

KENNAMETAL INC
Form 10-Q
February 03, 2015
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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, 2014
Commission file number 1-5318
KENNAMETAL INC.
(Exact name of registrant as specified in its charter)

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

World Headquarters
1600 Technology Way
P.O. Box 231 15650-0231
Latrobe, Pennsylvania
(Address of principal executive offices) (Zip Code)

Website: www.kennametal.com

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of capital stock, as of the latest practicable date.

| Title of Each Class | Outstanding at January 30, 2015 |
|---|---------------------------------|
| Capital Stock, par value \$1.25 per share | 79,162,006 |

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FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2014
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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” 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; availability and cost of the raw materials we use to manufacture our products; our foreign operations and international markets, such as currency exchange rates, different regulatory environments, trade barriers, exchange controls and social and political instability; changes in the regulatory environment in which we operate, including environmental, health and safety regulations; our ability to protect and defend our intellectual property; competition; our ability to retain our management and employees; demands on management resources; potential claims relating to our products; integrating acquisitions and achieving the expected savings and synergies; business divestitures; global or regional catastrophic events; energy costs; commodity prices; labor relations; demand for and market acceptance of new and existing products; and implementation of environmental remediation matters. 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.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KENNAMETAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

| (in thousands, except per share amounts) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-------------|
| | December 31, | | December 31, | |
| | 2014 | 2013 | 2014 | 2013 |
| Sales | \$675,631 | \$689,936 | \$1,370,572 | \$1,309,743 |
| Cost of goods sold | 476,173 | 482,965 | 953,015 | 904,536 |
| Gross profit | 199,458 | 206,971 | 417,557 | 405,207 |
| Operating expense | 137,459 | 148,421 | 285,947 | 282,685 |
| Restructuring and asset impairment charges (Notes 8 and 18) | 388,839 | 2,310 | 390,402 | 2,310 |
| Amortization of intangibles | 6,931 | 6,524 | 13,959 | 11,667 |
| Operating (loss) income | (333,771) | 49,716 | (272,751) | 108,545 |
| Interest expense | 7,960 | 8,037 | 16,170 | 15,118 |
| Other expense, net | 2,223 | 856 | 409 | 1,466 |
| (Loss) income before income taxes | (343,954) | 40,823 | (289,330) | 91,961 |
| Provision for income taxes | 43,751 | 16,656 | 58,248 | 29,236 |
| Net (loss) income | (387,705) | 24,167 | (347,578) | 62,725 |
| Less: Net income (loss) attributable to noncontrolling interests | 597 | (42) | 1,236 | 679 |
| Net (loss) income attributable to Kennametal | \$(388,302) | \$24,209 | \$(348,814) | \$62,046 |
| PER SHARE DATA ATTRIBUTABLE TO KENNAMETAL SHAREHOLDERS | | | | |
| Basic (loss) earnings per share | \$(4.89) | \$0.31 | \$(4.40) | \$0.79 |
| Diluted (loss) earnings per share | \$(4.89) | \$0.30 | \$(4.40) | \$0.78 |
| Dividends per share | \$0.18 | \$0.18 | \$0.36 | \$0.36 |
| Basic weighted average shares outstanding | 79,343 | 78,729 | 79,229 | 78,587 |
| Diluted weighted average shares outstanding | 79,343 | 79,776 | 79,229 | 79,597 |

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

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KENNAMETAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

| (in thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|----------|------------------|----------|
| | December 31, | | December 31, | |
| | 2014 | 2013 | 2014 | 2013 |
| Net (loss) income | \$(387,705) | \$24,167 | \$(347,578) | \$62,725 |
| Unrealized gain (loss) on derivatives designated and qualified as cash flow hedges, net of income tax expense (benefit) of \$0.8 million, (\$0.2) million, \$1.7 million and (\$0.5) million, respectively | 1,206 | (273) | 2,713 | (843) |
| Reclassification of unrealized (gain) loss on expired derivatives designated and qualified as cash flow hedges, net of income tax (expense) benefit of (\$0.0) million, \$0.3 million, \$0.2 million and \$0.5 million, respectively | (35) | 440 | 329 | 849 |
| Unrecognized net pension and other postretirement benefit gain (loss), net of income tax expense (benefit) of \$0.7 million, (\$0.3) million, \$2.0 million and (\$1.0) million, respectively | 1,924 | (810) | 5,565 | (2,776) |
| Reclassification of net pension and other postretirement benefit loss, net of income tax benefit of \$0.3 million, \$0.2 million, \$0.7 million and \$0.4 million, respectively | 735 | 498 | 1,489 | 982 |
| Foreign currency translation adjustments, net of income tax (benefit) expense of (\$1.5) million, \$0.7 million, (\$4.8) million and \$2.1 million, respectively | (30,209) | 11,675 | (81,722) | 39,586 |
| Total comprehensive (loss) income | (414,084) | 35,697 | (419,204) | 100,523 |
| Comprehensive (loss) income attributable to noncontrolling interests | (184) | 371 | (1,037) | 906 |
| Comprehensive (loss) income attributable to Kennametal Shareholders | \$(413,900) | \$35,326 | \$(418,167) | \$99,617 |

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

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| (in thousands, except per share data) | December 31, 2014 | June 30, 2014 |
|---|----------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$146,267 | \$177,929 |
| Accounts receivable, less allowance for doubtful accounts of \$13,616 and \$14,027, respectively | 449,166 | 531,515 |
| Inventories (Note 11) | 662,883 | 703,766 |
| Deferred income taxes | 45,644 | 47,897 |
| Other current assets | 70,027 | 64,089 |
| Total current assets | 1,373,987 | 1,525,196 |
| Property, plant and equipment: | | |
| Land and buildings | 422,301 | 437,783 |
| Machinery and equipment | 1,596,571 | 1,638,215 |
| Less accumulated depreciation | (1,175,771) | (1,191,540) |
| Property, plant and equipment, net | 843,101 | 884,458 |
| Other assets: | | |
| Investments in affiliated companies | 408 | 495 |
| Goodwill (Note 18) | 579,567 | 975,576 |
| Other intangible assets, less accumulated amortization of \$143,355 and \$139,245, respectively (Note 18) | 310,251 | 343,176 |
| Deferred income taxes | 36,260 | 41,006 |
| Other | 108,869 | 98,179 |
| Total other assets | 1,035,355 | 1,458,432 |
| Total assets | \$3,252,443 | \$3,868,086 |
| LIABILITIES | | |
| Current liabilities: | | |
| Current maturities of long-term debt and capital leases (Note 12) | \$8,629 | \$7,662 |
| Notes payable to banks | 86,884 | 72,455 |
| Accounts payable | 159,464 | 206,891 |
| Accrued income taxes | 66,223 | 16,953 |
| Accrued expenses | 63,182 | 99,892 |
| Other current liabilities | 144,322 | 158,903 |
| Total current liabilities | 528,704 | 562,756 |
| Long-term debt and capital leases, less current maturities (Note 12) | 867,103 | 981,666 |
| Deferred income taxes | 105,382 | 118,092 |
| Accrued pension and postretirement benefits | 167,284 | 180,784 |
| Accrued income taxes | 19,653 | 21,384 |
| Other liabilities | 33,730 | 41,796 |
| Total liabilities | 1,721,856 | 1,906,478 |
| Commitments and contingencies | | |
| EQUITY (Note 16) | | |
| Kennametal Shareholders' Equity: | | |
| Preferred stock, no par value; 5,000 shares authorized; none issued | — | — |
| | 98,932 | 98,340 |

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Capital stock, \$1.25 par value; 120,000 shares authorized; 79,147 and 78,672 shares issued, respectively

| | | |
|---------------------------------------|-------------|-------------|
| Additional paid-in capital | 411,979 | 395,890 |
| Retained earnings | 1,123,892 | 1,501,157 |
| Accumulated other comprehensive loss | (135,483 |) (66,131) |
| Total Kennametal Shareholders' Equity | 1,499,320 | 1,929,256 |
| Noncontrolling interests | 31,267 | 32,352 |
| Total equity | 1,530,587 | 1,961,608 |
| Total liabilities and equity | \$3,252,443 | \$3,868,086 |

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)

| (in thousands) | Six Months Ended | |
|--|----------------------|------------|
| | December 31, 2014 | 2013 |
| OPERATING ACTIVITIES | | |
| Net (loss) income | \$(347,578) | \$62,725 |
| Adjustments for non-cash items: | | |
| Depreciation | 53,341 | 48,267 |
| Amortization | 13,959 | 11,667 |
| Stock-based compensation expense | 13,475 | 12,108 |
| Restructuring and asset impairment charges (Notes 8 and 18) | 383,489 | — |
| Deferred income tax provision | (13,824) | 13,116 |
| Other | 8,938 | 1,587 |
| Changes in certain assets and liabilities: | | |
| Accounts receivable | 54,928 | 26,942 |
| Inventories | 4,727 | (27,044) |
| Accounts payable and accrued liabilities | (74,969) | (34,322) |
| Accrued income taxes | 45,596 | (13,997) |
| Other | (6,760) | (16,432) |
| Net cash flow provided by operating activities | 135,322 | 84,617 |
| INVESTING ACTIVITIES | | |
| Purchases of property, plant and equipment | (54,672) | (48,804) |
| Disposals of property, plant and equipment | 978 | 444 |
| Business acquisitions, net of cash acquired | — | (634,615) |
| Other | (126) | (60) |
| Net cash flow used for investing activities | (53,820) | (683,035) |
| FINANCING ACTIVITIES | | |
| Net increase in notes payable | 15,241 | 40,910 |
| Net increase in short-term revolving and other lines of credit | 8,500 | 14,900 |
| Term debt borrowings | 50,727 | 345,485 |
| Term debt repayments | (154,547) | (5,000) |
| Purchase of capital stock | (168) | (4,400) |
| Dividend reinvestment and the effect of employee benefit and stock plans | 7,891 | 18,072 |
| Cash dividends paid to Shareholders | (28,451) | (28,180) |
| Other | (4,786) | 250 |
| Net cash flow (used for) provided by financing activities | (105,593) | 382,037 |
| Effect of exchange rate changes on cash and cash equivalents | (7,571) | 2,354 |
| CASH AND CASH EQUIVALENTS | | |
| Net decrease in cash and cash equivalents | (31,662) | (214,027) |
| Cash and cash equivalents, beginning of period | 177,929 | 377,316 |
| Cash and cash equivalents, end of period | \$146,267 | \$163,289 |

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.ORGANIZATION

From its founding in 1938, the McKenna family incorporated Kennametal Inc. 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. We operate two global business segments consisting of Industrial and Infrastructure.

2.BASIS OF PRESENTATION

The condensed consolidated financial statements, which include our accounts and those of our majority-owned subsidiaries, should be read in conjunction with our 2014 Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2014 was derived from the audited balance sheet included in our 2014 Annual Report on Form 10-K. These interim statements are unaudited; however, we believe that all adjustments necessary for a fair statement of the results of the interim periods were made and all adjustments are normal adjustments. The results for the six months ended December 31, 2014 and 2013 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 2015 is to the fiscal year ending June 30, 2015. 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.

During the current quarter, the Company revised its condensed consolidated statement of cash flow for the three months ended September 30, 2014 to correctly present the net cash flow provided by operating activities and effect of exchange rate changes on cash and cash equivalents, resulting in an increase of \$8.4 million to operating cash flows and a corresponding decrease in effect of exchange rate changes on cash and cash equivalents. The Company has evaluated this error and determined that the impact of the error was not material to the previously issued interim and annual financial statements.

3.NEW ACCOUNTING STANDARDS

Adopted

In July 2013, the Financial Accounting Standards Board (FASB) issued new guidance on the presentation in the financial statements of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance takes into account these losses and carryforwards as well as the intended or likelihood of use of the unrecognized tax benefit in determining the balance sheet classification as an asset or liability. This guidance was effective for Kennametal beginning July 1, 2014 and did not have a material impact.

4.SUPPLEMENTAL CASH FLOW DISCLOSURES

Six Months Ended
December 31,

| (in thousands) | 2014 | 2013 |
|---|----------|----------|
| Cash paid during the period for: | | |
| Interest | \$16,334 | \$14,231 |
| Income taxes | 24,894 | 24,868 |
| Supplemental disclosure of non-cash information: | | |
| Changes in accounts payable related to purchases of property, plant and equipment | 6,470 | 8,600 |

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

5. ACQUISITION

On November 4, 2013, the Company completed its transaction to acquire the Tungsten Materials Business (TMB) from Allegheny Technologies Incorporated (ATI) which included all of the assets of TDY Industries, LLC, a wholly owned subsidiary of ATI, used or held for use by TDY in connection with the business; and all of the shares of TDY Limited and ATI Holdings SAS, both wholly-owned subsidiaries of ATI, for a purchase price of \$607.0 million, net of cash acquired. We funded the acquisition primarily through a combination of cash from operations and available borrowings under our existing credit facility.

The accompanying condensed consolidated balance sheet as of December 31, 2014 reflects the final allocation of the purchase price. No material adjustments have been made to the allocation in conjunction with finalization.

The accompanying condensed consolidated statement of income for the six months ended December 31, 2014, includes net sales of \$123.3 million and net income of \$6.1 million related to TMB.

Unaudited Pro Forma Financial Information

The following unaudited pro forma summary of operating results presents the consolidated results of operations as if the TMB acquisition had occurred on July 1, 2012. These amounts were calculated after applying our accounting policies and adjusting TMB's results to reflect increased depreciation and amortization expense resulting from recording fixed assets and intangible assets at fair value, as well as increased cost of sales resulting from recording inventory at fair value. The pro forma results have been presented for comparative purposes only, include no expected sales or cost synergies and are not indicative of future results of operations or what would have occurred had the acquisition been made on July 1, 2012.

Unaudited pro forma summary of operating results of Kennametal, assuming the acquisition had occurred as of July 1, 2012, are as follows:

| | |
|--|-------------|
| Six months ended December 31 (in thousands, except per share data) | 2013 |
| Pro forma (unaudited): | |
| Net Sales | \$1,451,678 |
| Net income attributable to Kennametal | \$83,387 |
| Per share data attributable to Kennametal: | |
| Basic earnings per share | \$1.06 |
| Diluted earnings per share | \$1.05 |

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.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

As of December 31, 2014, the fair values of the Company's financial assets and financial liabilities measured at fair value on a recurring basis are categorized as follows:

| (in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---------------------------------|---------|---------|----------|----------|
| Assets: | | | | |
| Derivatives ⁽¹⁾ | \$— | \$9,762 | \$— | \$9,762 |
| Total assets at fair value | \$— | \$9,762 | \$— | \$9,762 |
| Liabilities: | | | | |
| Derivatives ⁽¹⁾ | \$— | \$120 | \$— | \$120 |
| Contingent consideration | — | — | 10,000 | 10,000 |
| Total liabilities at fair value | \$— | \$120 | \$10,000 | \$10,120 |

As of June 30, 2014, the fair value of the Company's financial assets and financial liabilities measured at fair value on a recurring basis are categorized as follows:

| (in thousands) | Level 1 | Level 2 | Level 3 | Total |
|---------------------------------|---------|---------|----------|----------|
| Assets: | | | | |
| Derivatives ⁽¹⁾ | \$— | \$253 | \$— | \$253 |
| Total assets at fair value | \$— | \$253 | \$— | \$253 |
| Liabilities: | | | | |
| Derivatives ⁽¹⁾ | \$— | \$1,053 | \$— | \$1,053 |
| Contingent consideration | — | — | 14,000 | 14,000 |
| Total liabilities at fair value | \$— | \$1,053 | \$14,000 | \$15,053 |

⁽¹⁾ Currency derivatives are valued based on observable market spot and forward rates and are classified within Level 2 of the fair value hierarchy.

The fair value of contingent consideration payable that was classified as Level 3 relates to our probability assessments of expected future milestone targets, primarily associated with product delivery, related to the Emura acquisition. The contingent consideration is to be paid over the next 2 years. During the three months ended December 31, 2014, the Company paid \$4.0 million in conjunction with achieved milestone targets. The Company reassessed this contingent consideration and determined that no adjustment to the fair value of the remaining contingent consideration was necessary and that no changes in the expected outcome have occurred during the quarter ended December 31, 2014.

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.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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, 2014 | June 30, 2014 | |
|---|----------------------|------------------|--------|
| Derivatives designated as hedging instruments | | | |
| Other current assets - range forward contracts | \$3,668 | \$184 | |
| Other current liabilities - range forward contracts | — | (6 |) |
| Other assets - range forward contracts | — | 42 | |
| Total derivatives designated as hedging instruments | 3,668 | 220 | |
| Derivatives not designated as hedging instruments | | | |
| Other current assets - currency forward contracts | 6,094 | 27 | |
| Other current liabilities - currency forward contracts | (120 |) | (1,047 |
| Total derivatives not designated as hedging instruments | 5,974 | (1,020 |) |
| Total derivatives | \$9,642 | \$(800 |) |

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, net. (Gains) losses related to derivatives not designated as hedging instruments have been recognized as follows:

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--|------------------------------------|--------|----------------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Other (income) expense, net - currency forward contracts | \$(2,273 |) \$72 | \$(7,169 |) \$114 |

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 (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, 2014 and June 30, 2014, was \$57.0 million and \$91.1 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, 2014, we expect to recognize into earnings in the next 12 months \$2.3 million of income on outstanding derivatives.

In February 2012, we settled forward starting interest rate swap contracts to convert \$150.0 million of our floating rate debt to fixed rate debt. Upon settlement, we made a cash payment of \$22.4 million. The loss is being amortized as a component of interest expense over the term of the related debt using the effective interest rate method. During the three months ended December 31, 2014 and 2013, \$0.5 million and \$0.5 million was recognized as interest expense, respectively. During the six months ended December 31, 2014 and 2013, \$1.0 million and \$1.0 million was recognized as interest expense, respectively.

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

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|----------------|------------------------------------|------|----------------------------------|------|
| | 2014 | 2013 | 2014 | 2013 |

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| | | | | | | |
|--|---------|--------|---|---------|--------|---|
| Gains (losses) recognized in other comprehensive income, net | \$1,205 | \$(273 |) | \$2,712 | \$(843 |) |
| Losses reclassified from accumulated other comprehensive loss into other expense (income), net | \$152 | \$324 | | \$502 | \$714 | |

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, 2014 and 2013.

8. RESTRUCTURING AND RELATED CHARGES AND ASSET IMPAIRMENT CHARGES

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Restructuring and Related

As previously set forth in the 2014 Annual Report on Form 10-K, we are implementing restructuring actions in conjunction with our Phase 1 restructuring program to achieve synergies across Kennametal as a result of the TMB acquisition by consolidating operations among both organizations, reducing administrative overhead and leveraging the supply chain. These restructuring actions are expected to be completed by the end of fiscal 2016 and are anticipated to be mostly cash expenditures.

During the six months ended December 31, 2014, we recognized restructuring and related charges of \$20.4 million, of this amount, restructuring charges totaled \$8.6 million, of which \$0.2 million were charges related to inventory disposals and were recorded in cost of goods sold. Restructuring-related charges of \$6.3 million were recorded in cost of goods sold and \$5.5 million in operating expense for the six months ended December 31, 2014.

During the six months ended December 31, 2013, we recorded restructuring charges of \$2.3 million.

The total pre-tax charges for Phase 1 programs are expected to be in the range of \$55 million to \$60 million, which is expected to be approximately 50 percent Industrial and 50 percent Infrastructure. Total restructuring and related charges since inception of \$39.5 million have been recorded for these programs through December 31, 2014: \$24.5 million in Industrial, \$13.1 million in Infrastructure, and \$1.8 million in Corporate.

The restructuring accrual is recorded in other current liabilities in our condensed consolidated balance sheet and the amount attributable to each segment is as follows:

| (in thousands) | June 30, 2014 | Expense | Asset Write-Down | Other ⁽²⁾ | Translation | Cash Expenditures | December 31, 2014 |
|-----------------------|------------------|---------|---------------------|----------------------|-------------|----------------------|----------------------|
| Industrial | | | | | | | |
| Severance | \$5,815 | \$3,361 | \$— | \$— | \$(282) | \$(4,291) | \$4,603 |
| Facilities | 444 | 489 | (489) | — | (22) | (389) | 33 |
| Other | 67 | 21 | — | — | (2) | (86) | — |
| Total Industrial | \$6,326 | \$3,871 | \$(489) | \$— | \$(306) | \$(4,766) | \$4,636 |
| Infrastructure | | | | | | | |
| Severance | \$2,458 | \$4,177 | \$— | \$(459) | \$(312) | \$(4,747) | \$1,117 |
| Facilities | 190 | 542 | (541) | — | (25) | (166) | — |
| Other | 28 | 23 | — | — | (3) | (48) | — |
| Total Infrastructure | \$2,676 | \$4,742 | \$(541) | \$(459) | \$(340) | \$(4,961) | \$1,117 |
| Total | \$9,002 | \$8,613 | \$(1,030) | \$(459) | \$(646) | \$(9,727) | \$5,753 |

(2) Special termination benefit charge for one of our U.S.-based benefit pension plans resulting from a plant closure - see Note 10.

Asset impairment

See discussion on Infrastructure segment goodwill and other intangible asset impairment charges in Note 18.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. STOCK-BASED COMPENSATION

Stock Options

The assumptions used in our Black-Scholes valuation related to grants made during the six months ended December 31, 2014 and 2013 were as follows:

| | | | | |
|--------------------------------------|------|---|------|---|
| | 2014 | | 2013 | |
| Risk-free interest rate | 1.5 | % | 1.3 | % |
| Expected life (years) ⁽³⁾ | 4.5 | | 4.5 | |
| Expected volatility ⁽⁴⁾ | 32.5 | % | 40.4 | % |
| Expected dividend yield | 1.6 | % | 1.5 | % |

(3) Expected life is derived from historical experience.

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

Changes in our stock options for the six months ended December 31, 2014 were as follows:

| | Options | Weighted Average Exercise Price | Weighted Average Remaining Life (years) | Aggregate Intrinsic value (in thousands) |
|--|-----------|---------------------------------------|---|--|
| Options outstanding, June 30, 2014 | 2,264,824 | \$33.95 | | |
| Granted | 436,541 | 40.81 | | |
| Exercised | (222,206) |) 27.54 | | |
| Lapsed and forfeited | (11,905) |) 41.10 | | |
| Options outstanding, December 31, 2014 | 2,467,254 | \$35.71 | 5.3 | \$7,580 |
| Options vested and expected to vest, December 31, 2014 | 2,206,567 | \$35.02 | 5.4 | \$7,578 |
| Options exercisable, December 31, 2014 | 1,600,847 | \$32.76 | 4.1 | \$7,562 |

During the six months ended December 31, 2014 and 2013, compensation expense related to stock options was \$2.8 million and \$3.5 million, respectively. As of December 31, 2014, the total unrecognized compensation cost related to options outstanding was \$3.7 million and is expected to be recognized over a weighted average period of 2.8 years. Weighted average fair value of options granted during the six months ended December 31, 2014 and 2013 was \$10.16 and \$13.79, respectively. Fair value of options vested during the six months ended December 31, 2014 and 2013 was \$6.9 million and \$5.0 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. Tax benefits resulting from stock-based compensation deductions exceeded amounts reported for financial reporting purposes by \$1.3 million and \$4.5 million for the six months ended December 31, 2014 and 2013, respectively.

The amount of cash received from the exercise of capital stock options during the six months ended December 31, 2014 and 2013 was \$6.1 million and \$12.7 million, respectively. The related tax benefit for the six months ended December 31, 2014 and 2013 was \$1.3 million and \$2.7 million, respectively. The total intrinsic value of options exercised during the six months ended December 31, 2014 and 2013 was \$3.4 million and \$9.2 million, respectively. Under the provisions of the Kennametal Inc. Stock and Incentive Plan of 2010 as amended and restated on October 22, 2013, 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 the six months ended December 31, 2014 was immaterial. The fair market value of shares delivered

during the six months ended December 31, 2013 was \$0.2 million.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 payment date after the three-year performance period, with the exception of retirement eligible grantees, who upon retirement are entitled to receive payment for 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.

Changes in our time vesting and performance vesting restricted stock units for the six months ended December 31, 2014 were as follows:

| | Performance Vesting Stock Units | Performance Vesting Weighted Average Fair Value | Time Vesting Stock Units | Time Vesting Weighted Average Fair Value |
|---|---------------------------------|---|--------------------------|--|
| Unvested performance vesting and time vesting restricted stock units, June 30, 2014 | 197,356 | \$40.92 | 743,326 | \$39.20 |
| Granted | 88,536 | 43.16 | 438,795 | 42.27 |
| Vested | (28,022) |) 38.95 | (306,484) |) 36.26 |
| Performance metric not achieved | (65,373) |) 43.16 | — | — |
| Forfeited | — | — | (25,471) |) 41.69 |
| Unvested performance vesting and time vesting restricted stock units, December 31, 2014 | 192,497 | \$42.98 | 850,166 | \$41.78 |

During the six months ended December 31, 2014 and 2013, compensation expense related to time vesting and performance vesting restricted stock units was \$10.6 million and \$8.4 million, respectively. As of December 31, 2014, the total unrecognized compensation cost related to unvested time vesting and performance vesting restricted stock units was \$21.3 million and is expected to be recognized over a weighted average period of 2.7 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.

During the quarter we recognized a special termination benefit charge of \$0.5 million and a curtailment loss of \$0.4 million for one of our U.S.-based defined benefit pension plans resulting from a plant closure. The special termination benefit charge was recognized in restructuring expense.

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

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---------------------------------------|------------------------------------|------------|----------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Service cost | \$1,384 | \$1,732 | \$2,799 | \$3,448 |
| Interest cost | 9,745 | 10,308 | 19,681 | 20,484 |
| Expected return on plan assets | (14,900) |) (14,916) |) (29,947) |) (29,712) |
| Amortization of transition obligation | 19 | 20 | 40 | 38 |
| Amortization of prior service credit | (71) |) (58) |) (141) |) (117) |

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| | | | | |
|------------------------------------|------------|------------|------------|------------|
| Recognition of actuarial losses | 937 | 670 | 1,937 | 1,312 |
| Curtailment loss | 358 | — | 358 | — |
| Special termination benefit charge | 459 | — | 459 | — |
| Net periodic pension income | \$(2,069) | \$(2,244) | \$(4,814) | \$(4,547) |

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

| (in thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------|------------------|-------|
| | December 31, | | December 31, | |
| | 2014 | 2013 | 2014 | 2013 |
| Service cost | \$27 | \$14 | \$54 | \$28 |
| Interest cost | 259 | 251 | 519 | 502 |
| Amortization of prior service credit | (28 |) (28 |) (55 |) (56 |
| Recognition of actuarial loss | 207 | 79 | 414 | 158 |
| Curtailment gain | (221 |) — | (221 |) — |
| Net periodic other postretirement benefit cost | \$244 | \$316 | \$711 | \$632 |

The curtailment gain of \$0.2 million was a result of the plant closure discussed above.

11. INVENTORIES

We used the last-in, first-out (LIFO) method of valuing inventories for 47 percent and 43 percent of total inventories at December 31, 2014 and June 30, 2014, 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, 2014 | June 30, 2014 |
|-----------------------------------|----------------------|---------------|
| Finished goods | \$362,979 | \$371,599 |
| Work in process and powder blends | 286,841 | 308,129 |
| Raw materials | 110,756 | 126,004 |
| Inventories at current cost | 760,576 | 805,732 |
| Less: LIFO valuation | (97,693 |) (101,966 |
| Total inventories | \$662,883 | \$703,766 |

12. LONG-TERM DEBT

Our \$600 million five-year, multi-currency, revolving credit facility (2011 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 December 31, 2014. We had \$174.1 million and \$287.1 million of borrowings outstanding under the 2011 Credit Agreement as of December 31, 2014 and June 30, 2014, respectively. Borrowings under the 2011 Credit Agreement are guaranteed by our significant domestic subsidiaries. The 2011 Credit Agreement matures in April 2018.

Fixed rate debt had a fair market value of \$703.3 million and \$705.3 million at December 31, 2014 and June 30, 2014, respectively. The Level 2 fair value is determined based on the quoted market price of this debt as of December 31, 2014 and June 30, 2014, respectively.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 We are involved as a potentially responsible party (PRP) at various sites designated by the United States Environmental Protection Agency (USEPA) as Superfund sites. For certain of these sites, we have evaluated the claims and potential liabilities and have determined that neither are material, individually or in the aggregate. For certain other sites, proceedings are in the very early stages and have not yet progressed to a point where it is possible to estimate the ultimate cost of remediation, the timing and extent of remedial action that may be required by governmental authorities or the amount of our liability alone or in relation to that of any other PRP.

Other Environmental Matters We establish and maintain reserves for other potential environmental issues. At December 31, 2014 and June 30, 2014, the balances of these reserves were \$12.6 million and \$11.0 million. These reserves represent anticipated costs associated with the remediation of these issues.

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 rate for the three months ended December 31, 2014 and 2013 was negative 12.7 percent (provision on a loss) and 40.8 percent (provision on income), respectively. The effective income tax rate for six months ended December 31, 2014 and 2013 was negative 20.1 percent (provision on a loss) and 31.8 percent (provision on income), respectively. The change in both periods was primarily driven by the asset impairment charges recorded in the current quarter, most of which could not be tax effected, lower relative U.S. current year earnings compared with the rest of the world where the tax rates are generally lower, and favorable effects of the extension of the credit for increase in research activities contained in the Tax Increase Prevention Act of 2014 that was enacted during the current quarter. The prior year rate included a tax charge related to a change in assertion of a foreign subsidiary's certain undistributed earnings, which were no longer considered permanently reinvested.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 occurs 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 the three and six months ended December 31, 2014, the effect of unexercised capital stock options and unvested restricted stock units was anti-dilutive as a result of a net loss in the periods and therefore has been excluded from diluted shares outstanding as well as from the diluted earnings per share calculation. For purposes of determining the number of diluted shares outstanding for the three and six months ended December 31, 2013, weighted average shares outstanding for basic earnings per share calculations were increased due solely to the dilutive effect of unexercised capital stock options and unvested restricted stock units by \$1.0 million and 1.0 million shares, respectively.

Unexercised capital stock options and restricted stock units of 0.2 million shares and 0.3 million shares for the three and six months ended December 31, 2013, respectively, 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.

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 December 31, 2014 and 2013 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, 2014 | \$98,340 | \$395,890 | \$1,501,157 | \$(66,131) | \$32,352 | \$1,961,608 |
| Net (loss) income | — | — | (348,814) | — | 1,236 | (347,578) |
| Other comprehensive loss | — | — | — | (69,352) | (2,274) | (71,626) |
| Dividend reinvestment | 5 | 163 | — | — | — | 168 |
| Capital stock issued under employee benefit and stock plans | — | 16,089 | — | — | — | 16,681 |
| Purchase of capital stock | (5) | (163) | — | — | — | (168) |
| Cash dividends paid | — | — | (28,451) | — | (47) | (28,498) |
| Balance as of December 31, 2014 | \$98,932 | \$411,979 | \$1,123,892 | \$(135,483) | \$31,267 | \$1,530,587 |

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

| (in thousands) | Kennametal Shareholders' Equity | | | | | |
|---|---------------------------------|----------------------------|-------------------|--------------------------------------|---------------------------|--------------|
| | Capital stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Non-controlling interests | Total equity |
| Balance as of June 30, 2013 | \$97,303 | \$374,300 | \$1,399,227 | \$(89,004) |) \$30,467 | \$1,812,293 |
| Net income | — | — | 62,046 | — | 679 | 62,725 |
| Other comprehensive income | — | — | — | 37,571 | 227 | 37,798 |
| Dividend reinvestment | 3 | 149 | — | — | — | 152 |
| Capital stock issued under employee benefit and stock plans | 1,056 | 21,926 | — | — | — | 22,982 |
| Purchase of capital stock | (128) |) (4,272) | — | — | — | (4,400) |
| Cash dividends paid | — | — | (28,180) |) — | (66) |) (28,246) |
| Balance as of December 31, 2013 | \$98,234 | \$392,103 | \$1,433,093 | \$(51,433) |) \$31,307 | \$1,903,304 |

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

17. ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

Total accumulated other comprehensive (loss) income (AOCL) consists of net (loss) income 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.

The components of, and changes in, AOCL were as follows (net of tax) for the three months ended December 31, 2014 (in thousands):

| Attributable to Kennametal: | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total |
|---|------------------------------|---------------------------------|-------------|---------------|
| Balance, September 30, 2014 | \$(89,347) |) \$(11,210) |) \$(9,329) |) \$(109,886) |
| Other comprehensive loss before reclassifications | 1,924 | (29,427) |) 1,206 | (26,297) |
| Amounts reclassified from AOCL | 735 | — | (35) |) 700 |
| Net current period other comprehensive loss | 2,659 | (29,427) |) 1,171 | (25,597) |
| AOCL, December 31, 2014 | \$(86,688) |) \$(40,637) |) \$(8,158) |) \$(135,483) |

Attributable to noncontrolling interests:

| | | | | | |
|---|-----|----------|------|----------|---|
| Balance, September 30, 2014 | \$— | \$(405 |)\$— | \$(405 |) |
| Other comprehensive loss before reclassifications | — | (782 |)— | (782 |) |
| Net current period other comprehensive loss | — | (782 |)— | (782 |) |
| AOCL, December 31, 2014 | \$— | \$(1,187 |)\$— | \$(1,187 |) |

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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 six months ended December 31, 2014 (in thousands):

| Attributable to Kennametal: | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total | |
|---|------------------------------|---------------------------------|-------------|-------------|---|
| Balance, June 30, 2014 | \$(93,742 |)\$38,811 | \$(11,200 |)\$(66,131 |) |
| Other comprehensive loss before reclassifications | 5,565 | (79,448 |)2,713 | (71,170 |) |
| Amounts reclassified from AOCL | 1,489 | — | 329 | 1,818 | |
| Net current period other comprehensive loss | 7,054 | (79,448 |)3,042 | (69,352 |) |
| AOCL, December 31, 2014 | \$(86,688 |)\$(40,637 |)\$(8,158 |)\$(135,483 |) |
| Attributable to noncontrolling interests: | | | | | |
| Balance, June 30, 2014 | \$— | \$1,087 | \$— | \$1,087 | |
| Other comprehensive loss before reclassifications | — | (2,274 |)— | (2,274 |) |
| Net current period other comprehensive loss | — | (2,274 |)— | (2,274 |) |
| AOCL, December 31, 2014 | \$— | \$(1,187 |)\$— | \$(1,187 |) |

The components of, and changes in, AOCL were as follows (net of tax) for the three months ended December 31, 2013 (in thousands):

| Attributable to Kennametal: | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total | |
|--|------------------------------|---------------------------------|-------------|------------|---|
| Balance, September 30, 2013 | \$(85,419 |)\$35,510 | \$(12,642 |)\$(62,551 |) |
| Other comprehensive (loss) income before reclassifications | (810 |)11,263 | (273 |)10,180 | |
| Amounts reclassified from AOCL | 498 | — | 440 | 938 | |
| Net current period other comprehensive (loss) income | (312 |)11,263 | 167 | 11,118 | |
| AOCL, December 31, 2013 | \$(85,731 |)\$46,773 | \$(12,475 |)\$(51,433 |) |
| Attributable to noncontrolling interests: | | | | | |
| Balance, September 30, 2013 | \$— | \$535 | \$— | \$535 | |
| Other comprehensive income before reclassifications | — | 413 | — | 413 | |
| | — | 413 | — | 413 | |

Net current period other
comprehensive
income

| | | | | |
|-------------------------|-----|-------|-----|-------|
| AOCL, December 31, 2013 | \$— | \$948 | \$— | \$948 |
|-------------------------|-----|-------|-----|-------|

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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 six months ended December 31, 2013 (in thousands):

| Attributable to Kennametal: | Postretirement benefit plans | Currency translation adjustment | Derivatives | Total | |
|--|------------------------------|---------------------------------|-------------|------------|---|
| Balance, June 30, 2013 | \$(83,937 |)\$7,414 | \$(12,481 |)\$(89,004 |) |
| Other comprehensive (loss) income before reclassifications | (2,776 |)39,359 | (843 |)35,740 | |
| Amounts reclassified from AOCL | 982 | — | 849 | 1,831 | |
| Net current period other comprehensive (loss) income | (1,794 |)39,359 | 6 | 37,571 | |
| AOCL, December 31, 2013 | \$(85,731 |)\$46,773 | \$(12,475 |)\$(51,433 |) |

Attributable to noncontrolling interests:

| | | | | |
|---|-----|-------|-----|-------|
| Balance, June 30, 2013 | \$— | \$721 | \$— | \$721 |
| Other comprehensive income before reclassifications | — | 227 | — | 227 |
| Net current period other comprehensive income | — | 227 | — | 227 |
| AOCL, December 31, 2013 | \$— | \$948 | \$— | \$948 |

Reclassifications out of AOCL for the three and six months ended December 31, 2014 and 2013, respectively consisted of the following (in thousands):

| Details about AOCL components | Three Months Ended December 31, | | Six Months Ended December 31, | | Affected line item in the Income Statement |
|--|---------------------------------|---------|-------------------------------|--------|--|
| | 2014 | 2013 | 2014 | 2013 | |
| Gains and losses on cash flow hedges: | | | | | |
| Forward starting interest rate swaps | \$505 | \$486 | \$1,010 | \$973 | Interest expense |
| Currency exchange contracts | (562 |) 224 | (474 |) 396 | Other expense, net |
| Total before tax | (57 |) 710 | 536 | 1,369 | |
| Tax (expense) benefit | (22 |) 270 | 207 | 520 | Provision for income taxes |
| Net of tax | \$(35 |) \$440 | \$329 | \$849 | |
| Postretirement benefit plans: | | | | | |
| Amortization of transition obligations | \$19 | \$20 | \$40 | \$38 | See note 10 for further details |
| Amortization of prior service credit | (99 |) (86 |) (196 |) (173 |) See note 10 for further details |
| Recognition of actuarial losses | 1,144 | 749 | 2,351 | 1,470 | |

| | | | | | |
|--------------------|-------|-------|---------|-------|---------------------------------|
| | | | | | See note 10 for further details |
| Total before taxes | 1,064 | 683 | 2,195 | 1,335 | |
| Tax benefit | 329 | 185 | 706 | 353 | Provision for income taxes |
| Net of tax | \$735 | \$498 | \$1,489 | \$982 | |

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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. We also perform specific impairment tests on an interim basis based on the results of an ongoing cumulative qualitative assessment if indicative of impairment of the goodwill for a reporting unit or an indefinite-lived intangible asset. 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.

Late in the December quarter, the Company experienced an abrupt change in customer demand in the oil and gas markets that is expected to continue into the foreseeable future, coupled with the severe and persistent decline in the earthworks markets. In view of the severe downturn in the global Infrastructure markets in the December quarter, we made an assessment of the possible impairment of the goodwill and other long-lived assets of our Infrastructure reporting unit. As a result of this assessment, we determined that the magnitude and duration of the economic downturn of the Infrastructure end markets, as well as other factors, necessitated an interim impairment test of our Infrastructure reporting unit. As a result of our test, we recorded a preliminary non-cash pre-tax impairment charge of \$376.5 million in the Infrastructure segment, of which \$375.0 million was for goodwill and \$1.5 million was for an indefinite-lived trademark intangible asset. The goodwill impairment charge is subject to finalization of fair values related to intangibles and property, plant and equipment, which we expect to complete in the third quarter of fiscal 2015. Goodwill of \$266.2 million remains on the books of our Infrastructure segment.

Identifiable assets with finite lives are reviewed for impairment whenever events or circumstances indicate that the carrying value may not be recoverable. During the December quarter, we performed a preliminary review of our identifiable assets with finite lives and preliminarily determined that the assets were not impaired. The review is subject to finalization, which we expect to complete in the third quarter of fiscal 2015.

The further acceleration or extended persistence of the current downturn in the global end markets could have a further negative impact on our business and financial performance. We are currently in the beginning stages of exploring strategic alternatives for several businesses within the Infrastructure segment, which have total estimated net book values of approximately \$150 million to \$200 million as of December 31, 2014. As the strategic direction has not yet been determined for these businesses, the Company cannot determine if additional impairment charges are either probable or estimable.

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 | Infrastructure | Total |
|-------------------------------|------------|----------------|-------------|
| Gross goodwill | \$472,337 | \$654,081 | \$1,126,418 |
| Accumulated impairment losses | (150,842 |) — | (150,842) |
| Balance as of June 30, 2014 | \$321,495 | \$654,081 | \$975,576 |

Activity for the six months ended December 31, 2014:

| | | | |
|---------------------------------|-----------|------------|--------------|
| Acquisition | 2,984 | — | 2,984 |
| Translation | (11,082 |) (12,911 |) (23,993) |
| Change in gross goodwill | (8,098 |) (12,911 |) (21,009) |
| Impairment charge | — | (375,000 |) (375,000) |
| Gross goodwill | 464,239 | 641,170 | 1,105,409 |
| Accumulated impairment losses | (150,842 |) (375,000 |) (525,842) |
| Balance as of December 31, 2014 | \$313,397 | \$266,170 | \$579,567 |

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The components of our other intangible assets were as follows:

| (in thousands) | Estimated Useful Life (in years) | December 31, 2014 | | June 30, 2014 | |
|----------------------------|----------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
| | | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Contract-based | 3 to 15 | \$8,534 | \$(7,624) | \$23,446 | \$(10,820) |
| Technology-based and other | 4 to 20 | 53,657 | (28,361) | 54,842 | (28,516) |
| Customer-related | 10 to 21 | 278,993 | (82,567) | 285,751 | (76,376) |
| Unpatented technology | 10 to 30 | 60,201 | (13,395) | 61,867 | (12,549) |
| Trademarks | 5 to 20 | 18,764 | (11,408) | 19,256 | (10,984) |
| Trademarks | Indefinite | 33,457 | — | 37,259 | — |
| Total | | \$453,606 | \$(143,355) | \$482,421 | \$(139,245) |

During the three months ended December 31, 2014, an impairment of \$10.5 million was recorded for a contract-based technology intangible asset that was part of the Infrastructure segment, resulting in a non-cash impairment charge of \$5.5 million and a reduction in a liability of \$5.0 million. As previously mentioned, we recorded a \$1.5 million impairment for an indefinite-lived trademark intangible asset as a result of our interim impairment test of our Infrastructure segment.

During the six months ended December 31, 2014, we recorded amortization expense of \$14.0 million related to our other intangible assets and unfavorable currency translation adjustments of \$7.1 million.

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 metalcutting 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.

The Industrial segment generally serves customers that operate in industrial end markets such as aerospace and defense, transportation and general engineering. 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.

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.

Corporate expenses related to executive retirement plans, the Company's Board of Directors and strategic initiatives, as well as certain other costs, are reported as Corporate.

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KENNAMETAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

| (in thousands) | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------|------------------|-------------|
| | December 31, | | December 31, | |
| | 2014 | 2013 | 2014 | 2013 |
| Sales: | | | | |
| Industrial | \$371,557 | \$370,647 | \$749,415 | \$708,876 |
| Infrastructure | 304,074 | 319,289 | 621,157 | 600,867 |
| Total sales | \$675,631 | \$689,936 | \$1,370,572 | \$1,309,743 |
| Operating (loss) income: | | | | |
| Industrial | \$41,795 | \$33,218 | \$85,812 | \$73,038 |
| Infrastructure ⁽⁵⁾ | (371,920) | 18,604 | (352,699) | 40,294 |
| Corporate | (3,646) | (2,106) | (5,864) | (4,787) |
| Total operating (loss) income | (333,771) | 49,716 | (272,751) | 108,545 |
| Interest expense | 7,960 | 8,037 | 16,170 | 15,118 |
| Other expense, net | 2,223 | 856 | 409 | 1,466 |
| (Loss) income from continuing operations before income taxes | \$(343,954) | \$40,823 | \$(289,330) | \$91,961 |

⁽⁵⁾ See Note 18 regarding Infrastructure segment impairment charges for goodwill and other intangible assets.

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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, infrastructure 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 systems; machine tool, light machinery and heavy machinery industries; airframe and aerospace components and systems, 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 metalcutting tools and tooling supplies.

Our sales of \$675.6 million for the quarter ended December 31, 2014 decreased 2 percent compared to sales for the December quarter one year ago. Operating loss was \$333.8 million, compared to operating income of \$49.7 million in the prior year quarter. Our operating results were negatively impacted by impairment charges of \$382.0 million, organic sales decline and unfavorable mix in Infrastructure, offset partially by lower employment costs.

Raw material price fluctuations did not materially impact the quarter, although we have seen a change in commodity prices in the Infrastructure segment, it has not significantly impacted us due to our contractual arrangements with our suppliers.

The permanent savings that we are realizing from restructuring are the result of Phase 1 programs that we have undertaken over the past 12 months. Pre-tax benefits from these restructuring actions reached approximately \$6 million in the current quarter due to manufacturing rationalization and workforce reduction programs. These benefits were incremental to the same quarter one year ago. Kennametal has made significant progress in integrating TMB, and we have continued to accelerate restructuring actions to reduce costs and improve efficiencies.

We reported current quarter loss per diluted share of \$4.89, which included \$5.28 per share of goodwill and other intangible asset impairment charges and \$0.13 per share of restructuring and related charges.

We generated strong cash flow from operating activities of \$135.3 million during the six months ended December 31, 2014. Capital expenditures were \$54.7 million during the quarter.

We invested further in technology and innovation to continue delivering a high level of new products to our customers. Research and development expenses included in operating expense totaled \$12.1 million for the three months ended December 31, 2014.

Late in the December quarter, the Company experienced an abrupt change in customer demand in the oil and gas markets that is expected to continue into the foreseeable future, coupled with the severe and persistent decline in the earthworks markets. This has had a corresponding effect on our projected sales levels and operating performance in our Infrastructure segment. As a result of these declining economic conditions preliminary non-cash pre-tax impairment charges of \$376.5 million, or \$5.24 per share were recorded in the Infrastructure segment in the December quarter. See Note 18 in our condensed consolidated financial statements set forth in Part I Item 1 of this Quarterly Report on Form 10-Q for a description of goodwill and other intangible assets (Note 18).

In January 2015, we announced additional restructuring actions to streamline the Company's cost structure with Phase 2 of restructuring initiatives. This is estimated to achieve an additional \$40-\$50 million of annualized savings and will incur \$90-\$100 million of pre-tax charges as it is being implemented over the next 12 to 24 months. These initiatives are expected to enhance operational efficiencies through the rationalization of certain manufacturing facilities as well as other employment and cost reduction programs. On a combined basis, both Phase 1 and Phase 2 restructuring programs are expected to produce annual ongoing pre-tax permanent savings of \$90-\$105 million. Together, total pre-tax charges for these initiatives are expected to be approximately \$145-\$160 million.

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

RESTRUCTURING AND RELATED CHARGES AND SAVINGS

| | Estimated Charges | Charges To Date | Estimated Annualized Savings | Savings To Date | Expected Completion Date |
|---------|-------------------|-----------------|------------------------------|-----------------|--------------------------|
| Phase 1 | \$55M-\$60M | \$39M | \$50M-\$55M | \$12M | 6/30/2016 |
| Phase 2 | \$90M-\$100M | — | \$40M-\$50M | — | 12/31/2016 |
| Total | \$145M-\$160M | \$39M | \$90M-\$105M | \$12M | |

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

RESULTS OF CONTINUING OPERATIONS

SALES

Sales for the three months ended December 31, 2014 were \$675.6 million, a decrease of \$14.3 million or 2 percent, from \$689.9 million in the prior year quarter. The decrease in sales was driven by unfavorable currency exchange of 4 percent and organic decline of 2 percent, offset partially by a 3 percent increase from acquisition and a 1 percent increase due to more business days. The decrease in organic sales was primarily due to continuing weakness in the mining sector and deterioration in the energy market, offset partially by improved demand from customers in our Industrial end markets. Sales decreased by approximately 7 percent in earthworks, 3 percent in transportation and 1 percent in energy, while sales remained flat in aerospace and defense and increased 2 percent in general engineering markets.

Sales for the six months ended December 31, 2014 were \$1,370.6 million, an increase of \$60.8 million or 5 percent, from \$1,309.7 million in the prior year period. The increase in sales was driven by 7 percent growth from acquisition and 1 percent increase due to more business days, partially offset by a 2 percent decline due to unfavorable currency exchange and 1 percent organic decline. The increase in sales was primarily due to slightly improved demand from customers in our Industrial end markets, partially offset by continued weakness in the mining sector and declines in the oil and gas markets in the second quarter. Excluding the impact of currency, sales increased by 3 percent in general engineering and decreased by approximately 7 percent in earthworks and 3 percent in aerospace and defense, while the transportation and energy markets remained flat.

GROSS PROFIT

Gross profit for the three months ended December 31, 2014 was \$199.5 million, a decrease of \$7.5 million from \$207.0 million in the prior year quarter. The decrease was primarily due to organic sales decline and unfavorable business mix in the Infrastructure segment, partially offset by restructuring benefits. The gross profit margin for the three months ended December 31, 2014 was 29.5 percent, as compared to 30.0 percent generated in the prior year quarter.

Gross profit for the six months ended December 31, 2014 was \$417.6 million, an increase of \$12.4 million from \$405.2 million in the prior year period. The increase was primarily due to contributions from the TMB acquisition, the benefit of a non-recurring inventory adjustment of approximately \$6 million that occurred in the prior year and

restructuring benefits, offset partially by organic sales decline and unfavorable business mix in the Infrastructure segment. The gross profit margin for the six months ended December 31, 2014 was 30.5 percent, as compared to 30.9 percent generated in the prior year period.

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

OPERATING EXPENSE

Operating expense for the three months ended December 31, 2014 decreased \$11.0 million or 7.4 percent to \$137.5 million as compared to \$148.4 million in the prior year quarter. The decrease was primarily due foreign currency exchange, lower employment costs and TMB acquisition-related charges of \$1.7 million in the prior period, partially offset by \$3.4 million of restructuring-related charges.

Operating expense for the six months ended December 31, 2014 increased \$3.3 million or 1.2 percent to \$285.9 million as compared to \$282.7 million in the prior year period. The increase was primarily due to restructuring-related charges of \$5.5 million and higher employment costs, offset partially by foreign currency exchange and TMB acquisition-related charges in the prior period.

RESTRUCTURING AND RELATED CHARGES AND ASSET IMPAIRMENT CHARGES

Restructuring and Related

We are implementing restructuring actions in conjunction with Phase 1 to achieve synergies across Kennametal as a result of the TMB acquisition by consolidating operations among both organizations, reducing administrative overhead and leveraging the supply chain. These restructuring actions are expected to be completed by the end of fiscal 2016 and are anticipated to be mostly cash expenditures.

We have recorded restructuring and related charges of \$12.9 million for the three months ended December 31, 2014. Of this amount, restructuring charges totaled \$6.7 million. Restructuring-related charges of \$2.8 million were recorded in cost of goods sold and \$3.4 million in operating expense for the three months ended December 31, 2014.

We have recorded restructuring and related charges of \$20.4 million for the six months ended December 31, 2014. Of this amount, restructuring charges totaled \$8.6 million, of which \$0.2 million were charges related to inventory disposals and were recorded in cost of goods sold. Restructuring-related charges of \$6.3 million were recorded in cost of goods sold and \$5.5 million in operating expense for the six months ended December 31, 2014. Total restructuring and related charges since the inception of our restructuring plans through December 31, 2014 were \$39.5 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.

Asset Impairment

Late in the December quarter, the Company performed an interim impairment test of goodwill and indefinite-lived intangible assets for its Infrastructure reporting unit. This preliminary test was undertaken in view of the recent abrupt change in the global energy market, coupled with the severe and persistent decline in the earthworks markets. The test resulted in an estimated non-cash pre-tax impairment charge of \$376.5 million, or \$5.24 per share recorded in the Infrastructure segment in the December quarter, of which \$375.0 million was for goodwill and \$1.5 million was for an indefinite-lived trademark intangible asset. The goodwill impairment charge is subject to finalization of fair values, which we expect to complete in the third quarter of fiscal 2015. We also recorded a non-cash impairment charge of \$5.5 million or \$0.04 per share for an Infrastructure contract-based technology asset. See Note 18.

INTEREST EXPENSE

Interest expense for the three months ended December 31, 2014 stayed flat at \$8.0 million compared to the prior year quarter.

For the six months ended December 31, 2014, interest expense increased \$1.1 million to \$16.2 million as compared to \$15.1 million in the prior year period. The increase in was primarily due to higher year-over-year borrowings due to acquisitions.

OTHER EXPENSE, NET

Other expense, net for the three months ended December 31, 2014, was \$2.2 million compared to other expense, net of \$0.9 million, for the prior year quarter. The increase was primarily due to unfavorable currency exchange rate losses of \$0.5 million.

Other expense, net for the six months ended December 31, 2014, was \$0.4 million compared to other expense, net of \$1.5 million, for the prior year period. The decrease was primarily due to favorable currency exchange rate gains of \$1.8 million.

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

INCOME TAXES

The effective income tax rate for the three months ended December 31, 2014 and 2013 was negative 12.7 percent (provision on a loss) and 40.8 percent (provision on income), respectively. The effective income tax rate for six months ended December 31, 2014 and 2013 was negative 20.1 percent (provision on a loss) and 31.8 percent (provision on income), respectively. The change in both periods was primarily driven by the asset impairment charges recorded in the current quarter, most of which could not be tax effected, lower relative U.S. current year earnings compared with the rest of the world where the tax rates are generally lower, and favorable effects of the extension of the credit for increase in research activities contained in the Tax Increase Prevention Act of 2014 that was enacted during the current quarter. The prior year rate included a tax charge related to a change in assertion of a foreign subsidiary's certain undistributed earnings, which were no longer considered permanently reinvested.

BUSINESS SEGMENT REVIEW

We operate two reportable segments consisting of Industrial 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, the availability of separate financial results and materiality considerations.

INDUSTRIAL

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|------------------|------------------------------------|-----------|----------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Sales | \$371,557 | \$370,647 | \$749,415 | \$708,876 |
| Operating income | 41,795 | 33,218 | 85,812 | 73,038 |

For the three months ended December 31, 2014, Industrial sales remained flat due to increases of 2 percent from organic growth, 1 percent from net acquisition and divestiture and 1 percent due to more business days, offset partially by unfavorable currency exchange impact of 4 percent. Excluding the impact of currency, sales increased 3 percent in general engineering and 2 percent in transportation, while aerospace and defense remained relatively flat. General engineering increased due to sales in the indirect channel and to tier suppliers in the Americas, and the transportation market increased due to new project tooling package sales in the Asia region. On a regional basis sales increased approximately 14 percent in Asia and 3 percent in the Americas, offset partially by a decrease of 1 percent in Europe. The sales increase in Asia was primarily driven by the performance in the transportation and aerospace and defense end markets. The sales increase in the Americas was primarily driven by the general engineering end markets.

For the three months ended December 31, 2014, Industrial operating income increased by \$8.6 million, benefiting from organic growth, restructuring initiatives and lower employment costs. Industrial operating margin was 11.2 percent compared with 9.0 percent in the prior year.

For the six months ended December 31, 2014, Industrial sales increased by 6 percent due to increases of 4 percent from organic growth, 4 percent from net acquisition and divestiture and 1 percent from more business days, offset partially by 3 percent decrease due to unfavorable currency exchange. Excluding the impact of currency, sales increased by 5 percent in general engineering and 4 percent in transportation, offset partially by a decrease of 1 percent in aerospace and defense. General engineering increased due to improvements in production and overall

demand for machinery and the transportation market increased due to new project tooling package sales in the Asia region and improvement in the light vehicle market. On a regional basis, sales increased approximately 11 percent in Asia and 5 percent in the Americas while sales remained flat in Europe. The sales increase in Asia was primarily driven by the performance in the transportation and aerospace and defense end markets and to a lesser extent the general engineering end markets. The sales increase in the Americas was primarily driven by the general engineering end markets.

For the six months ended December 31, 2014, Industrial operating income increased by \$12.8 million, benefiting from acquisition and organic growth. Industrial operating margin was 11.5 percent compared with 10.3 percent in the prior year.

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

INFRASTRUCTURE

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|-------------------------|------------------------------------|-----------|----------------------------------|-----------|
| | 2014 | 2013 | 2014 | 2013 |
| Sales | \$304,074 | \$319,289 | \$621,157 | \$600,867 |
| Operating (loss) income | (371,920) | 18,604 | (352,699) | 40,294 |

For the three months ended December 31, 2014, Infrastructure sales decreased by 5 percent, due to an 8 percent organic sales decline and a 3 percent unfavorable currency exchange impact, offset partially by a 5 percent increase from acquisition and 1 percent due to more business days. Excluding the impact of currency, sales decreased by 6 percent in earthworks and 3 percent in energy. Earthworks sales declined from persistently weak underground and surface mining globally, particularly in the U.S. and Asia, combined with reduced demand for road rehabilitation tools and less infrastructure development activity in China. Energy sales decreased due to lower activity in power generation and surface finishing projects, while oil and gas sales were relatively flat year over year. On a regional basis sales decreased 14 percent in Europe, 9 percent in Asia and 2 percent in the Americas. The sales decreases in all geographic regions were driven by the performance in the earthworks and energy markets.

For the three months ended December 31, 2014, Infrastructure operating loss was \$371.9 million compared to operating income of \$18.6 million for the prior year quarter. During the quarter non-cash pre-tax goodwill and other intangible asset impairment charges of \$382.0 million were recorded. See Note 18. In addition, operating results were negatively impacted by lower organic sales as well as an unfavorable mix, partially offset by the benefits restructuring initiatives and lower employment costs.

For the six months ended December 31, 2014, Infrastructure sales increased by 3 percent, due to a 10 percent increase from acquisition and a 1 percent increase from more business days, partially offset by a 6 percent organic sales decline and a 2 percent impact from unfavorable currency exchange. Excluding the impact of currency, the sales decline was driven by a 7 percent decrease in earthworks and a 1 percent decrease in the energy markets. Earthworks sales declined from persistently weak underground and surface mining markets, globally, as well as lower road construction activity and less infrastructure development activity in China. Energy sales decreased due to lower activity in power generation and surface finishing projects. On a regional basis sales decreased 13 percent in Europe and 8 percent in Asia, while sales in the Americas remained flat. The sales decreases in Europe and Asia were driven by the performance in the earthworks and energy markets.

For the six months ended December 31, 2014, Infrastructure operating loss was \$352.7 million compared to operating income of \$40.3 million for the prior period. In addition to the aforementioned impairment charges, operating results for the current period were impacted by lower organic sales, unfavorable mix and higher employment costs, partly offset by the impacts of the TMB acquisition. Prior year operating income included a non-recurring inventory charge of \$5.7 million.

CORPORATE

| (in thousands) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|----------------|------------------------------------|------|----------------------------------|------|
| | 2014 | 2013 | 2014 | 2013 |

Corporate unallocated expense \$(3,646) \$(2,106) \$(5,864) \$(4,787)

For the three months ended December 31, 2014, Corporate unallocated expense increased \$1.5 million primarily due to restructuring related-charges of \$1.8 million in the current period.

For the six months ended December 31, 2014, Corporate unallocated expense increased \$1.1 million primarily due to an increase in restructuring related-charges of \$0.7 million in the current period.

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

LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operations and borrowings against our five-year, multi-currency, revolving credit facility (2011 Credit Agreement) are the primary sources of funding for capital expenditures and internal growth. Year to date December 31, 2014 cash flow provided by operating activities was \$135.3 million, driven by our operating performance partially offset by the change in working capital. We had \$174.1 million of borrowings outstanding on our 2011 Credit Agreement as of December 31, 2014.

The 2011 Credit Agreement is used to augment cash from operations and as an additional source of funds. The 2011 Credit Agreement permits revolving credit loans of up to \$600.0 million for working capital, capital expenditures and general corporate purposes. The 2011 Credit Agreement allows for borrowings in U.S. dollars, euro, Canadian dollars, pound sterling and Japanese yen. Interest payable under the 2011 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 2011 Credit Agreement matures in April 2018.

The 2011 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 December 31, 2014. For the six months ended December 31, 2014, average daily borrowings outstanding under the 2011 Credit Agreement were approximately \$237.6 million. Borrowings under the 2011 Credit Agreement are guaranteed by our significant domestic subsidiaries.

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 December 31, 2014, cash and cash equivalents of \$96.3 million and short-term intercompany advances made by our foreign subsidiaries to our U.S. parent of \$19.8 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, including liquidity needs associated with our domestic debt service requirements.

At December 31, 2014, cash and cash equivalents were \$146.3 million, total debt was \$962.6 million and total Kennametal Shareholders' equity was \$1,499.3 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 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, 2014.

Cash Flow Provided by Operating Activities

During the six months ended December 31, 2014, cash flow provided by operating activities was \$135.3 million, compared to \$84.6 million for the prior year period. Cash flow provided by operating activities for the current year period consisted of net loss and non-cash items amounting to an inflow of \$111.8 million, partially offset by changes in certain assets and liabilities netting to an outflow of \$23.5 million. Contributing to the changes in certain assets and liabilities were a decrease in accounts payable and accrued liabilities of \$75.0 million primarily driven by timing of

payroll payments and a decrease in accrued bonus payable. Offsetting these cash outflows were a decrease in accounts receivable of \$54.9 million due to lower sales volume and an increase in accrued income taxes of \$45.6 million.

During the six months ended December 31, 2013, cash flow provided by operating activities consisted of net income and non-cash items amounting to an inflow of \$149.5 million, partially offset by changes in certain assets and liabilities netting to an outflow of \$64.9 million. Contributing to the changes in certain assets and liabilities were a decrease in accounts payable and accrued liabilities of \$34.3 million primarily driven by timing of payroll payments and a decrease in federal tax payments of \$16.5 million, an increase in inventory of \$27.0 million primarily driven by higher work in process and finished goods inventory, a decrease in other of \$16.4 million and a decrease in accrued income taxes of \$14.0 million. Offsetting these cash outflows were a decrease in accounts receivable of \$26.9 million due to improved collections.

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

Cash Flow Used for Investing Activities

Cash flow used for investing activities was \$53.8 million for the six months ended December 31, 2014, compared to \$683.0 million in the prior year period. During the current year period, cash flow used for investing activities included capital expenditures, net of \$53.7 million, which consisted primarily of equipment upgrades.

For the six months ended December 31, 2013, cash flow used for investing activities included \$634.6 million used for acquisitions, primarily TMB of \$607.0 million and two other acquisitions in the Infrastructure segment. Capital expenditures, net were \$48.4 million, which consisted primarily of equipment upgrades.

Cash Flow (Used for) Provided by Financing Activities

Cash flow used for financing activities was \$105.6 million for the six months ended December 31, 2014 compared to cash flow provided by financing activities of \$382.0 million in the prior year period. During the current year period, cash flow used for financing activities primarily included \$80.1 million net decrease in borrowings and \$28.5 million of cash dividends paid to Shareholders. These cash flows were offset by \$7.9 million of dividend reinvestment and the effect of employee benefit and stock plans.

For the six months ended December 31, 2013, cash flow provided by financing activities included \$396.3 million net increase in borrowings and \$18.1 million of dividend reinvestment and the effect of employee benefit and stock plans. These cash flows were offset by \$28.2 million of cash dividends paid to Shareholders and \$4.4 million used for the purchase of capital stock.

FINANCIAL CONDITION

Working capital was \$845.3 million at December 31, 2014, a decrease of \$117.2 million from \$962.4 million at June 30, 2014. The decrease in working capital was primarily driven by a decrease in accounts receivable of \$82.3 million due to lower sales volume, an increase in accrued income taxes of \$49.3 million, a decrease in inventory of \$40.9 million due to lower work in process and raw materials, a decrease in cash and cash equivalents of \$31.7 million and an increase in notes payable of \$14.4 million. Partially offsetting these items was a decrease in accounts payable of \$47.4 million and a decrease in accrued expenses of \$36.7 million driven by payroll timing and lower accrued bonus payable. Currency exchange effects accounted for \$53.9 million of the working capital change.

Property, plant and equipment, net decreased \$41.4 million from \$884.5 million at June 30, 2014 to \$843.1 million at December 31, 2014, primarily due to depreciation expense of \$53.3 million and unfavorable currency exchange impact of \$33.9 million during the current quarter, partially offset by capital expenditures of \$54.7 million, which includes \$6.5 million change in accounts payable related to purchases of property, plant and equipment.

At December 31, 2014, other assets were \$1,035.4 million, a decrease of \$423.1 million from \$1,458.4 million at June 30, 2014. The primary drivers for the decrease were a decrease in goodwill of \$396.0 million and a decrease in other intangible assets of \$32.9 million. The change in goodwill was due to an impairment charge of in the Infrastructure segment of \$375.0 million and unfavorable currency exchange effects. The change in other intangible assets was due to amortization expense of \$14.0 million, Infrastructure contract-based technology and other intangible asset impairments of \$12.0 million and unfavorable currency exchange effects of \$7.1 million.

Long-term debt and capital leases decreased by \$114.6 million to \$867.1 million at December 31, 2014 from \$981.7 million at June 30, 2014. This change was driven by the \$113.0 million decrease of borrowings outstanding on our 2011 Credit Agreement.

Kennametal Shareholders' equity was \$1,499.3 million at December 31, 2014, a decrease of \$429.9 million from \$1,929.3 million at June 30, 2014. The decrease was primarily due net loss attributable to Kennametal of \$388.3 million, unfavorable currency exchange of \$79.4 million and cash dividends paid to Shareholders of \$28.5 million, partially offset by capital stock issued under employee benefit and stock plans of \$16.7 million.

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

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 We are involved as a potentially responsible party (PRP) at various sites designated by the United States Environmental Protection Agency (USEPA) as Superfund sites. For certain of these sites, we have evaluated the claims and potential liabilities and have determined that neither are material, individually or in the aggregate. For certain other sites, proceedings are in the very early stages and have not yet progressed to a point where it is possible to estimate the ultimate cost of remediation, the timing and extent of remedial action that may be required by governmental authorities or the amount of our liability alone or in relation to that of any other PRP.

Other Environmental Matters We establish and maintain reserves for other potential environmental issues. At December 31, 2014 and June 30, 2014, the balances of these reserves were \$12.6 million and \$11.0 million, respectively. These reserves represent anticipated costs associated with the remediation of these issues.

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, 2014.

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

There have been no material changes to our market risk exposure since June 30, 2014.

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ITEM 4. CONTROLS AND PROCEDURES

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 December 31, 2014 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares Purchased ⁽¹⁾ | 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 ⁽²⁾ |
|--------------------------------------|---|------------------------------|--|---|
| October 1 through October 31, 2014 | 1,130 | \$38.92 | — | 10,100,100 |
| November 1 through November 30, 2014 | 1,987 | 44.90 | — | 10,100,100 |
| December 1 through December 31, 2014 | 706 | 36.02 | — | 10,100,100 |
| Total | 3,823 | \$41.49 | — | |

During the current period, 1,987 shares were purchased on the open market on behalf of Kennametal to fund the (1) Company's dividend reinvestment program. Also, during the current period employees delivered 1,836 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.

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ITEM 6. EXHIBITS

| | | |
|-----------|--|---|
| (3) | Articles of Incorporation and Bylaws | |
| (3.1) | Articles of Incorporation (as amended through October 28, 2014) | Exhibit 3.1 of the Form 8-K filed October 30, 2014 (File No. 001-05318) is incorporated herein by reference. |
| (3.2) | By-Laws of Kennametal Inc. (as amended through October 28, 2014) | Exhibit 3.2 of the Form 8-K filed October 30, 2014 (File No. 001-05318) is incorporated herein by reference. |
| (10) | Material Contracts | |
| (10.1) | Officer's Employment Agreement with Donald A. Nolan | Exhibit 10.1 of the Form 8-K filed November 17, 2014 (File No 001-05318) is incorporated herein by reference. |
| (10.2) | Form of Kennametal Inc. Nonstatutory Stock Option Award Agreement - CEO | Exhibit 10.2 of the Form 8-K filed November 17, 2014 (File No 001-05318) is incorporated herein by reference. |
| (10.3) | Form of Kennametal Inc. Restricted Stock Unit Award Agreement - CEO | Exhibit 10.3 of the Form 8-K filed November 17, 2014 (File No 001-05318) is incorporated herein by reference. |
| (31) | Rule 13a-14(a)/15d-14(a) Certifications | |
| (31.1) | Certification executed by Donald A. Nolan, President and Chief Executive Officer of Kennametal Inc. | Filed herewith. |
| (31.2) | Certification executed by Frank P. Simpkins, Vice President and Chief Financial Officer of Kennametal Inc. | Filed herewith. |
| (32) | Section 1350 Certifications | |
| (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 Donald A. Nolan, President and Chief Executive Officer of Kennametal Inc., and Frank P. Simpkins, Vice President and Chief Financial Officer of Kennametal Inc. | Filed herewith. |
| (101) | XBRL | |
| (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: February 3, 2015

By: /s/ Martha Fusco

Martha Fusco
Vice President Finance and Corporate Controller