KENNAMETAL INC
Form 10-Q
February 05, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2018
Commission file number 1-5318
KENNAMETAL INC.
(Exact name of registrant as specified in its charter)

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

600 Grant Street Suite 5100 Pittsburgh, Pennsylvania	15219-2706
(Address of principal executive offices)	(Zip Code)

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 [X] NO [ ]
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES [X] 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 [X]	Accelerated filer [ ]
Non-accelerated filer [ ]	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 [X]
Indicate the number of shares outstanding of each of the issuer’s classes of capital stock, as of the latest practicable date.

Title of Each Class	Outstanding at January 31, 2019
Capital Stock, par value $1.25 per share	82,233,615

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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,” “pl 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: downturns in the business cycle or the economy; our ability to achieve anticipated benefits of our restructuring, simplification and modernization initiatives; risks related to our foreign operations and international markets, such as fluctuations in 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; 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. Except as required by law, we do not intend to release publicly any revisions to forward-looking statements as a result of future events or developments.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KENNAMETAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands, except per share amounts)	2018	2017	2018	2017
Sales (Note 3)	$587,394	$571,345	$1,174,080	$1,113,799
Cost of goods sold	388,796	381,844	764,389	742,348
Gross profit	198,598	189,501	409,691	371,451
Operating expense	114,635	122,138	237,920	242,731
Restructuring and asset impairment charges (Note 7)	1,545	45	2,620	5,570
Amortization of intangibles	3,560	3,677	7,141	7,338
Operating income	78,858	63,641	162,010	115,812
Interest expense	8,104	7,231	16,201	14,379
Other income, net	(4,022)	(3,220)	(6,782)	(7,437)
Income before income taxes	74,776	59,630	152,591	108,870
Provision for income taxes	18,529	17,472	37,921	27,074
Net income	56,247	42,158	114,670	81,796
Less: Net income attributable to noncontrolling interests	1,549	557	3,274	1,011
Net income attributable to Kennametal	$54,698	$41,601	$111,396	$80,785
PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREHOLDERS				
Basic earnings per share	$0.66	$0.51	$1.35	$0.99
Diluted earnings per share	$0.66	$0.50	$1.34	$0.98
Dividends per share	$0.20	$0.20	$0.40	$0.40
Basic weighted average shares outstanding	82,331	81,477	82,218	81,274
Diluted weighted average shares outstanding	83,310	82,778	83,233	82,446

KENNAMETAL INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Net income	$56,247	$42,158	$114,670	$81,796
Other comprehensive (loss) income, net of tax				
Unrealized gain (loss) on derivatives designated and qualified as cash flow hedges	170	(286)	(91)	(905)
Reclassification of unrealized loss on derivatives designated and qualified as cash flow hedges	262	1,007	857	1,403
Unrecognized net pension and other postretirement benefit gain (loss)	871	(625)	1,194	(2,590)

Reclassification of net pension and other postretirement benefit loss	1,298	1,569	2,606	3,348
Foreign currency translation adjustments	(3,400)	13,924	(19,605)	33,793
Total other comprehensive (loss) income, net of tax	(799)	15,589	(15,039)	35,049
Total comprehensive income	55,448	57,747	99,631	116,845
Less: comprehensive income attributable to noncontrolling interests	2,049	1,445	2,542	2,184
Comprehensive income attributable to Kennametal Shareholders	$53,399	$56,302	$97,089	$114,661

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)	December 31, 2018	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 96,276	$ 556,153
Accounts receivable, less allowance for doubtful accounts of $10,951 and $11,807, respectively	380,683	401,290
Inventories (Note 10)	578,566	525,466
Other current assets	63,509	63,257
Total current assets	1,119,034	1,546,166
Property, plant and equipment:		
Land and buildings	349,857	351,953
Machinery and equipment	1,753,544	1,702,243
Less accumulated depreciation	(1,248,298)	(1,229,983)
Property, plant and equipment, net	855,103	824,213
Other assets:		
Goodwill (Note 17)	300,003	301,802
Other intangible assets, less accumulated amortization of $151,364 and $145,334, respectively (Note 17)	168,486	176,468
Deferred income taxes	16,052	17,015
Other	72,430	60,073
Total other assets	556,971	555,358
Total assets	$ 2,531,108	$ 2,925,737
LIABILITIES		
Current liabilities:		
Current maturities of long-term debt (Note 11)	$ —	$ 399,266
Notes payable to banks	3,371	934
Accounts payable	198,350	221,903
Accrued income taxes	28,621	18,603
Accrued expenses	57,780	95,239
Other current liabilities	123,931	150,586
Total current liabilities	412,053	886,531
Long-term debt, less current maturities (Note 11)	591,688	591,505
Deferred income taxes	28,563	26,991
Accrued pension and postretirement benefits	157,818	159,522
Accrued income taxes	8,374	6,249
Other liabilities	24,328	24,612
Total liabilities	1,222,824	1,695,410
Commitments and contingencies		
EQUITY (Note 15)		
Kennametal Shareholders’ Equity:		
Preferred stock, no par value; 5,000 shares authorized; none issued	—	—
Capital stock, $1.25 par value; 120,000 shares authorized; 82,160 and 81,646 shares issued, respectively	102,700	102,058
Additional paid-in capital	522,413	511,909
Retained earnings	979,259	900,683

Accumulated other comprehensive loss	(334,632)	(320,325)
Total Kennametal Shareholders’ Equity	1,269,740	1,194,325
Noncontrolling interests	38,544	36,002
Total equity	1,308,284	1,230,327
Total liabilities and equity	$ 2,531,108	$ 2,925,737

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

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

	Six Months Ended December 31,	
(in thousands)	2018	2017
OPERATING ACTIVITIES		
Net income	$114,670	$81,796
Adjustments for non-cash items:		
Depreciation	47,807	46,061
Amortization	7,141	7,338
Stock-based compensation expense	13,435	11,995
Restructuring and asset impairment charges (Note 7)	(257)	3,172
Deferred income tax provision	1,512	7,241
Other	2,109	3,474
Changes in certain assets and liabilities:		
Accounts receivable	14,026	(3,290)
Inventories	(59,190)	(9,080)
Accounts payable and accrued liabilities (Note 4)	(82,828)	(92,320)
Accrued income taxes	7,995	3,966
Accrued pension and postretirement benefits	(9,760)	(13,824)
Other	4,841	(5,455)
Net cash flow provided by operating activities	61,501	41,074
INVESTING ACTIVITIES		
Purchases of property, plant and equipment (Note 4)	(88,076)	(59,523)
Disposals of property, plant and equipment	2,490	846
Other	89	244
Net cash flow used for investing activities	(85,497)	(58,433)
FINANCING ACTIVITIES		
Net increase in notes payable	2,473	643
Net decrease in short-term revolving and other lines of credit	(174)	—
Term debt repayments	(400,000)	(141)
Purchase of capital stock	(107)	(109)
The effect of employee benefit and stock plans and dividend reinvestment	(2,182)	15,020
Cash dividends paid to Shareholders	(32,820)	(32,456)
Other	151	(271)
Net cash flow used for financing activities	(432,659)	(17,314)
Effect of exchange rate changes on cash and cash equivalents	(3,222)	3,984
CASH AND CASH EQUIVALENTS		
Net decrease in cash and cash equivalents	(459,877)	(30,689)
Cash and cash equivalents, beginning of period	556,153	190,629
Cash and cash equivalents, end of period	$96,276	$159,940

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

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KENNAMETAL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1.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 2018 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2018 was derived from the audited balance sheet included in our 2018 Annual Report on Form 10-K. These interim statements are unaudited; however, we believe that all adjustments necessary for a fair statement of the results of the interim periods were made and all adjustments are normal recurring adjustments. The results for the six months ended December 31, 2018 and 2017 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 2019 is to the fiscal year ending June 30, 2019. When used in this Quarterly Report on Form 10-Q, unless the context requires otherwise, the terms “we,” “our” and “us” refer to Kennametal Inc. and its subsidiaries.

2.NEW ACCOUNTING STANDARDS

Adopted

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," which requires an entity to recognize revenue in a manner that depicts the transfer of promised goods to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange. The standard also expands the disclosure requirements around contracts with customers. We adopted Topic 606 July 1, 2018 using the modified retrospective transition method applied to those contracts that were not completed as of that date. The adoption did not have a material impact on the condensed consolidated financial statements beyond the additional disclosure requirements. Refer to Notes 3 and 18 to the condensed consolidated financial statements for further details.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)," which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice with respect to how these are classified in the statement of cash flows. We adopted this ASU July 1, 2018. Adoption of this guidance did not have a material effect on our condensed consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory," which clarifies that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. We adopted this ASU July 1, 2018. Adoption of this guidance did not have a material effect on our condensed consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which 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. We adopted this ASU July 1, 2018, with the amendments applied on a retrospective basis. Refer to Note 9 to the condensed consolidated financial statements for further details.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting," which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. We adopted this ASU July 1, 2018. Adoption of this guidance did not have a material effect on

our condensed consolidated financial statements.
Issued
In February 2016, the FASB issued ASU No. 2016-02, "Leases: Topic 842," which replaces the existing guidance in ASC 840, Leases. The standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for substantially all leases. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. This standard is effective for Kennametal beginning July 1, 2019. Currently, we are inventorying our leasing arrangements and gathering lease data in order to determine the impact this ASU will have on our consolidated financial statements.

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

3. REVENUE RECOGNITION

Revenue Accounting Description and Policy

The Company's contracts with customers are comprised of purchase orders, and for larger customers, may also include long-term agreements. We account for a contract when it has approval and commitment from both parties, the rights of the parties and payment terms are identified, the contract has commercial substance and collectability of consideration is probable. These contracts with customers typically relate to the manufacturing of products, which represent single performance obligations that are satisfied when control of the product passes to the customer. The Company considers the timing of right to payment, transfer of risk and rewards, transfer of title, transfer of physical possession and customer acceptance when determining when control transfers to the customer. As a result, revenue is generally recognized at a point in time - either upon shipment or delivery - based on the specific shipping terms in the contract. The shipping terms vary across all businesses and depend on the product, customary local commercial terms and the type of transportation. Shipping and handling activities are accounted for as activities to fulfill a promise to transfer a product to a customer and as such, costs incurred are recorded when the related revenue is recognized. Payment for products is due within a limited time period after shipment or delivery, typically within 30 to 90 calendar days of the respective invoice dates. The Company does not generally offer extended payment terms.

Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods. Amounts billed and due from our customers are classified as accounts receivable, less allowance for doubtful accounts on the condensed consolidated balance sheet. Certain contracts with customers, primarily distributor customers, have an element of variable consideration that is estimated when revenue is recognized under the contract. Variable consideration primarily includes volume incentive rebates, which are based on achieving a certain level of purchases and other performance criteria as established by our distributor programs. These rebates are estimated based on projected sales to the customer and accrued as a reduction of net sales as they are earned. The majority of our products are consumed by our customers or end users in the manufacture of their products. Historically, we have experienced very low levels of returned products and do not consider the effect of returned products to be material.

See "Note 18. Segment Data" for disaggregation of revenue by geography and end market.

Contract Balances

The Company records a contract asset when it has a right to payment from a customer that is conditioned on events that have occurred other than the passage of time. The Company also records a contract liability when customers prepay but the Company has not yet satisfied its performance obligation. The Company did not have any material remaining performance obligations, contract assets or liabilities as of December 31, 2018 and June 30, 2018.

Practical Expedient

The Company pays sales commissions related to certain contracts, which qualify as incremental costs of obtaining a contract. However, the Company applies the practical expedient that allows an entity to recognize incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that would have been recognized is one year or less. These costs are recorded within operating expense in our condensed consolidated statement of income.

4. SUPPLEMENTAL CASH FLOW DISCLOSURES

	Six Months Ended December 31,			
(in thousands)	2018		2017	
Cash paid during the period for:				
Income taxes	$	28,414	$	15,866
Interest	16,745		13,714	

Supplemental disclosure of non-cash information:		
Changes in accounts payable related to purchases of property, plant and equipment	(100)	14,200

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

During the current quarter, the Company revised its condensed consolidated statement of cash flow for the six months ended December 31, 2017 to correctly present the changes in accounts payable and accrued liabilities and in purchases of property, plant and equipment, resulting in a decrease of $25.7 million to previously reported net cash flow provided by operating activities and a corresponding decrease to previously reported net cash flow used for investing activities. Revisions of $22.7 million will be made in future filings to the condensed consolidated statements of cash flow for the nine months ended March 31, 2018 with similar effects on the condensed consolidated statements of cash flow. The supplemental disclosure of non-cash information for changes in accounts payable related to purchases of property, plant and equipment for the six months ended December 31, 2017 was also revised accordingly, at an increase of $14.2 million. The amount of that disclosure will be revised in future filings for the nine months ended March 31, 2018 to depict an increase of $11.2 million. The Company has evaluated the correction and determined it was not material to the previously issued interim financial statements. The correction had no effect on the previously issued annual financial statements.

5.FAIR VALUE MEASUREMENTS
Fair value is defined as the price that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy consists of three levels to prioritize the inputs used in valuations, as defined below:
Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
Level 3: Inputs that are unobservable.
As of December 31, 2018, 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
Assets:				
Derivatives [1]	$ —	$ 513	$ —	$513
Total assets at fair value	$ —	$ 513	$ —	$513
Liabilities:				
Derivatives [1]	$ —	$ 49	$ —	$49
Total liabilities at fair value	$ —	$ 49	$ —	$49

As of June 30, 2018, 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
Assets:				
Derivatives [1]	$ —	$1,665	$ —	$1,665
Total assets at fair value	$ —	$1,665	$ —	$1,665
Liabilities:				

Derivatives [1]	$ —	$ 207	$ —	$ 207
Total liabilities at fair value	$ —	$ 207	$ —	$ 207

[1] 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.

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

6. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

(in thousands)	December 31, 2018	June 30, 2018
Derivatives designated as hedging instruments		
Other current assets - range forward contracts	$ 513	$799
Other current liabilities - range forward contracts	—	(5)
Other assets - range forward contracts	—	27
Total derivatives designated as hedging instruments	513	821
Derivatives not designated as hedging instruments		
Other current assets - currency forward contracts	—	839
Other current liabilities - currency forward contracts	(49)	(202)
Total derivatives not designated as hedging instruments	(49)	637
Total derivatives	$ 464	$1,458

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

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Other income, net - currency forward contracts	$(2)	$(92)	$76	$(208)

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 are recorded in accumulated other comprehensive loss and are recognized as a component of other income, 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 December 31, 2018 and June 30, 2018, was $43.5 million and $62.9 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 December 31, 2018, we expect to recognize into earnings $0.3 million of income on outstanding derivatives in the next 12 months.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Gaines (losses) recognized in other comprehensive (loss) income, net	$170	$(287)	$(91)	$(906)
Losses reclassified from accumulated other comprehensive loss into other income, net	$565	$870	$1,097	$1,262

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KENNAMETAL INC.
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 six months ended December 31, 2018 and 2017.

NET INVESTMENT HEDGES

As of December 31, 2018, we had certain foreign currency-denominated intercompany loans payable with total aggregate principal amounts of €71.0 million as net investment hedges to hedge the foreign exchange exposure of our net investment in Euro-based subsidiaries. We recorded a gain of $0.5 million and a loss of $0.5 million as a component of foreign currency translation adjustments in other comprehensive (loss) income for the three months ended December 31, 2018 and 2017, respectively. We recorded a gain of $0.5 million and a loss of $1.9 million as a component of foreign currency translation adjustments in other comprehensive (loss) income for the six months ended December 31, 2018 and 2017, respectively.

As of December 31, 2018, the foreign currency-denominated intercompany loans payable designated as net investment hedges consisted of:

Instrument	Notional (EUR in thousands)[2]	Notional (USD in thousands)[2]	Maturity
Foreign currency-denominated intercompany loan payable	€40,125	$ 45,927	June 27, 2019
Foreign currency-denominated intercompany loan payable	27,728	31,738	June 26, 2022
Foreign currency-denominated intercompany loan payable	6,509	7,450	November 20, 2021
Foreign currency-denominated intercompany loan payable	2,024	2,316	October 11, 2019

[2] Includes principal and accrued interest.

7. RESTRUCTURING AND RELATED CHARGES

In the June quarter of fiscal 2018, we implemented and substantially completed restructuring actions to simplify the Industrial segment's cost structure by directing resources to more profitable business and increasing sales force productivity. We supplemented this with the rationalization of small manufacturing facilities in the Infrastructure and Industrial segments, which we expect to complete in fiscal 2019. Total restructuring and related charges since inception of $13.9 million have been recorded for this program through December 31, 2018.

We recorded restructuring and related charges of $2.1 million and $1.5 million for the three months ended December 31, 2018 and 2017, respectively. Of these amounts, restructuring charges totaled $1.5 million for the three months ended December 31, 2018 and were less than $0.1 million for the three months ended December 31, 2017. Restructuring-related charges of $0.6 million and $1.3 million were recorded in cost of goods sold for the three months ended December 31, 2018 and 2017, respectively. For the three months ended December 31, 2017, restructuring-related charges of $0.2 million were recorded in operating expense.

We recorded restructuring and related charges of $3.1 million and $8.4 million for the six months ended December 31, 2018 and 2017, respectively. Of these amounts, restructuring charges totaled $2.6 million and $5.6 million, respectively. Restructuring-related charges of $0.5 million and $2.5 million were recorded in cost of goods sold for the six months ended December 31, 2018 and 2017, respectively. For the six months ended December 31, 2017, restructuring-related charges of $0.3 million were recorded in operating expense.

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

As of December 31, 2018, the total restructuring accrual is recorded in other current liabilities in our condensed consolidated balance sheet. As of June 30, 2018, $17.5 million and $0.1 million of the restructuring accrual is recorded in other current liabilities and other liabilities, respectively. The amount attributable to each segment is as follows:

(in thousands)	June 30, 2018	Expense	Asset Write-Down	Translation	Cash Expenditures	December 31, 2018
Industrial						
Severance	$7,967	$1,552	$ —	$ (128)	$ (3,568)	$ 5,823
Facilities	—	(9)	9	—	—	—
Other	—	29	—	(1)	10	38
Total Industrial	$7,967	$1,572	$ 9	$ (129)	$ (3,558)	$ 5,861
Widia						
Severance	$2,087	$113	$ —	$ (9)	$ (261)	$ 1,930
Facilities	—	—	—	—	—	—
Other	15	2	—	—	1	18
Total Widia	$2,102	$115	$ —	$ (9)	$ (260)	$ 1,948
Infrastructure						
Severance	$7,558	$1,159	$ —	$ (96)	$ (2,665)	$ 5,956
Facilities	—	(248)	248	—	—	—
Other	12	22	—	—	7	41
Total Infrastructure	$7,570	$933	$ 248	$ (96)	$ (2,658)	$ 5,997
Total	$17,639	$2,620	$ 257	$ (234)	$ (6,476)	$ 13,806

8. STOCK-BASED COMPENSATION

Stock Options

Changes in our stock options for the six months ended December 31, 2018 were as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Life (years)	Aggregate Intrinsic value (in thousands)
Options outstanding, June 30, 2018	989,992	$ 33.08		
Exercised	(136,405)	29.18		
Lapsed or forfeited	(7,000)	45.24		
Options outstanding, December 31, 2018	846,587	$ 33.61	4.0	$ 3,018
Options vested and expected to vest, December 31, 2018	846,587	$ 33.61	4.0	$ 3,018
Options exercisable, December 31, 2018	841,920	$ 33.68	4.0	$ 2,960

Fair value of options vested during the six months ended December 31, 2018 and 2017 was $1.2 million and $1.7 million, respectively. The amount of cash received from the exercise of capital stock options during the six months ended December 31, 2018 and 2017 was $3.9 million and $19.1 million, respectively. The total intrinsic value of options exercised during the six months ended December 31, 2018 and 2017 was $1.8 million and $4.8 million, respectively.

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Restricted Stock Units – Performance Vesting and Time Vesting

Changes in our performance vesting and time vesting restricted stock units for the six months ended December 31, 2018 were as follows:

	Performance Vesting Stock Units	Performance Vesting Weighted Average Fair Value	Time Vesting Stock Units	Time Vesting Weighted Average Fair Value
Unvested, June 30, 2018	409,297	$ 31.22	1,083,675	$ 30.47
Granted	161,066	40.10	536,910	38.92
Vested	(36,394)	31.86	(461,851)	31.22
Performance metric adjustments, net	41,196	29.69	—	—
Forfeited	(44,179)	31.04	(26,371)	32.27
Unvested, December 31, 2018	530,986	$ 33.77	1,132,363	$ 34.15

During the six months ended December 31, 2018 and 2017, compensation expense related to time vesting and performance vesting restricted stock units was $12.8 million and $11.0 million, respectively. As of December 31, 2018, the total unrecognized compensation cost related to unvested time vesting and performance vesting restricted stock units was $26.7 million and is expected to be recognized over a weighted average period of 2.3 years.

9. PENSION AND OTHER POSTRETIREMENT BENEFITS

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Service cost	$407	$406	$818	$810
Interest cost	7,970	7,678	15,960	15,335
Expected return on plan assets	(13,434)	(14,132)	(26,896)	(28,221)
Amortization of transition obligation	23	23	45	46
Amortization of prior service (credit) cost	(5)	(41)	(10)	132
Recognition of actuarial losses	1,679	1,718	3,374	3,428
Net periodic pension income	$(3,360)	$(4,348)	$(6,709)	$(8,470)

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

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Interest cost	$153	$157	$307	$314
Amortization of prior service credit	(22)	(6)	(45)	(11)
Recognition of actuarial loss	62	70	124	140

Net periodic other postretirement benefit cost	$193	$221	$386	$443

In accordance with ASU 2017-07, as described in Note 2, the service cost of $0.4 million and $0.8 million for the three and six months ended December 31, 2018 and 2017 was reported as a component of cost of goods sold and operating expense. The other components of net periodic pension income and net periodic other postretirement benefit cost totaling a net benefit of $3.6 million and $7.1 million for the three and six months ended December 31, 2018 were presented as a component of other income, net. For the three and six months ended December 31, 2017, we reclassified a net benefit of $3.0 million and $6.1 million, respectively, from cost of goods sold to other income, net and a net benefit of $1.5 million and $2.8 million, respectively, from operating expense to other income, net.

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10. INVENTORIES

We used the last-in, first-out (LIFO) method of valuing inventories for 39 percent and 40 percent of total inventories at December 31, 2018 and June 30, 2018, 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)	December 31, 2018	June 30, 2018
Finished goods	$306,680	$279,240
Work in process and powder blends	256,271	232,973
Raw materials	99,145	96,859
Inventories at current cost	662,096	609,072
Less: LIFO valuation	(83,530)	(83,606)
Total inventories	$578,566	$525,466

11. LONG-TERM DEBT

Our five-year, multi-currency, revolving credit facility, as amended and restated in June 2018 (Credit Agreement), provides for revolving credit loans of up to $700 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 Credit Agreement). We were in compliance with all such covenants as of December 31, 2018. We had no borrowings outstanding under the Credit Agreement as of December 31, 2018 and June 30, 2018. Borrowings under the Credit Agreement are guaranteed by our significant domestic subsidiaries. The Credit Agreement matures in June 2023.

Fixed rate debt had a fair market value of $597.5 million and $996.4 million at December 31, 2018 and June 30, 2018, respectively. The Level 2 fair value is determined based on the quoted market prices for similar debt instruments as of December 31, 2018 and June 30, 2018, respectively.

On July 9, 2018, the Company completed the early redemption of its previously outstanding $400.0 million of 2.650 percent Senior Unsecured Notes due 2019.

12. 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.

We establish and maintain reserves for certain potential environmental issues. At December 31, 2018 and June 30, 2018, the balances of these reserves were $12.5 million and $12.6 million, respectively. These reserves represent anticipated costs associated with the remediation of these issues and are generally not discounted.

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 United States Environmental Protection Agency (USEPA), other governmental agencies and by the Potentially Responsible Party (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.

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KENNAMETAL INC.
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Superfund Sites Among other environmental laws, we are subject to the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), under which we have been designated by the USEPA as a 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.

13. INCOME TAXES
Tax Cuts and Jobs Act of 2017 (TCJA)
The three primary items from TCJA that effect the Company for fiscal 2019 are the reduction in the statutory tax rate, the one-time tax that is imposed on our unremitted foreign earnings (Toll Tax) and the tax on global intangible low-taxed income (GILTI) which we elected to record as a period cost.
The U.S. federal tax rate reduction was effective as of January 1, 2018. As a June 30 fiscal year-end taxpayer, our fiscal 2018 U.S. federal statutory tax rate was a blended rate of 28.1 percent. Our U.S. federal statutory tax rate is 21.0 percent in fiscal 2019.
During the three months ended December 31, 2018, we finalized our estimate of the Toll Tax charge based upon the U.S. Department of the Treasury regulations and other relevant guidance issued through December 31, 2018. The adjustment to the toll charge during the quarter resulted in an additional net benefit of $3.9 million, decreasing the total Toll Tax charge to $78.0 million. We do not expect to make a cash payment associated with the Toll Tax.
In addition to the direct effects of TCJA, the provisions of TCJA caused the Company to re-evaluate its permanent reinvestment assertion in all jurisdictions, concluding that a portion of the unremitted earnings and profits of certain non-U.S. subsidiaries and affiliates will no longer be permanently reinvested. These changes in assertion required the recognition of a tax charge of $6.1 million primarily for foreign withholding and U.S. state income taxes. The remaining amount of unremitted earnings of non-U.S. subsidiaries continue to be indefinitely reinvested. With regard to the unremitted earnings which remain indefinitely reinvested, 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, including liquidity needs associated with our domestic debt service requirements.
At this time, the Company does not anticipate a material impact to the fiscal 2019 condensed consolidated financial statements from the base erosion anti-abuse tax or a deduction for foreign-derived intangible income.
In accordance with the SEC Staff Accounting Bulletin 118, we have finalized our accounting for the impacts of the TCJA provisions enacted in fiscal 2018, including the remeasurement of deferred tax assets and liabilities at the reduced U.S. federal rate of 21.0 percent.
Effective Tax Rates
The effective income tax rates for the three months ended December 31, 2018 and 2017 were 24.8 percent and 29.3 percent, respectively. The current year rate reflects the lower U.S. federal statutory tax rate, the $6.1 million charge related to changes in the indefinite reinvestment assertion on certain foreign subsidiaries' undistributed earnings which are no longer considered permanently reinvested, GILTI and the $3.9 million benefit recorded to reflect the finalization of the amount of the Toll Tax. The prior year rate includes the tax effects associated with the release of a valuation allowance that was previously recorded against our net deferred tax assets in the U.S. and a charge related to an out of period adjustment.
The effective income tax rates for the six months ended December 31, 2018 and 2017 were 24.9 percent. The current year rate reflects the lower U.S. federal statutory tax rate, the $6.1 million charge related to changes in the indefinite reinvestment assertion on certain foreign subsidiaries' undistributed earnings which are no longer considered permanently reinvested, GILTI and the $3.9 million benefit recorded to reflect the finalization of the amount of the

Toll Tax. The prior year rate includes a benefit from the release of a valuation allowance that was previously recorded against our net deferred tax assets in the U.S. and a charge related to an out of period adjustment.

14. 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, performance awards and restricted stock units. The difference between basic and diluted earnings per share relates solely to the effect of capital stock options, performance awards and restricted stock units.

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

The following tables provide the computation of diluted shares outstanding for the three and six months ended December 31, 2018 and 2017:

	Three Months Ended December 31,		Six Months Ended December 31,	
(in thousands)	2018	2017	2018	2017
Weighted-average shares outstanding during period	82,331	81,477	82,218	81,274
Add: Unexercised capital stock options, unvested performance awards and unvested restricted stock units	979	1,301	1,015	1,172
Number of shares on which diluted earnings per share is calculated	83,310	82,778	83,233	82,446
Unexercised capital stock options, performance awards and restricted stock units not included in the computation because the option exercise price was greater than the average market price	469	219	400	483

15. EQUITY

A summary of the changes in the carrying amounts of total equity, Kennametal Shareholders' equity and equity attributable to noncontrolling interests as of December 31, 2018 and 2017 is as follows:

	Kennametal Shareholders' Equity					
(in thousands)	Capital stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Non-controlling interests	Total equity
Balance as of June 30, 2018	$102,058	$511,909	$900,683	$ (320,325)	$ 36,002	$1,230,327
Net income	—	—	111,396	—	3,274	114,670
Other comprehensive loss	—	—	—	(14,307)	(732)	(15,039)
Dividend reinvestment	3	104	—	—	—	107
Capital stock issued under employee benefit and stock plans(3)	642	10,504	—	—	—	11,146
Purchase of capital stock	(3)	(104)	—	—	—	(107)
Cash dividends	—	—	(32,820)	—	—	(32,820)
Balance as of December 31, 2018	$102,700	$522,413	$979,259	$ (334,632)	$ 38,544	$1,308,284

	Kennametal Shareholders' Equity					
(in thousands)	Capital stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Non-controlling interests	Total equity
Balance as of June 30, 2017	$100,832	$474,547	$765,607	$ (323,692)	$ 35,359	$1,052,653
Net income	—	—	80,785	—	1,011	81,796
Other comprehensive income	—	—	—	33,876	1,173	35,049
Dividend reinvestment	3	106	—	—	—	109
Capital stock issued under employee benefit and stock plans(3)	1,065	25,841	—	—	—	26,906
Purchase of capital stock	(3)	(106)	—	—	—	(109)

Cash dividends	—	—	(32,456)	—	—	(32,456)
Balance as of December 31, 2017	$101,897	$500,388	$813,936	$ (289,816)	$ 37,543	$1,163,948

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

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

16. ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of, and changes in, accumulated other comprehensive loss (AOCL) were as follows, net of tax, for the six months ended December 31, 2018:

(in thousands)	Postretirement benefit plans	Currency translation adjustment	Derivatives	Total
Attributable to Kennametal:				
Balance, June 30, 2018	$ (187,755)	$ (127,347)	$ (5,223)	$ (320,325)
Other comprehensive income (loss) before reclassifications	1,194	(18,873)	(91)	(17,770)
Amounts reclassified from AOCL	2,606	—	857	3,463
Net current period other comprehensive income (loss)	3,800	(18,873)	766	(14,307)
AOCL, December 31, 2018	$ (183,955)	$ (146,220)	$ (4,457)	$ (334,632)
Attributable to noncontrolling interests:				
Balance, June 30, 2018	$ —	$ (2,913)	$ —	$ (2,913)
Other comprehensive loss before reclassifications	—	(732)	—	(732)
Net current period other comprehensive loss	—	(732)	—	(732)
AOCL, December 31, 2018	$ —	$ (3,645)	$ —	$ (3,645)

The components of, and changes in, AOCL were as follows, net of tax, for the six months ended December 31, 2017:

(in thousands)	Postretirement benefit plans	Currency translation adjustment	Derivatives	Total
Attributable to Kennametal:				
Balance, June 30, 2017	$ (189,038)	$ (126,606)	$ (8,048)	$ (323,692)
Other comprehensive (loss) income before reclassifications	(2,590)	32,620	(905)	29,125
Amounts reclassified from AOCL				