are calculated each period with changes reported in foreign currency translation adjustment within accumulated other comprehensive loss. Such amounts will remain in accumulated other comprehensive loss unless we complete or substantially complete liquidation or disposal of our investment in the underlying foreign operations. A loss of \$0.5 million was recorded as a component of foreign currency translation adjustments in other comprehensive income (loss) for the three and nine months ended March 31, 2017. We did not have net investment hedges during the three and nine months ended March 31, 2016.

As of March 31, 2017, the foreign currency-denominated intercompany loans payable designated as net investment hedges consisted of:

| Instrument   | Notional (EUR in thousands) <sup>(2)</sup> | Notional (USD in thousands) <sup>(2)</sup> | Maturity          |
|--|--|--|-------------------|
| Foreign currency-denominated intercompany loan payable | € 30,046                                   | \$ 32,083                                  | June 30, 2017     |
| Foreign currency-denominated intercompany loan payable | 26,327                                     | 28,112                                     | June 26, 2022     |
| Foreign currency-denominated intercompany loan payable | 8,612                                      | 9,196                                      | November 20, 2018 |
| Foreign currency-denominated intercompany loan payable | 2,032                                      | 2,169                                      | October 11, 2017  |

(2) Includes principal and accrued interest.

**8. RESTRUCTURING AND RELATED CHARGES**

We are implementing restructuring actions to streamline the Company's cost structure. These initiatives are expected to improve the alignment of our cost structure with the current operating environment through headcount reductions, as well as rationalization and consolidation of certain manufacturing facilities. These restructuring actions are expected to be completed by December of fiscal 2019 and are anticipated to be mostly cash expenditures.

The total pre-tax charges for these programs are expected to be in the range of \$165 million to \$195 million, which is expected to be approximately 60 percent Industrial, 5 percent Widia, 30 percent Infrastructure and 5 percent Corporate. Total restructuring and related charges since inception of \$124.5 million have been recorded for these programs through March 31, 2017: \$65.4 million in Industrial, \$40.7 million in Infrastructure, \$11.1 million in Widia and \$7.3 million in Corporate.

We have recorded restructuring and related charges of \$9.6 million and \$14.0 million for the three months ended March 31, 2017 and 2016, respectively. Of these amounts, restructuring charges totaled \$7.1 million and \$7.5 million for the three months ended March 31, 2017 and 2016, respectively. Restructuring charges of \$0.4 million were related to inventory and were recorded in cost of goods sold for the three months ended March 31, 2016. Restructuring-related charges of \$1.7 million and \$1.1 million were recorded in cost of goods sold and \$0.8 million and \$5.4 million in operating expense for the three months ended March 31, 2017 and 2016, respectively.

We have recorded restructuring and related charges of \$53.1 million and \$38.0 million for the nine months ended March 31, 2017 and 2016, respectively. Of these amounts, restructuring charges totaled \$44.5 million and \$20.1 million, of which expense of \$0.3 million and \$0.1 million were related to inventory and were recorded in cost of goods sold for the nine months ended March 31, 2017 and 2016, respectively. Restructuring-related charges of \$5.8 million and \$4.7 million were recorded in cost of goods sold and \$2.8 million and \$13.2 million in operating expense for the nine months ended March 31, 2017 and 2016, respectively.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

As of March 31, 2017, \$13.3 million and \$2.5 million of the restructuring accrual is recorded in other current liabilities and other liabilities, respectively, in our condensed consolidated balance sheet. The restructuring accrual of \$15.7 million as of June 30, 2016 is recorded in other current liabilities. The amount attributable to each segment is as follows:

| (in thousands)              | June 30, 2016    | Expense          | Asset Write-Down  | Translation     | Cash Expenditures  | March 31, 2017   |
|-----------------------------|------------------|------------------|-------------------|-----------------|--------------------|------------------|
| <b>Industrial</b>           |                  |                  |                   |                 |                    |                  |
| Severance                   | \$ 8,180         | \$ 25,359        | \$ —              | \$ (313)        | \$ (24,395)        | \$ 8,831         |
| Facilities                  | —                | 111              | (111)             | —               | —                  | —                |
| Other                       | 809              | (30)             | —                 | (10)            | (546)              | 223              |
| <b>Total Industrial</b>     | <b>\$ 8,989</b>  | <b>\$ 25,440</b> | <b>\$ (111)</b>   | <b>\$ (323)</b> | <b>\$ (24,941)</b> | <b>\$ 9,054</b>  |
| <b>Widia</b>                |                  |                  |                   |                 |                    |                  |
| Severance                   | \$ 909           | \$ 4,820         | \$ —              | \$ (60)         | \$ (4,637)         | \$ 1,032         |
| Facilities                  | —                | 10               | (10)              | —               | —                  | —                |
| Other                       | 90               | (6)              | —                 | (1)             | (83)               | —                |
| <b>Total Widia</b>          | <b>\$ 999</b>    | <b>\$ 4,824</b>  | <b>\$ (10)</b>    | <b>\$ (61)</b>  | <b>\$ (4,720)</b>  | <b>\$ 1,032</b>  |
| <b>Infrastructure</b>       |                  |                  |                   |                 |                    |                  |
| Severance                   | \$ 5,301         | \$ 12,838        | \$ —              | \$ (159)        | \$ (12,351)        | \$ 5,629         |
| Facilities                  | 33               | 1,399            | (1,399)           | —               | —                  | 33               |
| Other                       | 381              | (15)             | —                 | (5)             | (279)              | 82               |
| <b>Total Infrastructure</b> | <b>\$ 5,715</b>  | <b>\$ 14,222</b> | <b>\$ (1,399)</b> | <b>\$ (164)</b> | <b>\$ (12,630)</b> | <b>\$ 5,744</b>  |
| <b>Total</b>                | <b>\$ 15,703</b> | <b>\$ 44,486</b> | <b>\$ (1,520)</b> | <b>\$ (548)</b> | <b>\$ (42,291)</b> | <b>\$ 15,830</b> |

9. STOCK-BASED COMPENSATION

*Stock Options*

There were no grants made during the nine months ended March 31, 2017.

The assumptions used in our Black-Scholes valuation related to grants made during the nine months ended March 31, 2016 were as follows:

|                                      |       |
|--------------------------------------|-------|
| Risk-free interest rate              | 1.4%  |
| Expected life (years) <sup>(3)</sup> | 4.5   |
| Expected volatility <sup>(4)</sup>   | 31.7% |
| Expected dividend yield              | 2.1%  |

(3) Expected life is derived from historical experience.

(4) Expected volatility is based on the implied historical volatility of our stock.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Changes in our stock options for the nine months ended March 31, 2017 were as follows:

|   | Options   | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining Life (years) | Aggregate<br>Intrinsic value<br>(in thousands) |
|---|-----------|---------------------------------------|--|--|
| Options outstanding, June 30, 2016                  | 2,547,809 | \$ 33.72                              |  |  |
| Granted   | —         | —                                     |  |  |
| Exercised   | (250,366) | 28.59                                 |  |  |
| Lapsed or forfeited                                 | (183,249) | 31.29                                 |  |  |
| Options outstanding, March 31, 2017                 | 2,114,194 | \$ 34.53                              | 4.2  | \$ 12,207                                      |
| Options vested and expected to vest, March 31, 2017 | 2,096,072 | \$ 34.58                              | 4.2  | \$ 12,017                                      |
| Options exercisable, March 31, 2017                 | 1,641,869 | \$ 35.97                              | 3.1  | \$ 7,382                                       |

During the nine months ended March 31, 2017 and 2016, compensation expense related to stock options was \$1.3 million and \$2.8 million, respectively. As of March 31, 2017, the total unrecognized compensation cost related to options outstanding was \$1.1 million and is expected to be recognized over a weighted average period of 1.4 years.

Weighted average fair value of options granted during the nine months ended March 31, 2016 was \$6.45 per option. Fair value of options vested during the nine months ended March 31, 2017 and 2016 was \$3.3 million and \$2.3 million, respectively.

Tax benefits relating to excess stock-based compensation deductions are presented in the condensed consolidated statements of cash flow as financing cash inflows. No tax benefits were realized resulting from stock-based compensation deductions for the nine months ended March 31, 2017 due to the valuation allowance on U.S. deferred tax assets. Tax benefits resulting from stock-based compensation deductions were less than amounts reported for financial reporting purposes by \$1.8 million for the nine months ended March 31, 2016.

The amount of cash received from the exercise of capital stock options during the nine months ended March 31, 2017 and 2016 was \$7.2 million and \$1.0 million, respectively. No related tax benefit was realized for the nine months ended March 31, 2017 due to the valuation allowance on U.S. deferred tax assets, and the related tax benefit was immaterial for the nine months ended March 31, 2016. The total intrinsic value of options exercised during the nine months ended March 31, 2017 was \$1.6 million, and the total intrinsic value of options exercised during the nine months ended March 31, 2016 was immaterial.

Under the provisions of the Kennametal Inc. Stock and Incentive Plan of 2010 as amended and restated on October 22, 2013 and as further amended January 27, 2015, and the Kennametal Inc. 2016 Stock and Incentive Plan, plan participants may deliver stock, owned by the holder for at least six months, in payment of the option price and receive credit for the fair market value of the shares on the date of delivery. The fair market value of shares delivered during both the nine months ended March 31, 2017 and 2016 was immaterial.

*Restricted Stock Units – Time Vesting and Performance Vesting*

Performance vesting restricted stock units are earned pro rata each year if certain performance goals are met over a three-year period and are also subject to a service condition that requires the individual to be employed by the Company at the vesting date after the three-year performance period, with the exception of retirement eligible grantees, who upon retirement are entitled to vest in any units that have been earned, including a prorated portion in the partially completed fiscal year in which the retirement occurs. Time vesting stock units are valued at the market value of the stock on the grant date. Performance vesting stock units with a market condition are valued using a Monte Carlo model.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Changes in our time vesting and performance vesting restricted stock units for the nine months ended March 31, 2017 were as follows:

|                                 | Performance Vesting<br>Stock Units | Performance Vesting<br>Weighted Average Fair<br>Value | Time Vesting<br>Stock Units | Time Vesting Weighted<br>Average Fair Value |
|---------------------------------|------------------------------------|---|-----------------------------|---|
| Unvested, June 30, 2016         | 115,467                            | \$ 36.96  | 1,014,744                   | \$ 31.97                                    |
| Granted                         | 235,241                            | 26.35   | 610,633                     | 25.45                                       |
| Vested                          | (17,124)                           | 45.24   | (362,563)                   | 35.27                                       |
| Performance metric not achieved | (35,980)                           | 26.35   | —                           | —   |
| Forfeited                       | (17,354)                           | 35.31   | (68,458)                    | 27.60                                       |
| Unvested, March 31, 2017        | 280,250                            | \$ 27.62  | 1,194,356                   | \$ 27.87                                    |

During the nine months ended March 31, 2017 and 2016, compensation expense related to time vesting and performance vesting restricted stock units was \$15.8 million and \$11.7 million, respectively. As of March 31, 2017, the total unrecognized compensation cost related to unvested time vesting and performance vesting restricted stock units was \$17.0 million and is expected to be recognized over a weighted average period of 2.0 years.

10. BENEFIT PLANS

We sponsor several defined benefit pension plans. Additionally, we provide varying levels of postretirement health care and life insurance benefits to some U.S. employees.

The table below summarizes the components of net periodic pension income:

| (in thousands)                        | Three Months Ended March 31, |            | Nine Months Ended March 31, |            |
|---------------------------------------|------------------------------|------------|-----------------------------|------------|
|                                       | 2017                         | 2016       | 2017                        | 2016       |
| Service cost                          | \$ 720                       | \$ 1,154   | \$ 2,180                    | \$ 3,473   |
| Interest cost                         | 7,756                        | 9,375      | 23,335                      | 28,299     |
| Expected return on plan assets        | (14,659)                     | (14,560)   | (44,088)                    | (43,924)   |
| Amortization of transition obligation | 22                           | 19         | 67                          | 61         |
| Amortization of prior service credit  | (113)                        | (104)      | (339)                       | (313)      |
| Recognition of actuarial losses       | 2,066                        | 1,805      | 6,266                       | 5,452      |
| Settlement gain                       | (320)                        | —          | (320)                       | —          |
| Special termination benefit charge    | —                            | —          | —                           | 214        |
| Net periodic pension income           | \$ (4,528)                   | \$ (2,311) | \$ (12,899)                 | \$ (6,738) |

The settlement gain of \$0.3 million during the three and nine months ended March 31, 2017 is the result of income from the settlement with several terminated Executive Retirement Plan participants. The special termination benefit charge of \$0.2 million during the nine months ended March 31, 2016 is the result of lump sum payments to several terminated Executive Retirement Plan participants.

The table below summarizes the components of net periodic other postretirement benefit cost:

| (in thousands)                                 | Three Months Ended March 31, |        | Nine Months Ended March 31, |        |
|--|------------------------------|--------|-----------------------------|--------|
|  | 2017                         | 2016   | 2017                        | 2016   |
| Interest cost                                  | \$ 168                       | \$ 210 | \$ 505                      | \$ 630 |
| Amortization of prior service credit           | (6)                          | (6)    | (16)                        | (16)   |
| Recognition of actuarial loss                  | 89                           | 81     | 266                         | 242    |
| Net periodic other postretirement benefit cost | \$ 251                       | \$ 285 | \$ 755                      | \$ 856 |

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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11. INVENTORIES

We used the last-in, first-out (LIFO) method of valuing inventories for 45 percent and 44 percent of total inventories at March 31, 2017 and June 30, 2016, respectively. Since 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 our projections of expected year-end inventory levels and costs. Therefore, the interim financial results are subject to any final year-end LIFO inventory adjustments.

Inventories consisted of the following:

| (in thousands)                    | March 31, 2017 | June 30, 2016 |
|-----------------------------------|----------------|---------------|
| Finished goods                    | \$ 286,990     | \$ 284,054    |
| Work in process and powder blends | 168,354        | 166,274       |
| Raw materials                     | 90,389         | 68,472        |
| Inventories at current cost       | 545,733        | 518,800       |
| Less: LIFO valuation              | (55,521)       | (59,970)      |
| Total inventories                 | \$ 490,212     | \$ 458,830    |

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12. LONG-TERM DEBT

Our five-year, multi-currency, revolving credit facility, as amended and restated in April 2016 (Credit Agreement) permits revolving credit loans of up to \$600 million for working capital, capital expenditures and general corporate purposes. The Credit Agreement requires us to comply with various restrictive and affirmative covenants, including two financial covenants: a maximum leverage ratio and a minimum consolidated interest coverage ratio (as those terms are defined in the agreement). We were in compliance with all covenants as of March 31, 2017. We had no borrowings outstanding under the Credit Agreement as of March 31, 2017 and June 30, 2016. Borrowings under the Credit Agreement are guaranteed by our significant domestic subsidiaries. The Credit Agreement matures in April 2021.

Fixed rate debt had a fair market value of \$700.7 million and \$704.0 million at March 31, 2017 and June 30, 2016, respectively. The Level 2 fair value is determined based on the quoted market price of this debt as of March 31, 2017 and June 30, 2016, respectively.

13. ENVIRONMENTAL MATTERS

The operation of our business has exposed us to certain liabilities and compliance costs related to environmental matters. We are involved in various environmental cleanup and remediation activities at certain of our locations.

*Superfund Sites* Among other environmental laws, we are subject to the Comprehensive Environmental Response Compensation and Liability Act of 1980 (Superfund), under which we have been designated by the United States Environmental Protection Agency (USEPA) as a potentially responsible party (PRP) with respect to environmental remedial costs at certain Superfund sites. We have evaluated our claims and liabilities associated with these Superfund sites based upon best currently available information. We believe our environmental accruals are adequate to cover our portion of the environmental remedial costs at the Superfund sites where we have been designated a PRP, to the extent these expenses are probable and reasonably estimable.

*Other Environmental Matters* We establish and maintain reserves for other potential environmental issues. At March 31, 2017 and June 30, 2016, the balances of these reserves were \$12.1 million and \$12.5 million, respectively. These reserves represent anticipated costs associated with the remediation of these issues.



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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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The reserves we have established for environmental liabilities represent our best current estimate of the costs of addressing all identified environmental situations, based on our review of currently available evidence, and taking into consideration our prior experience in remediation and that of other companies, as well as public information released by the USEPA, other governmental agencies and by the PRP groups in which we are participating. Although the reserves currently appear to be sufficient to cover these environmental liabilities, there are uncertainties associated with environmental liabilities, and we can give no assurance that our estimate of any environmental liability will not increase or decrease in the future. The reserved and unreserved liabilities for all environmental concerns could change substantially due to factors such as the nature and extent of contamination, changes in remedial requirements, technological changes, discovery of new information, the financial strength of other PRPs, the identification of new PRPs and the involvement of and direction taken by the government on these matters.

We maintain a Corporate Environmental Health and Safety (EHS) Department to monitor compliance with environmental regulations and to oversee remediation activities. In addition, we have designated EHS coordinators who are responsible for each of our global manufacturing facilities. Our financial management team periodically meets with members of the Corporate EHS Department and the Corporate Legal Department to review and evaluate the status of environmental projects and contingencies. On a quarterly basis, we review financial provisions and reserves for environmental contingencies and adjust these reserves when appropriate.

14. INCOME TAXES

The effective income tax rates for the three months ended March 31, 2017 and 2016 were 19.0 percent and 24.7 percent, respectively. The decrease is primarily driven by a prior year asset impairment charge, current quarter earnings in the U.S. that cannot be tax affected in the current year and a prior year loss on divestiture, offset partially by a favorable impact in the prior year quarter related to a U.S. provision to return adjustment that did not repeat in the current year.

The effective income tax rates for the nine months ended March 31, 2017 and 2016 were 45.9 percent (provision on income) and 28.0 percent (benefit on a loss), respectively. The change was primarily driven by restructuring and related charges, a favorable impact in the prior year quarter related to a U.S. provision to return adjustment that did not repeat in the current year and current year-to-date losses in the U.S. that cannot be tax affected in the current year, offset partially by a prior year asset impairment charge and a prior year loss on divestiture.

15. EARNINGS PER SHARE

Basic earnings per share is computed using the weighted average number of shares outstanding during the period, while diluted earnings per share is calculated to reflect the potential dilution that would occur related to the issuance of capital stock under stock option grants and restricted stock units. The difference between basic and diluted earnings per share relates solely to the effect of capital stock options and restricted stock units.

For purposes of determining the number of diluted shares outstanding, weighted average shares outstanding for basic earnings per share calculations were increased due solely to the dilutive effect of unexercised capital stock options, unvested performance awards and unvested restricted stock units by 1.0 million shares and 0.4 million shares for the three months ended March 31, 2017 and 2016, respectively, and 0.7 million shares for the nine months ended March 31, 2017. Unexercised capital stock options, performance awards and restricted stock units of 1.2 million shares and 3.1 million shares for the three months ended March 31, 2017 and 2016, respectively, and 1.8 million shares for the nine months ended March 31, 2017, were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price, and therefore the inclusion would have been anti-dilutive. For the nine months ended March 31, 2016, the effect of unexercised capital stock options and unvested restricted stock units was anti-dilutive as a result of a net loss in the period and therefore has been excluded from diluted shares outstanding as well as from the diluted earnings per share calculation.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

16. EQUITY

A summary of the changes in the carrying amounts of total equity, Kennametal Shareholders' equity and equity attributable to noncontrolling interests as of March 31, 2017 and 2016 is as follows:

| (in thousands)   | Kennametal Shareholders' Equity |                            |                   |                                      |           | Non-controlling interests | Total equity |
|--|---------------------------------|----------------------------|-------------------|--------------------------------------|-----------|---------------------------|--------------|
|  | Capital stock                   | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss |           |                           |              |
| Balance as of June 30, 2016  | \$ 99,618                       | \$ 436,617                 | \$ 780,597        | \$ (352,509)                         | \$ 31,478 | \$ 995,801                |              |
| Net income   | —                               | —                          | 24,495            | —                                    | 1,873     | 26,368                    |              |
| Other comprehensive (loss) income  | —                               | —                          | —                 | (16,228)                             | 330       | (15,898)                  |              |
| Dividend reinvestment  | 7                               | 181                        | —                 | —                                    | —         | 188                       |              |
| Capital stock issued under employee benefit and stock plans <sup>(5)</sup> | 697                             | 20,688                     | —                 | —                                    | —         | 21,385                    |              |
| Purchase of capital stock  | (7)                             | (181)                      | —                 | —                                    | —         | (188)                     |              |
| Cash dividends paid  | —                               | —                          | (48,013)          | —                                    | (72)      | (48,085)                  |              |
| Balance as of March 31, 2017   | \$ 100,315                      | \$ 457,305                 | \$ 757,079        | \$ (368,737)                         | \$ 33,609 | \$ 979,571                |              |

| (in thousands)   | Kennametal Shareholders' Equity |                            |                   |                                      |           | Non-controlling interests | Total equity |
|--|---------------------------------|----------------------------|-------------------|--------------------------------------|-----------|---------------------------|--------------|
|  | Capital stock                   | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss |           |                           |              |
| Balance as of June 30, 2015  | \$ 99,219                       | \$ 419,829                 | \$ 1,070,282      | \$ (243,523)                         | \$ 29,628 | \$ 1,375,435              |              |
| Net (loss) income  | —                               | —                          | (159,454)         | —                                    | 1,634     | (157,820)                 |              |
| Other comprehensive loss   | —                               | —                          | —                 | (5,656)                              | (540)     | (6,196)                   |              |
| Dividend reinvestment  | 12                              | 219                        | —                 | —                                    | —         | 231                       |              |
| Capital stock issued under employee benefit and stock plans <sup>(5)</sup> | 380                             | 10,863                     | —                 | —                                    | —         | 11,243                    |              |
| Purchase of capital stock  | (12)                            | (219)                      | —                 | —                                    | —         | (231)                     |              |
| Cash dividends paid  | —                               | —                          | (47,780)          | —                                    | (71)      | (47,851)                  |              |
| Balance as of March 31, 2016   | \$ 99,599                       | \$ 430,692                 | \$ 863,048        | \$ (249,179)                         | \$ 30,651 | \$ 1,174,811              |              |

(5) Net of restricted stock units delivered upon vesting to satisfy tax withholding requirements.

The amounts of comprehensive loss attributable to Kennametal Shareholders and noncontrolling interests are disclosed in the condensed consolidated statements of comprehensive income.

17. ACCUMULATED OTHER COMPREHENSIVE LOSS

Total accumulated other comprehensive loss (AOCL) consists of net income (loss) and other changes in equity from transactions and other events from sources other than shareholders. It includes postretirement benefit plan adjustments, currency translation adjustments and unrealized gains and losses from derivative instruments designated as cash flow hedges.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The components of, and changes in, AOCL were as follows, net of tax, for the nine months ended March 31, 2017 (in thousands):

| Attributable to Kennametal:                                | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total        |
|--|------------------------------|---------------------------------|-------------|--------------|
| Balance, June 30, 2016                                     | \$ (212,163)                 | \$ (131,212)                    | \$ (9,134)  | \$ (352,509) |
| Other comprehensive income (loss) before reclassifications | 3,376                        | (26,810)                        | 614         | (22,820)     |
| Amounts reclassified from AOCL                             | 5,434                        | —                               | 1,158       | 6,592        |
| Net current period other comprehensive income (loss)       | 8,810                        | (26,810)                        | 1,772       | (16,228)     |
| AOCL, March 31, 2017                                       | \$ (203,353)                 | \$ (158,022)                    | \$ (7,362)  | \$ (368,737) |

| Attributable to noncontrolling interests:           | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total      |
|---|------------------------------|---------------------------------|-------------|------------|
| Balance, June 30, 2016                              | \$ —                         | \$ (3,446)                      | \$ —        | \$ (3,446) |
| Other comprehensive income before reclassifications | —                            | 330                             | —           | 330        |
| Net current period other comprehensive income       | —                            | 330                             | —           | 330        |
| AOCL, March 31, 2017                                | \$ —                         | \$ (3,116)                      | \$ —        | \$ (3,116) |

The components of, and changes in, AOCL were as follows, net of tax, for the nine months ended March 31, 2016 (in thousands):

| Attributable to Kennametal:                                | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total        |
|--|------------------------------|---------------------------------|-------------|--------------|
| Balance, June 30, 2015                                     | \$ (138,793)                 | \$ (97,309)                     | \$ (7,421)  | \$ (243,523) |
| Other comprehensive income (loss) before reclassifications | 1,561                        | (24,165)                        | 165         | (22,439)     |
| Amounts reclassified from AOCL                             | 3,641                        | 15,088                          | (1,946)     | 16,783       |
| Net current period other comprehensive income (loss)       | 5,202                        | (9,077)                         | (1,781)     | (5,656)      |
| AOCL, March 31, 2016                                       | \$ (133,591)                 | \$ (106,386)                    | \$ (9,202)  | \$ (249,179) |

| Attributable to noncontrolling interests:         | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total      |
|---|------------------------------|---------------------------------|-------------|------------|
| Balance, June 30, 2015                            | \$ —                         | \$ (2,258)                      | \$ —        | \$ (2,258) |
| Other comprehensive loss before reclassifications | —                            | (540)                           | —           | (540)      |
| Net current period other comprehensive loss       | —                            | (540)                           | —           | (540)      |
| AOCL, March 31, 2016                              | \$ —                         | \$ (2,798)                      | \$ —        | \$ (2,798) |

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

Reclassifications out of AOCL for the three and nine months ended March 31, 2017 and 2016 consisted of the following (in thousands):

| Details about AOCL components                    | Three Months Ended March 31, |            | Nine Months Ended March 31, |            | Affected line item in the Income Statement |
|--|------------------------------|------------|-----------------------------|------------|--|
|  | 2017                         | 2016       | 2017                        | 2016       |  |
| <b>Gains and losses on cash flow hedges:</b>     |                              |            |                             |            |  |
| Forward starting interest rate swaps             | \$ 545                       | \$ 525     | \$ 1,635                    | \$ 1,574   | Interest expense                           |
| Currency exchange contracts                      | (156)                        | (141)      | (477)                       | (4,713)    | Other expense (income), net                |
| Total before tax                                 | 389                          | 384        | 1,158                       | (3,139)    |  |
| Tax impact                                       | —                            | (146)      | —                           | 1,193      | Provision (benefit) for income taxes       |
| Net of tax                                       | \$ 389                       | \$ 238     | \$ 1,158                    | \$ (1,946) |  |
| <b>Postretirement benefit plans:</b>             |                              |            |                             |            |  |
| Amortization of transition obligations           | \$ 22                        | \$ 19      | \$ 67                       | \$ 61      | See note 10 for further details            |
| Amortization of prior service credit             | (119)                        | (110)      | (355)                       | (329)      | See note 10 for further details            |
| Recognition of actuarial losses                  | 2,155                        | 1,886      | 6,532                       | 5,694      | See note 10 for further details            |
| Total before tax                                 | 2,058                        | 1,795      | 6,244                       | 5,426      |  |
| Tax impact                                       | (254)                        | (576)      | (810)                       | (1,785)    | Provision (benefit) for income taxes       |
| Net of tax                                       | \$ 1,804                     | \$ 1,219   | \$ 5,434                    | \$ 3,641   |  |
| <b>Foreign currency translation adjustments:</b> |                              |            |                             |            |  |
| Released due to divestiture                      | \$ —                         | \$ (1,940) | \$ —                        | \$ 15,088  | Loss on divestiture                        |
| Total before taxes                               | —                            | (1,940)    | —                           | 15,088     |  |
| Tax impact                                       | —                            | —          | —                           | —          | Provision (benefit) for income taxes       |
| Net of tax                                       | \$ —                         | \$ (1,940) | \$ —                        | \$ 15,088  |  |

The amount of income tax allocated to each component of other comprehensive income for the three months ended March 31, 2017 and 2016:

| (in thousands)  | 2017      |            |            | 2016       |            |            |
|---|-----------|------------|------------|------------|------------|------------|
|   | Pre-tax   | Tax impact | Net of tax | Pre-tax    | Tax impact | Net of tax |
| Unrealized loss on derivatives designated and qualified as cash flow hedges                             | \$ (866)  | \$ —       | \$ (866)   | \$ (1,027) | \$ 390     | \$ (637)   |
| Reclassification of unrealized loss on expired derivatives designated and qualified as cash flow hedges | 389       | —          | 389        | 384        | (146)      | 238        |
| Unrecognized net pension and other postretirement benefit loss  | (970)     | 245        | (725)      | (1,332)    | 444        | (888)      |
| Reclassification of net pension and other postretirement benefit loss                                   | 2,058     | (254)      | 1,804      | 1,795      | (576)      | 1,219      |
| Foreign currency translation adjustments  | 13,706    | 79         | 13,785     | 19,432     | (1,649)    | 17,783     |
| Reclassification of foreign currency translation adjustment gain realized upon sale                     | —         | —          | —          | (1,940)    | —          | (1,940)    |
| Other comprehensive income  | \$ 14,317 | \$ 70      | \$ 14,387  | \$ 17,312  | \$ (1,537) | \$ 15,775  |

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The amount of income tax allocated to each component of other comprehensive loss for the nine months ended March 31, 2017 and 2016:

| (in thousands)   | 2017        |            |             | 2016       |            |            |
|--|-------------|------------|-------------|------------|------------|------------|
|  | Pre-tax     | Tax impact | Net of tax  | Pre-tax    | Tax impact | Net of tax |
| Unrealized gain on derivatives designated and qualified as cash flow hedges                                    | \$ 614      | \$ —       | \$ 614      | \$ 266     | \$ (101)   | \$ 165     |
| Reclassification of unrealized loss (gain) on expired derivatives designated and qualified as cash flow hedges | 1,158       | —          | 1,158       | (3,139)    | 1,193      | (1,946)    |
| Unrecognized net pension and other postretirement benefit gain   | 4,431       | (1,055)    | 3,376       | 1,884      | (323)      | 1,561      |
| Reclassification of net pension and other postretirement benefit loss  | 6,244       | (810)      | 5,434       | 5,426      | (1,785)    | 3,641      |
| Foreign currency translation adjustments   | (26,559)    | 79         | (26,480)    | (25,294)   | 589        | (24,705)   |
| Reclassification of foreign currency translation adjustment loss realized upon sale                            | —           | —          | —           | 15,088     | —          | 15,088     |
| Other comprehensive loss   | \$ (14,112) | \$ (1,786) | \$ (15,898) | \$ (5,769) | \$ (427)   | \$ (6,196) |

18. **GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill represents the excess of cost over the fair value of the net assets of acquired companies. Goodwill and other intangible assets with indefinite lives are tested at least annually for impairment. We perform our annual impairment tests during the June quarter in connection with our annual planning process, unless there are impairment indicators based on the results of an ongoing cumulative qualitative assessment that warrant a test prior to that. We evaluate the recoverability of goodwill for each of our reporting units by comparing the fair value of each reporting unit with its carrying value. The fair values of our reporting units are determined using a combination of a discounted cash flow analysis and market multiples based upon historical and projected financial information. We apply our best judgment when assessing the reasonableness of the financial projections used to determine the fair value of each reporting unit. We evaluate the recoverability of indefinite-lived intangible assets using a discounted cash flow analysis based on projected financial information. This evaluation is sensitive to changes in market interest rates and other external factors.

Identifiable assets with finite lives are reviewed for impairment when events or circumstances indicate that the carrying value may not be recoverable.

At the beginning of fiscal 2017, we reorganized our operating structure in a manner that changed the composition of our reporting units. The Industrial and Widia reporting units in fiscal 2017 were formed from the fiscal 2016 Industrial reporting unit. In connection with this reporting unit realignment, during the first quarter of fiscal 2017 we updated our goodwill impairment assessment based on a quantitative analysis. We evaluated the goodwill of our reporting units immediately prior to and after the realignment and concluded in both cases that there was no impairment. We allocated our goodwill from the former Industrial segment to the current Industrial and Widia segments using a relative fair value approach. The restated Industrial reporting unit passed the goodwill impairment test with fair value substantially exceeded the carrying value. The new Widia reporting unit's fair value approximates its carrying value.

See Note 19 for further discussion regarding the Company's segments.

We are currently exploring strategic alternatives for one of our non-core Infrastructure businesses. The estimated net book value of the business is approximately \$30 million as of March 31, 2017. As the strategic direction has not yet been determined for this business, the Company cannot determine if additional impairment charges will be incurred.

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

A summary of the carrying amount of goodwill attributable to each segment, as well as the changes in such, is as follows:

| (in thousands)                | Industrial | Widia     | Infrastructure | Total        |
|-------------------------------|------------|-----------|----------------|--------------|
| Gross goodwill                | \$ 408,705 | \$ 40,624 | \$ 633,211     | \$ 1,082,540 |
| Accumulated impairment losses | (137,204)  | (13,638)  | (633,211)      | (784,053)    |
| Balance as of June 30, 2016   | \$ 271,501 | \$ 26,986 | \$ —           | \$ 298,487   |

Activity for the nine months ended March 31, 2017:

|   |            |           |           |            |
|---|------------|-----------|-----------|------------|
| Change in gross goodwill due to translation | (4,459)    | 287       | —         | (4,172)    |
| Gross goodwill                              | 404,246    | 40,911    | 633,211   | 1,078,368  |
| Accumulated impairment losses               | (137,204)  | (13,638)  | (633,211) | (784,053)  |
| Balance as of March 31, 2017                | \$ 267,042 | \$ 27,273 | \$ —      | \$ 294,315 |

*Fiscal 2016 December Quarter Impairment Charge*

As previously disclosed, we recorded a non-cash pre-tax impairment charge during the three months ended December 31, 2015 of \$106.1 million in the Infrastructure segment, of which \$105.7 million was for goodwill and \$0.4 million was for an indefinite-lived trademark intangible asset. We also recorded a preliminary non-cash pre-tax impairment charge during the three months ended December 31, 2015 of \$2.3 million in the Widia segment for an indefinite-lived trademark intangible asset. These impairment charges were recorded in restructuring and asset impairment charges in our condensed consolidated statements of income.

*Divestiture Impact on Goodwill and Other Intangible Assets*

During the nine months ended March 31, 2016, we completed the sale of non-core businesses, see Note 5. As a result of this transaction, goodwill decreased by \$1.1 million and \$6.5 million in our Industrial and Infrastructure segments, respectively. These decreases were recorded in the loss on divestiture account in our condensed consolidated statements of income.

The components of our other intangible assets were as follows:

| (in thousands)             | Estimated Useful Life (in years) | March 31, 2017        |                          | June 30, 2016         |                          |
|----------------------------|----------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                            |                                  | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Contract-based             | 3 to 15                          | \$ 7,059              | \$ (7,002)               | \$ 7,152              | \$ (6,886)               |
| Technology-based and other | 4 to 20                          | 45,753                | (27,822)                 | 47,323                | (27,011)                 |
| Customer-related           | 10 to 21                         | 204,088               | (70,983)                 | 205,471               | (66,938)                 |
| Unpatented technology      | 10 to 30                         | 31,691                | (9,967)                  | 31,837                | (4,614)                  |
| Trademarks                 | 5 to 20                          | 12,259                | (8,389)                  | 12,668                | (8,644)                  |
| Trademarks                 | Indefinite                       | 16,382                | —                        | 16,850                | —                        |
| Total                      |                                  | \$ 317,232            | \$ (124,163)             | \$ 321,301            | \$ (114,093)             |

During the nine months ended March 31, 2017 and 2016, we recorded amortization expense of \$12.7 million and \$16.3 million, respectively, related to our other intangible assets.

19. SEGMENT DATA

Kennametal delivers productivity to customers seeking peak performance in demanding environments by providing innovative custom and standard wear-resistant solutions. To provide these solutions, we harness our knowledge of advanced materials and application development with a commitment to environmental sustainability. Our product offering includes a wide selection of standard and customized technologies for metalworking, such as sophisticated metal cutting tools, tooling systems and services, as well as advanced, high-performance materials, such as cemented tungsten carbide products, super alloys, coatings and investment castings to address customer demands. We offer these products through a variety of channels to meet customer-specified needs.

[Table of Contents](#)**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

The Company's reportable operating segments have been determined in accordance with the Company's internal management structure, which is organized based on operating activities, the manner in which we organize segments for making operating decisions and assessing performance and the availability of separate financial results. We do not allocate certain corporate expenses related to executive retirement plans, the Company's Board of Directors and strategic initiatives, as well as certain other costs and report them in Corporate. None of our three reportable operating segments represent the aggregation of two or more operating segments.

The Industrial segment generally serves customers that operate in industrial end markets such as transportation, general engineering and aerospace and defense, delivering high performance metalworking tools for specified purposes. The customers in these end markets manufacture engines, airframes, automobiles, trucks, ships and various types of industrial equipment. The technology and customization requirements for customers we serve vary by customer, application and industry. The value we deliver to our Industrial segment customers centers on our application expertise and our diverse offering of products and services, with products delivered through a diverse base including direct and indirect channels.

The Widia segment generally serves customers that operate in industrial end markets, primarily in general engineering, delivering high performance metalworking tools for general purposes. Whereas the Industrial segment's core is in application expertise and specific customer needs, Widia offers a competitive alternative for general metal cutting solutions across a broader platform for application, with products delivered primarily through indirect channels.

The Infrastructure segment generally serves customers that operate in the earthworks and energy sectors who support primary industries such as oil and gas, power generation, underground, surface and hard-rock mining, highway construction and road maintenance. Generally, we rely on customer intimacy to serve this segment. By gaining an in-depth understanding of our customers' engineering and development needs, we are able to offer complete system solutions and high-performance capabilities to optimize and add value to their operations.

Our sales and operating income (loss) by segment are as follows:

| (in thousands)  | Three Months Ended March 31, |                   | Nine Months Ended March 31, |                     |
|---|------------------------------|-------------------|-----------------------------|---------------------|
|   | 2017                         | 2016              | 2017                        | 2016                |
| <b>Sales:</b>   |                              |                   |                             |                     |
| Industrial <sup>(6)</sup>   | \$ 289,455                   | \$ 274,123        | \$ 825,990                  | \$ 812,892          |
| Widia <sup>(6)</sup>  | 46,297                       | 42,249            | 130,186                     | 127,696             |
| Infrastructure  | 192,878                      | 181,465           | 537,167                     | 636,624             |
| <b>Total sales</b>  | <b>\$ 528,630</b>            | <b>\$ 497,837</b> | <b>\$ 1,493,343</b>         | <b>\$ 1,577,212</b> |
| <b>Operating income (loss):</b>                                     |                              |                   |                             |                     |
| Industrial <sup>(6)</sup>   | \$ 38,535                    | \$ 26,371         | \$ 62,138                   | \$ 59,855           |
| Widia <sup>(6)</sup>  | 606                          | (1,679)           | (7,797)                     | (8,053)             |
| Infrastructure  | 19,770                       | 3,748             | 22,457                      | (242,417)           |
| Corporate   | (999)                        | (1,105)           | (4,084)                     | (9,391)             |
| <b>Total operating income (loss)</b>                                | <b>57,912</b>                | <b>27,335</b>     | <b>72,714</b>               | <b>(200,006)</b>    |
| Interest expense  | 7,331                        | 7,113             | 21,475                      | 20,895              |
| Other expense (income), net   | 1,626                        | (1,938)           | 2,470                       | (1,582)             |
| <b>Income (loss) from continuing operations before income taxes</b> | <b>\$ 48,955</b>             | <b>\$ 22,160</b>  | <b>\$ 48,769</b>            | <b>\$ (219,319)</b> |

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**KENNAMETAL INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

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Total assets by segment are as follows:

| (in thousands)            | March 31, 2017      | June 30, 2016       |
|---------------------------|---------------------|---------------------|
| Industrial <sup>(6)</sup> | \$ 1,100,690        | \$ 1,019,887        |
| Widia <sup>(6)</sup>      | 191,453             | 195,339             |
| Infrastructure            | 791,194             | 849,447             |
| Corporate                 | 251,402             | 298,110             |
| <b>Total assets</b>       | <b>\$ 2,334,739</b> | <b>\$ 2,362,783</b> |

(6) Amounts for the three and nine months ended March 31, 2017 and as of June 30, 2016 have been restated to reflect the change in reportable operating segments.



**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

---

**OVERVIEW**

Kennametal Inc. is a leading global manufacturer and supplier of tooling, engineered components and advanced materials consumed in production processes. We deliver productivity solutions to customers seeking peak performance in demanding environments. The Company provides innovative wear-resistant products, application engineering and services backed by advanced material science serving customers across diverse sectors of industrial production, transportation, earthworks, energy, construction, process industries and aerospace. Kennametal solutions are built around industry-essential technology platforms, including precision-engineered metalworking tools and components, surface technologies and earth cutting tools that are mission-critical to customer operations battling extreme conditions associated with wear fatigue, corrosion and high temperatures. The Company's reputation for material and industrial technology excellence, as well as expertise and innovation in development of custom solutions and services, contributes to its leading position in its primary industrial and infrastructure markets. End users of the Company's products include manufacturers, metalworking suppliers, machinery operators and processors engaged in a diverse array of industries, including the manufacture of transportation vehicles and components; machine tool, light machinery and heavy machinery industries; airframe and aerospace components, defense; as well as producers and suppliers in equipment-intensive operations such as coal mining, road construction, quarrying, oil and gas exploration, refining, production and supply. We believe we are one of the largest global providers of consumable metal cutting tools and tooling supplies.

This quarter's results exceeded our expectations by almost every metric. Sales grew and costs declined, reflecting continuing progress with the work we began nine months ago. Our sales of \$528.6 million for the quarter ended March 31, 2017 increased 6 percent compared to sales for the quarter ended March 31, 2016. Every segment and every region reported increased sales. The Widia segment posted quarterly profit for the first time with operating margin of 1.3 percent. The Industrial and Infrastructure segments posted operating margins of 13.3 percent and 10.3 percent, respectively.

Operating income was \$57.9 million, compared to \$27.3 million in the prior year quarter. Year-over-year comparative operating results reflect incremental restructuring benefits of approximately \$20 million, organic sales growth, higher absorption and productivity, lower restructuring and related charges in the current period and favorable mix, partially offset by higher performance-based compensation and the negative effects of higher raw material costs.

The permanent savings that we are realizing from restructuring are the result of all programs that we have undertaken over the past 27 months. Pre-tax benefits from these restructuring actions were approximately \$30 million in the current quarter, of which approximately \$20 million were incremental to the same quarter one year ago. As of March 31, 2017, we are anticipating approximately \$90 million of the annualized savings associated with our employment reduction initiative. We expect our other restructuring programs to deliver annualized savings of \$75 million to \$90 million once completed. Refer to the Results of Continuing Operations section of Item 2 for further discussion and analysis of our restructuring programs.

In addition to these restructuring programs, our product and process simplification, End-to-End and factory modernization initiatives are underway. Very little of the current period progress reflects the structural benefits from the modernization and End-to-End initiatives that we have planned, nor the benefits from the ongoing product and process simplification initiatives. The results of those programs are expected to accrue to the Company over the next two to three years.

We reported current quarter earnings per diluted share of \$0.48, which include \$0.12 per share of restructuring and related charges. Earnings per diluted share of \$0.20 in the prior year quarter included \$0.18 per share of restructuring and related charges, a net gain of \$0.03 per share from divestiture, and a tax impact of \$0.02 per share related to prior year second quarter asset impairment charges.

We generated cash flow from operating activities of \$80.0 million and \$145.4 million during the nine months ended March 31, 2017 and 2016, respectively. The decrease is due primarily to increases in primary working capital and higher restructuring payments, partially offset by higher cash earnings and lower tax and pension payments. Capital expenditures were \$94.1 million and \$83.3 million during the nine months ended March 31, 2017 and 2016, respectively.

We invested further in technology and innovation to continue meeting our customers' needs. Research and development expenses included in operating expense totaled \$9.4 million for the three months ended March 31, 2017.

The following narrative provides further discussion and analysis of our results of operations, liquidity and capital resources, as well as other pertinent matters.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

---

**NEW OPERATING STRUCTURE IMPLEMENTED IN FISCAL 2017**

In order to take advantage of the growth opportunities of our WIDIA brand, we implemented a new operating structure in fiscal 2017.

A key attribute of the new structure is the establishment of the Widia operating segment. In order to better leverage the opportunities in this business, in addition to being more agile and competitive in the marketplace, we are placing higher levels of focus, determination and leadership in the business. The newly formed Industrial and Widia segments were formed from the previously reported Industrial segment. Amounts for the three and nine months ended March 31, 2016 and as of June 30, 2016 have been restated to reflect the change in reportable operating segments.

We now have three reportable operating segments going forward: Industrial, Widia and Infrastructure.

In connection with this change, we updated our goodwill impairment assessment based on a quantitative analysis during the first quarter of fiscal 2017. We evaluated the goodwill of our reporting units immediately prior to and after the realignment and concluded in both cases that there was no impairment. We allocated our goodwill from the former Industrial segment to the current Industrial and Widia segments using a relative fair value approach. The restated Industrial reporting unit passed the goodwill impairment test with fair value substantially exceeded the carrying value. The new Widia reporting unit's fair value approximates its carrying value. The amount of goodwill allocated to the Widia reporting unit was \$27.0 million.

We completed Step 1 of the Widia goodwill impairment test using both an income approach and a market approach. The discounted cash flow method was used to measure the fair value of our equity under the income approach. A terminal value utilizing a constant growth rate of cash flows was used to calculate a terminal value after the explicit projection period. The estimates and assumptions used in our calculations include revenue growth rates, expense growth rates, expected capital expenditures to determine projected cash flows, expected tax rates and an estimated discount rate to determine present value of expected cash flows. These estimates are based on historical experiences, our projections of future operating activity and our weighted average cost of capital ("WACC"). The discount rate used was 14.5 percent. In order to determine the discount rate, the Company uses a market perspective WACC approach. The WACC is calculated incorporating weighted average returns on debt and equity from market participants. Therefore, changes in the market, which are beyond the control of the Company, may have an impact on future calculations of estimated fair value. Management forecasts were used for the years ending June 30, 2017-2021, with a residual period growth rate of 3.0 percent. The tax rate used was 25.0 percent. Under the market approach, we estimate the fair value based on market multiples of revenue and earnings of comparable publicly traded companies and comparable transactions of similar companies.

Fair value determinations require considerable judgment and are sensitive to changes in underlying assumptions and factors. As a result, there can be no assurance that the estimates and assumptions made for purposes of the goodwill and indefinite-lived intangible impairment test will prove to be an accurate prediction of the future. Examples of events or circumstances that could reasonably be expected to negatively affect the underlying key assumptions and ultimately impact the estimated fair value of our reporting units may include such items as: (i) a decrease in expected future cash flows, specifically, a decrease in sales volume driven by a prolonged weakness in consumer demand or other competitive pressures adversely affecting our long-term volume trends, unfavorable working capital changes and an inability to successfully achieve our cost savings targets; (ii) inability to achieve all of the anticipated benefits from restructuring actions assumed; (iii) an economic recovery that significantly differs from our assumptions in timing and/or degree; (iv) volatility in the equity and debt markets or other country specific factors which could result in a higher discount rate; and (v) sensitivity to market transaction multiples.

**RESULTS OF CONTINUING OPERATIONS**

**SALES**

Sales for the three months ended March 31, 2017 were \$528.6 million, an increase of \$30.8 million or 6 percent, from \$497.8 million in the prior year quarter. The increase in sales was driven by a 5 percent organic growth and a 2 percent increase due to more business days, partially offset by a 1 percent unfavorable currency exchange impact. Excluding the impact of currency exchange, sales increased by approximately 21 percent in energy, 8 percent in general engineering, 4 percent in earthworks and 3 percent in transportation, offset partially by a decrease of approximately 1 percent in aerospace and defense. On a regional basis excluding the impact of currency exchange, sales increased by 15 percent in Asia, 6 percent in the Americas and 5 percent in Europe.

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

---

Sales for the nine months ended March 31, 2017 were \$1,493.3 million, a decrease of \$83.9 million or 5 percent, from \$1,577.2 million in the prior year period. The decrease in sales was driven by a 5 percent decline from divestiture and a 1 percent unfavorable currency exchange impact, partially offset by 1 percent organic growth. Excluding the impact of currency exchange and divestiture, sales increased by approximately 5 percent in energy, 4 percent in general engineering, 3 percent in aerospace and defense and 1 percent in transportation, offset partially by a decrease of approximately 9 percent in earthworks. On a regional basis excluding the impact of currency exchange and divestiture, sales increased 6 percent in Asia while sales remained flat in both the Americas and Europe.

**GROSS PROFIT**

Gross profit for the three months ended March 31, 2017 was \$186.3 million, an increase of \$28.9 million from \$157.4 million in the prior year quarter. The increase was primarily due to incremental restructuring benefits of approximately \$10 million, sales volume growth, higher fixed cost absorption and productivity and favorable mix, partially offset by unfavorable currency exchange impact of \$3.1 million and higher raw material costs. The gross profit margin for the three months ended March 31, 2017 was 35.2 percent, as compared to 31.6 percent generated in the prior year quarter.

Gross profit for the nine months ended March 31, 2017 was \$477.4 million, an increase of \$28.0 million from \$449.4 million in the prior year period. The increase was primarily due to higher fixed cost absorption and productivity, lower raw material costs and incremental restructuring benefits of approximately \$20 million, partially offset by unfavorable mix, divestiture impact of \$11.4 million and unfavorable currency exchange impact of \$8.6 million. The gross profit margin for the nine months ended March 31, 2017 was 32.0 percent, as compared to 28.5 percent generated in the prior year period.

**OPERATING EXPENSE**

Operating expense for the three months ended March 31, 2017 decreased \$4.1 million or 3.4 percent to \$116.9 million as compared to \$121.0 million in the prior year quarter. The decrease was primarily due to incremental restructuring benefits of approximately \$10 million, \$4.6 million less in restructuring-related charges and favorable foreign currency exchange impacts of \$1.0 million, partially offset by \$7.3 million higher employment-related costs.

Operating expense for the nine months ended March 31, 2017 decreased \$26.0 million or 7.0 percent to \$347.8 million as compared to \$373.8 million in the prior year period. The decrease was primarily due to incremental restructuring benefits of approximately \$25 million, divestiture impact of \$10.5 million, \$10.4 million less in restructuring-related charges and favorable foreign currency exchange impacts of \$3.5 million, offset partially by higher employment-related costs of \$17.0 million.

**RESTRUCTURING AND RELATED CHARGES AND ASSET IMPAIRMENT CHARGES**

We have recorded restructuring and related charges of \$9.6 million and \$14.0 million for the three months ended March 31, 2017 and 2016, respectively. Of these amounts, restructuring charges totaled \$7.1 million and \$7.5 million for the three months ended March 31, 2017 and 2016, respectively. Restructuring charges of \$0.4 million were related to inventory and were recorded in cost of goods sold for the three months ended March 31, 2016. Restructuring-related charges of \$1.7 million and \$1.1 million were recorded in cost of goods sold and \$0.8 million and \$5.4 million in operating expense for the three months ended March 31, 2017 and 2016, respectively.

We have recorded restructuring and related charges of \$53.1 million and \$38.0 million for the nine months ended March 31, 2017 and 2016, respectively. Of these amounts, restructuring charges totaled \$44.5 million and \$20.1 million, of which expense of \$0.3 million and \$0.1 million were related to inventory and were recorded in cost of goods sold for the nine months ended March 31, 2017 and 2016, respectively. Restructuring-related charges of \$5.8 million and \$4.7 million were recorded in cost of goods sold and \$2.8 million and \$13.2 million in operating expense for the nine months ended March 31, 2017 and 2016, respectively.

Total restructuring and related charges since the inception of our restructuring plans through March 31, 2017 were \$124.5 million. See Note 8 in our condensed consolidated financial statements set forth in Part I Item 1 of this Quarterly Report on Form 10-Q (Note 8).

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

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We are implementing restructuring actions to streamline the Company's cost structure. These initiatives are expected to improve the alignment of our cost structure with the current operating environment through headcount reductions, as well as rationalization and consolidation of certain manufacturing facilities. These restructuring actions are currently anticipated to deliver annual ongoing pre-tax savings of \$165 million to \$180 million once completed by December of fiscal 2019 and are anticipated to be mostly cash expenditures. The total pre-tax charges for these programs are expected to be in the range of \$165 million to \$195 million.

*Asset Impairment Charges*

We recorded non-cash pre-tax asset impairment charges of \$108.5 million during the nine months ended March 31, 2016. See Note 18 in our condensed consolidated financial statements set forth in Part I Item 1 of this Quarterly Report on Form 10-Q (Note 18).

**LOSS ON DIVESTITURE**

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 estimated working capital adjustments, deal costs and transaction costs. We recorded a pre-tax net gain on divestiture during the three months ended March 31, 2016 of approximately \$2.6 million, which consists primarily of the write-off of the currency translation adjustments of a legal entity liquidated in the March quarter, partially offset by a refinement to our estimated working capital adjustment. The pre-tax net loss on divestiture during the nine months ended March 31, 2016 is \$130.8 million, of which \$127.2 million and \$3.6 million were recorded in the Infrastructure and Industrial segments, respectively. See Note 5 in our condensed consolidated financial statements set forth in Part I Item 1 of this Quarterly Report on Form 10-Q (Note 5).

**INTEREST EXPENSE**

Interest expense for the three months ended March 31, 2017 increased \$0.2 million to \$7.3 million as compared to \$7.1 million in the prior year quarter. Interest expense for the nine months ended March 31, 2017 increased \$0.6 million to \$21.5 million as compared to \$20.9 million in the prior year period.

**OTHER EXPENSE (INCOME), NET**

Other expense, net for the three months ended March 31, 2017, was \$1.6 million compared to other income, net of \$1.9 million in the prior year quarter. The year-over-year change was primarily due to foreign currency transaction losses.

Other expense, net for the nine months ended March 31, 2017, was \$2.5 million compared to other income, net of \$1.6 million in the prior year period. The year-over-year change was primarily due to losses on derivatives, partially offset by loss on sale of assets in the prior year and income from transition services provided to the acquirer of our non-core businesses.

**INCOME TAXES**

The effective income tax rates for the three months ended March 31, 2017 and 2016 were 19.0 percent and 24.7 percent, respectively. The decrease is primarily driven by a prior year asset impairment charge, current quarter earnings in the U.S. that cannot be tax affected in the current year and a prior year loss on divestiture, offset partially by a favorable impact in the prior year quarter related to a U.S. provision to return adjustment that did not repeat in the current year.

The effective income tax rates for the nine months ended March 31, 2017 and 2016 were 45.9 percent (provision on income) and 28.0 percent (benefit on a loss), respectively. The change was primarily driven by restructuring and related charges, a favorable impact in the prior year quarter related to a U.S. provision to return adjustment that did not repeat in the current year and current year-to-date losses in the U.S. that cannot be tax affected in the current year, offset partially by a prior year asset impairment charge and a prior year loss on divestiture.

**BUSINESS SEGMENT REVIEW**

We operate three reportable segments consisting of Industrial, Widia and Infrastructure. Expenses that are not allocated are reported in Corporate. Segment determination is based upon the manner in which we organize segments for making operating decisions and assessing performance and the availability of separate financial results.

Amounts for the three and nine months ended March 31, 2016 for Industrial and Widia have been restated to reflect the change in reportable operating segments.

[Table of Contents](#)**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

## INDUSTRIAL

| (in thousands)   | Three Months Ended March 31, |            | Nine Months Ended March 31, |            |
|------------------|------------------------------|------------|-----------------------------|------------|
|                  | 2017                         | 2016       | 2017                        | 2016       |
| Sales            | \$ 289,455                   | \$ 274,123 | \$ 825,990                  | \$ 812,892 |
| Operating income | 38,535                       | 26,371     | 62,138                      | 59,855     |

For the three months ended March 31, 2017, Industrial sales increased 6 percent from the prior year quarter, reflecting organic growth of 5 percent and a 3 percent increase due to more business days, partially offset by 2 percent unfavorable currency exchange. Excluding the impact of currency exchange, sales increased approximately 18 percent in energy, 9 percent in general engineering, 6 percent in aerospace and defense and 3 percent in transportation. General engineering sales benefited from growth in the indirect channel, due in part to the strengthening of oil and gas in the U.S. and growth in the China automotive market. Oil and gas in the Americas likewise contributed to overall growth in energy, coupled with increases in power generation globally. Transportation experienced growth in Asia with tiered suppliers and truck OEMs which was tempered slightly by lower project sales in the Americas. Conditions continue to be favorable in the aerospace sector, with engine growth being supplemented by increasing demand related to frames. On a segment regional basis excluding the impact of currency exchange, sales increased 17 percent in Asia, 6 percent in Europe and 4 percent in the Americas. The sales increase in Asia was primarily driven by the transportation, general engineering, aerospace and defense and energy end markets. The sales increase in Europe was primarily driven by the performance in the general engineering, aerospace and defense and transportation end markets. The sales increase in the Americas was primarily driven by the performance in the general engineering and energy end markets, partially offset by decreases in the transportation and aerospace and defense end markets.

For the three months ended March 31, 2017, Industrial operating income increased by \$12.2 million, driven primarily by incremental restructuring benefits of approximately \$11 million, organic sales growth, higher absorption and productivity and \$2.9 million less restructuring and related charges, partially offset by higher performance-based compensation, a prior year adjustment to the estimated loss on divestiture that resulted in a gain of \$3.7 million and unfavorable mix. Industrial operating margin was 13.3 percent compared with 9.6 percent in the prior year.

For the nine months ended March 31, 2017, Industrial sales increased 2 percent from the same period last year, reflecting organic growth of 4 percent, offset partially by unfavorable currency exchange of 2 percent. Excluding the impact of currency exchange and divestiture, sales increased 7 percent in general engineering, 6 percent in aerospace and defense and 1 percent in transportation, while energy remained flat. Activity in the aerospace sector remains elevated with sales growing globally. General engineering sales have benefited from stability in indirect channel stock levels, offsetting the general industrial weakness caused by the decline in the energy sector. The transportation market was mixed with more projects contributing to higher sales in Asia, partially offset by less favorable conditions in Europe and Americas. On a segment regional basis excluding the impact of divestiture and currency exchange, sales increased 10 percent in Asia, 4 percent in the Americas and 1 percent in Europe. The sales increase in Asia was primarily driven by the transportation and general engineering end markets and to a lesser extent the aerospace and defense end market. The sales increase in the Americas was primarily driven by the performance in the general engineering end market and to a lesser extent the energy end market, partially offset by a decrease in the transportation end market. The sales increase in Europe was primarily driven by the performance in the aerospace and defense and general engineering end markets, offset partially by a decrease in the transportation end market.

For the nine months ended March 31, 2017, Industrial operating income increased by \$2.3 million, driven primarily by \$24 million incremental restructuring benefits, organic sales growth, higher absorption and productivity and a \$3.6 million loss on divestiture in the prior period, partially offset by \$12.3 million higher restructuring and related charges, unfavorable currency exchange and unfavorable mix. Industrial operating margin was 7.5 percent compared with 7.4 percent in the prior year.

[Table of Contents](#)**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

## WIDIA

| (in thousands)          | Three Months Ended March 31, |           | Nine Months Ended March 31, |            |
|-------------------------|------------------------------|-----------|-----------------------------|------------|
|                         | 2017                         | 2016      | 2017                        | 2016       |
| Sales                   | \$ 46,297                    | \$ 42,249 | \$ 130,186                  | \$ 127,696 |
| Operating income (loss) | 606                          | (1,679)   | (7,797)                     | (8,053)    |

For the three months ended March 31, 2017, Widia sales increased 10 percent from the prior year quarter, driven by organic growth of 9 percent and a 1 percent increase due to more business days. On a segment regional basis excluding the impact of currency exchange, sales increased 14 percent in Asia, 11 percent in the Americas and 3 percent in Europe.

For the three months ended March 31, 2017, Widia operating income was \$0.6 million compared to a \$1.7 million loss for the prior year period. The year-over-year change of \$2.3 million was driven primarily by organic sales growth and incremental restructuring benefits of approximately \$2 million. Widia operating income margin was 1.3 percent compared with operating loss margin of 4.0 percent in the prior year.

For the nine months ended March 31, 2017, Widia segment sales increased by 2 percent from the same period last year, due to organic growth of 4 percent, offset partially by an unfavorable business days impact of 1 percent and unfavorable currency exchange of 1 percent. On a segment regional basis excluding the impact of currency exchange, sales increased 12 percent in Asia, offset partially by a decrease of 3 percent in Europe, while sales in the Americas remained flat.

For the nine months ended March 31, 2017, Widia operating loss was \$7.8 million compared to \$8.1 million for the prior year period. Operating loss decreased by \$0.3 million, driven primarily by incremental restructuring benefits of approximately \$4 million, a prior period other intangible asset impairment charge of \$2.3 million, lower raw material costs, higher absorption and productivity and organic sales growth, offset by \$2.8 million higher restructuring and related charges and unfavorable mix. Widia operating loss margin was 6.0 percent compared with 6.3 percent in the prior year.

## INFRASTRUCTURE

| (in thousands)          | Three Months Ended March 31, |            | Nine Months Ended March 31, |            |
|-------------------------|------------------------------|------------|-----------------------------|------------|
|                         | 2017                         | 2016       | 2017                        | 2016       |
| Sales                   | \$ 192,878                   | \$ 181,465 | \$ 537,167                  | \$ 636,624 |
| Operating income (loss) | 19,770                       | 3,748      | 22,457                      | (242,417)  |

For the three months ended March 31, 2017, Infrastructure sales increased by 6 percent from the prior year quarter, reflecting organic growth of 4 percent and a 2 percent increase due to more business days. Excluding the impact of currency exchange, sales increased by approximately 22 percent in energy, 3 percent in earthworks and 1 percent in general engineering. Key energy markets, particularly in North America, showed strong growth during the quarter with average quarterly land U.S. rig counts up 37 percent year-over-year. On a segment regional basis excluding the impact of currency exchange, sales increased 12 percent in Asia and 6 percent in the Americas, while Europe remained flat. The sales increase in Asia was driven primarily by the performance in the earthworks and general engineering end markets. The sales increase in the Americas was primarily driven by performance in the energy and earthworks end markets. Flat sales in Europe reflect an increase in the energy end market, offset by a decrease in the earthworks end market.

For the three months ended March 31, 2017, Infrastructure operating income increased by \$16.0 million, driven primarily by incremental restructuring program benefits of approximately \$8 million, higher absorption and productivity, favorable mix, a prior period \$1.1 million loss on divestiture and \$0.7 million lower restructuring and related charges in the current period, offset partially by higher raw material costs in the current period. Infrastructure operating margin was 10.3 percent compared with 2.1 percent in the prior year.

[Table of Contents](#)**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

For the nine months ended March 31, 2017, Infrastructure sales decreased by 16 percent, reflecting a 12 percent decline due to divestiture, a 3 percent organic sales decline and a 1 percent unfavorable currency exchange impact. Excluding the impact of currency exchange and divestiture, sales decreased by approximately 10 percent in earthworks and 2 percent in general engineering, offset partially by an increase of approximately 7 percent in energy. Key energy markets, particularly in North America, have continued to stabilize during the year. U.S. rig counts have increased steadily from fiscal 2016 year-end lower levels. Oil and gas sales in the Americas have increased year-over-year by 19 percent compared to the prior year. Conditions in underground mining in North America were impacted by challenges in the first half of the year and sales have declined by 17 percent compared to the prior year. On a segment regional basis excluding the impact of divestiture and currency exchange, sales decreased 4 percent in Europe, 3 percent in the Americas and 1 percent in Asia. The sales decrease in Europe was driven primarily by a decrease in earthworks, partially offset by an increase in energy. The sales decrease in the Americas was primarily driven by decreases in the earthworks and general engineering end markets, offset partially by an increase in the energy end market. The sales decrease in Asia was driven primarily by the performance in the earthworks end market, offset partially by increases in the general engineering end market, and to a lesser extent increases in the energy end market.

For the nine months ended March 31, 2017, Infrastructure operating income was \$22.5 million compared to operating loss of \$242.4 million for the prior year period. The change in operating results is due primarily to a prior period \$127.2 million loss on divestiture, prior period goodwill and other intangible asset impairment charges of \$106.1 million, lower raw material costs, higher productivity, incremental restructuring program benefits of approximately \$17 million and divestiture impact of \$1.9 million, offset partially by lower organic sales, \$5.6 million more restructuring and related charges and unfavorable mix. Infrastructure operating income margin was 4.2 percent compared with operating loss margin of 38.1 percent in the prior year.

**CORPORATE**

| (in thousands)                | Three Months Ended March 31, |            | Nine Months Ended December 31, |            |
|-------------------------------|------------------------------|------------|--------------------------------|------------|
|                               | 2017                         | 2016       | 2016                           | 2016       |
| Corporate unallocated expense | \$ (999)                     | \$ (1,105) | \$ (4,084)                     | \$ (9,391) |

For the three months ended March 31, 2017, Corporate unallocated expense decreased \$0.1 million, or 9.6 percent, from the prior year quarter.

For the nine months ended March 31, 2017, Corporate unallocated expense decreased \$5.3 million, or 56.5 percent, primarily due to \$5.6 million lower restructuring-related charges in the current period.

**LIQUIDITY AND CAPITAL RESOURCES**

Cash flow from operations is the primary source of funding for capital expenditures and internal growth. Year to date March 31, 2017 cash flow provided by operating activities was \$80.0 million, primarily driven by cash earnings, partially offset by increases in primary working capital and by net outflows from changes in other assets and liabilities.

Our five-year, multi-currency, revolving credit facility, as amended and restated in April 2016 (Credit Agreement) is used to augment cash from operations and is an additional source of funds. The Credit Agreement permits revolving credit loans of up to \$600.0 million for working capital, capital expenditures and general corporate purposes. The Credit Agreement allows for borrowings in U.S. dollars, euro, Canadian dollars, pound sterling and Japanese yen. Interest payable under the Credit Agreement is based upon the type of borrowing under the facility and may be (1) LIBOR plus an applicable margin, (2) the greater of the prime rate or the Federal Funds effective rate plus an applicable margin, or (3) fixed as negotiated by us. The Credit Agreement matures in April 2021. We had no borrowings outstanding on our Credit Agreement as of March 31, 2017.

The Credit Agreement requires us to comply with various restrictive and affirmative covenants, including two financial covenants: a maximum leverage ratio and a minimum consolidated interest coverage ratio (as those terms are defined in the agreement). We were in compliance with all covenants as of March 31, 2017. For the nine months ended March 31, 2017, average daily borrowings outstanding under the Credit Agreement were approximately \$29.1 million. Borrowings under the Credit Agreement are guaranteed by our significant domestic subsidiaries.



**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

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We consider the unremitted earnings of our non-U.S. subsidiaries that have not previously been taxed in the U.S. to be permanently reinvested. As of March 31, 2017, cash and cash equivalents of \$42.8 million and short-term intercompany advances made by our foreign subsidiaries to our U.S. parent of \$18.5 million would not be available for use in the U.S. on a long-term basis without incurring U.S. federal and state income tax consequences. We have not, nor do we anticipate the need to, repatriate funds to the U.S. to satisfy domestic liquidity needs arising in the ordinary course of business or associated with our domestic debt service requirements.

At March 31, 2017, cash and cash equivalents were \$100.8 million, total debt, including notes payable, was \$696.2 million and total Kennametal Shareholders' equity was \$946.0 million. Our current senior credit ratings are at investment grade levels. We believe that our current financial position, liquidity and credit ratings provide access to the capital markets. We believe that we have sufficient resources available to meet cash requirements for the next 12 months. We continue to closely monitor our liquidity position and the condition of the capital markets, as well as the counterparty risk of our credit providers.

There have been no material changes in our contractual obligations and commitments since June 30, 2016.

*Cash Flow Provided by Operating Activities*

During the nine months ended March 31, 2017, cash flow provided by operating activities was \$80.0 million, compared to \$145.4 million for the prior year period. Cash flow provided by operating activities for the current year period consisted of net income and non-cash items amounting to an inflow of \$124.5 million and changes in certain assets and liabilities netting to an outflow of \$44.5 million. Contributing to the changes in certain assets and liabilities were an increase in inventories of \$38.1 million, a decrease in accrued pension and postretirement benefits of \$18.8 million and an increase in accounts receivable of \$12.7 million. Partially offsetting these cash outflows was a net increase of accounts payable and accrued liabilities of \$25.8 million. The increases in inventories, accounts payable and accounts receivable is due in part to higher demand trends in most of our end markets.

During the nine months ended March 31, 2016, cash flow provided by operating activities for the period consisted of net loss and non-cash items amounting to an inflow of \$104.0 million, and by changes in certain assets and liabilities netting to an inflow of \$41.4 million. Contributing to the changes in certain assets and liabilities were a decrease in accounts receivable of \$44.1 million due to lower sales volume and a decrease in inventory of \$47.8 million due to our continued focus on working capital management. Offsetting these cash inflows were a decrease of accounts payable and accrued liabilities of \$16.2 million primarily driven by lower restructuring liabilities and accrued compensation, partially offset by an increase in accounts payable due to lower volumes and our continued focus on working capital management; a decrease in accrued pension and postretirement benefits of \$22.9 million primarily due to payments to previous executives; and a decrease of accrued income taxes of \$13.0 million primarily driven by payment of a capital gains tax related to a prior period tax reorganization.

*Cash Flow Used for Investing Activities*

Cash flow used for investing activities was \$90.1 million for the nine months ended March 31, 2017, compared to \$16.2 million in the prior year period. During the current year period, cash flow used for investing activities included capital expenditures, net of \$90.2 million, which consisted primarily of equipment upgrades.

For the nine months ended March 31, 2016, cash flow used for investing activities included capital expenditures, net of \$78.2 million, which consisted primarily of equipment upgrades. These capital expenditures were partially offset by \$61.1 million of proceeds from the sale of non-core businesses.

*Cash Flow Used for Financing Activities*

Cash flow used for financing activities was \$47.8 million for the nine months ended March 31, 2017 compared to \$94.7 million in the prior year period. During the current year period, cash flow used for financing activities included \$48.0 million of cash dividends paid to Shareholders and a \$6.4 million payment on the remaining contingent consideration related to a prior acquisition. These cash outflows were partially offset by \$7.1 million of dividend reinvestment and the effect of employee benefit and stock plans.

For the nine months ended March 31, 2016, cash flow used for financing activities primarily included \$48.4 million net decrease in borrowings and \$47.8 million of cash dividends paid to Shareholders. These cash flows were partially offset by \$1.7 million of dividend reinvestment and the effect of employee benefit and stock plans.



**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

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**FINANCIAL CONDITION**

Working capital was \$616.2 million at March 31, 2017, a decrease of \$31.8 million from \$648.1 million at June 30, 2016. The decrease in working capital was primarily driven by a decrease in cash and cash equivalents of \$60.8 million, a decrease in deferred income taxes of \$26.7 million due to the impact of prospective adoption of a new accounting standard requiring all deferred tax assets and liabilities to be classified as long-term and a decrease in accounts payable of \$8.8 million as a result of increasing volumes. Partially offsetting these items were an increase in inventories of \$31.4 million, an increase in other current assets of \$17.8 million due primarily to the reclassification of \$14 million prepaid taxes from noncurrent to current as we expect to receive a refund in the next 12 months, a decrease in other current liabilities of \$11.7 million due primarily to the payment to relieve the remaining contingent consideration related to a prior year acquisition lower accrued compensation and an increase in accounts receivable of \$6.0 million due to increasing volumes. Currency exchange rate effects decreased working capital in total by \$10.3 million, the impact of which is included in the aforementioned changes.

Property, plant and equipment, net decreased \$1.8 million from \$730.6 million at June 30, 2016 to \$728.8 million at March 31, 2017, primarily due to depreciation expense of \$68.4 million, a negative currency exchange impact of \$7.9 million during the current period and disposals of \$3.9 million. These decreases are partially offset by capital expenditures of \$94.1 million, which includes \$15.4 million change in accounts payable related to purchases of property, plant and equipment.

At March 31, 2017, other assets were \$562.9 million, an increase of \$6.1 million from \$556.8 million at June 30, 2016. The primary driver for the increase was an increase in deferred income taxes of \$20.0 million due in part to the impact of prospective adoption of a new accounting standard requiring all deferred tax assets and liabilities to be classified as long-term. This increase was partially offset by a \$14.1 million decrease in other intangible assets, which was due to amortization expense of \$12.7 million and unfavorable currency exchange effects of \$1.4 million, and a \$4.2 million decrease in goodwill due to currency exchange effects.

Long-term debt and capital leases increased by \$1.1 million to \$694.6 million at March 31, 2017 from \$693.5 million at June 30, 2016.

Kennametal Shareholders' equity was \$946.0 million at March 31, 2017, a decrease of \$18.4 million from \$964.3 million at June 30, 2016. The decrease was primarily due to cash dividends paid to Shareholders of \$48.0 million and unfavorable currency exchange of \$26.5 million, partially offset by net income attributable to Kennametal of \$24.5 million, capital stock issued under employee benefit and stock plans of \$21.4 million, reclassification of net pension and other postretirement benefit loss of \$5.4 million and unrecognized net pension and other postretirement benefit gain of \$3.4 million.

**ENVIRONMENTAL MATTERS**

The operation of our business has exposed us to certain liabilities and compliance costs related to environmental matters. We are involved in various environmental cleanup and remediation activities at certain of our locations.

*Superfund Sites* Among other environmental laws, we are subject to the Comprehensive Environmental Response Compensation and Liability Act of 1980 (Superfund), under which we have been designated by the United States Environmental Protection Agency (USEPA) as a potentially responsible party (PRP) with respect to environmental remedial costs at certain Superfund sites. We have evaluated our claims and liabilities associated with these Superfund sites based upon best currently available information. We believe our environmental accruals are adequate to cover our portion of the environmental remedial costs at the Superfund sites where we have been designated a PRP, to the extent these expenses are probable and reasonably estimable.

*Other Environmental Matters* We establish and maintain reserves for other potential environmental issues. At March 31, 2017 and June 30, 2016, the balances of these reserves were \$12.1 million and \$12.5 million, respectively. These reserves represent anticipated costs associated with the remediation of these issues.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)**

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The reserves we have established for environmental liabilities represent our best current estimate of the costs of addressing all identified environmental situations, based on our review of currently available evidence, and taking into consideration our prior experience in remediation and that of other companies, as well as public information released by the USEPA, other governmental agencies, and by the PRP groups in which we are participating. Although the reserves currently appear to be sufficient to cover these environmental liabilities, there are uncertainties associated with environmental liabilities, and we can give no assurance that our estimate of any environmental liability will not increase or decrease in the future. The reserved and unreserved liabilities for all environmental concerns could change substantially due to factors such as the nature and extent of contamination, changes in remedial requirements, technological changes, discovery of new information, the financial strength of other PRPs, the identification of new PRPs and the involvement of and direction taken by the government on these matters.

We maintain a Corporate Environmental Health and Safety (EHS) Department, to monitor compliance with environmental regulations and to oversee remediation activities. In addition, we have designated EHS coordinators who are responsible for each of our global manufacturing facilities. Our financial management team periodically meets with members of the Corporate EHS Department and the Corporate Legal Department to review and evaluate the status of environmental projects and contingencies. On a quarterly basis, we review financial provisions and reserves for environmental contingencies and adjust these reserves when appropriate.

**DISCUSSION OF CRITICAL ACCOUNTING POLICIES**

There have been no changes to our critical accounting policies since June 30, 2016.

**NEW ACCOUNTING STANDARDS**

See Note 3 to our condensed consolidated financial statements set forth in Part I Item 1 of this Quarterly Report on Form 10-Q for a description of new accounting standards.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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There have been no material changes to our market risk exposures since June 30, 2016.

**ITEM 4. CONTROLS AND PROCEDURES**

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As of the end of the period covered by this quarterly report on Form 10-Q, the Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). The Company's disclosure controls were designed to provide a reasonable assurance that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. However, the controls have been designed to provide reasonable assurance of achieving the controls' stated goals. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance at March 31, 2017 to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is (i) accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and (ii) recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Part I, Item 1, under the caption “Regulation” of the annual report on Form 10-K for the year ended June 30, 2016 is incorporated by reference into this Item 1. From time to time, we are party to legal claims and proceedings that arise in the ordinary course of business, which may relate to our operations or assets, including real, tangible or intellectual property. Although certain of these actions are currently pending, we do not believe that any individual proceeding is material or that our pending legal proceedings in the aggregate are material to Kennametal.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****ISSUER PURCHASES OF EQUITY SECURITIES**

| Period                               | Total Number of Shares Purchased <sup>(1)</sup> | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup> |
|--------------------------------------|---|------------------------------|--|---|
| January 1 through January 31, 2017   | 4,061   | \$ 34.46                     | —  | 10,100,100  |
| February 1 through February 28, 2017 | 9,477   | 37.44                        | —  | 10,100,100  |
| March 1 through March 31, 2017       | 3,469   | 38.75                        | —  | 10,100,100  |
| Total                                | 17,007  | \$ 37.00                     | —  |   |

- (1) During the current period, 1,616 shares were purchased on the open market on behalf of Kennametal to fund the Company’s dividend reinvestment program. Also, during the current period employees delivered 15,391 shares of restricted stock to Kennametal, upon vesting, to satisfy tax withholding requirements.
- (2) On July 25, 2013, the Company publicly announced an amended repurchase program for up to 17 million shares of its outstanding capital stock outside of the Company’s dividend reinvestment program.

**UNREGISTERED SALES OF EQUITY SECURITIES**

None.

**ITEM 6. EXHIBITS**

|              |   |                 |
|--------------|---|-----------------|
| <b>(31)</b>  | <b>Rule 13a-14(a)/15d-14(a) Certifications</b>  |                 |
| (31.1)       | Certification executed by Ronald M. De Feo, President and Chief Executive Officer of Kennametal Inc.  | Filed herewith. |
| (31.2)       | Certification executed by Jan Kees van Gaalen, Vice President and Chief Financial Officer of Kennametal Inc.  | Filed herewith. |
| <b>(32)</b>  | <b>Section 1350 Certifications</b>  |                 |
| (32.1)       | Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Ronald M. De Feo, President and Chief Executive Officer of Kennametal Inc., and Jan Kees van Gaalen, Vice President and Chief Financial Officer of Kennametal Inc. | Filed herewith. |
| <b>(101)</b> | <b>XBRL</b>   |                 |
| (101.INS)    | XBRL Instance Document  | Filed herewith. |
| (101.SCH)    | XBRL Taxonomy Extension Schema Document   | Filed herewith. |
| (101.CAL)    | XBRL Taxonomy Extension Calculation Linkbase Document   | Filed herewith. |
| (101.DEF)    | XBRL Taxonomy Definition Linkbase   | Filed herewith. |
| (101.LAB)    | XBRL Taxonomy Extension Label Linkbase Document   | Filed herewith. |
| (101.PRE)    | XBRL Taxonomy Extension Presentation Linkbase Document  | Filed herewith. |

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**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: May 9, 2017

By: /s/ Patrick S. Watson

Patrick S. Watson

Vice President Finance and Corporate Controller

I, Ronald M. De Feo, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kennametal Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions)
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 9, 2017

/s/ Ronald M. De Feo

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Ronald M. De Feo  
President and Chief Executive Officer

I, Jan Kees van Gaalen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kennametal Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions)
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 9, 2017

/s/ Jan Kees van Gaalen

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Jan Kees van Gaalen  
Vice President and Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Kennametal Inc. (the "Corporation") on Form 10-Q for the period ended March 31, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Corporation certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his knowledge:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Corporation.

/s/ Ronald M. De Feo

Ronald M. De Feo  
President and Chief Executive Officer

May 9, 2017

/s/ Jan Kees van Gaalen

Jan Kees van Gaalen  
Vice President and Chief Financial Officer

May 9, 2017

\*This certification is made solely for purposes of 18 U.S.C. Section 1350, subject to the knowledge standard contained therein, and not for any other purpose.

