

Kennametal Inc. (KMT)

\$27.82 (As of 08/05/20)

Price Target (6-12 Months): **\$29.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/26/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: D

Summary

Kennametal is poised to benefit from its diversified business structure, solid product offerings and innovation capabilities. Its simplification/modernization activities are predicted to yield savings of \$65-\$75 million in fiscal 2021. Also, its policy of rewarding shareholders with dividends bodes well. In fourth-quarter fiscal 2020, the company's earnings surpassed estimates by 25%, while sales lagged the same by 3.47%. Being wary of the adverse impacts of the pandemic, it refrained from providing financial projections for fiscal 2021. Higher restructuring charges, pandemic-woes and other headwinds might be detrimental to margins. Further, forex woes might be concerning. Notably, its cost-saving measures might be of help in the quarters ahead. In the past three months, the company's shares have underperformed the industry.

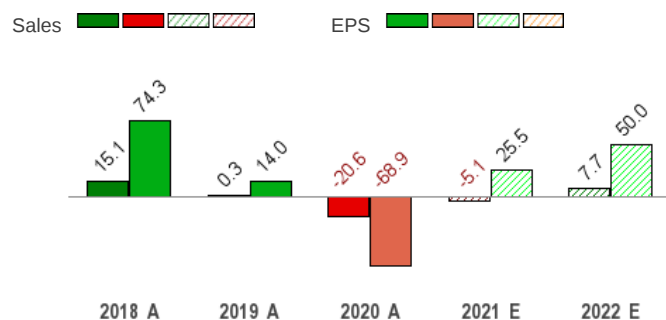
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$38.73 - \$14.45
20 Day Average Volume (sh)	709,610
Market Cap	\$2.3 B
YTD Price Change	-24.6%
Beta	2.31
Dividend / Div Yld	\$0.80 / 2.9%
Industry	Manufacturing - Tools & Related Products
Zacks Industry Rank	Top 9% (23 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	25.0%
Last Sales Surprise	-3.5%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	11/02/2020
Earnings ESP	18.9%
P/E TTM	29.3
P/E F1	23.6
PEG F1	4.7
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	492 E	546 E	539 E	458 E	1,926 E
2021	415 E	464 E	505 E	435 E	1,788 E
2020	518 A	505 A	483 A	379 A	1,885 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.19 E	\$0.48 E	\$0.65 E	\$0.49 E	\$1.77 E
2021	\$0.09 E	\$0.24 E	\$0.49 E	\$0.41 E	\$1.18 E
2020	\$0.17 A	\$0.17 A	\$0.46 A	\$0.15 A	\$0.94 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/05/2020. The reports text is as of 08/06/2020.

Overview

Based in Latrobe, PA, Kennametal Inc. is a manufacturer, marketer and distributor of high-speed metal cutting tools, tooling systems and wear-resistant parts. It has operations in various countries, including the Americas, the Asia Pacific, and Europe, Middle East and Africa. Exiting fiscal 2020 (ended June 2020), it had approximately 9,000 employees.

Its products are marketed through a number of channels to the end users, comprising manufacturers of machine tools, transportation vehicles and various components, airframe, aerospace components, machinery (light and heavy), components (energy-related), and others. Also, the company's products are used by manufacturers and suppliers in the oil and gas exploration, road construction, and other industries.

Kennametal reports results under three segments — including Industrial, WIDIA and Infrastructure. A brief discussion of the segments is provided below.

- **Industrial** (51.5% of revenues generated in fourth-quarter fiscal 2020) segment provides products and services in the industrial end markets such as general engineering, aerospace & defense, transportation, and energy.

The segment offerings — sold under Kennametal Brand — are, in turn, used for the production of automobiles, ships, aero engines, trucks, airframe and other equipment.

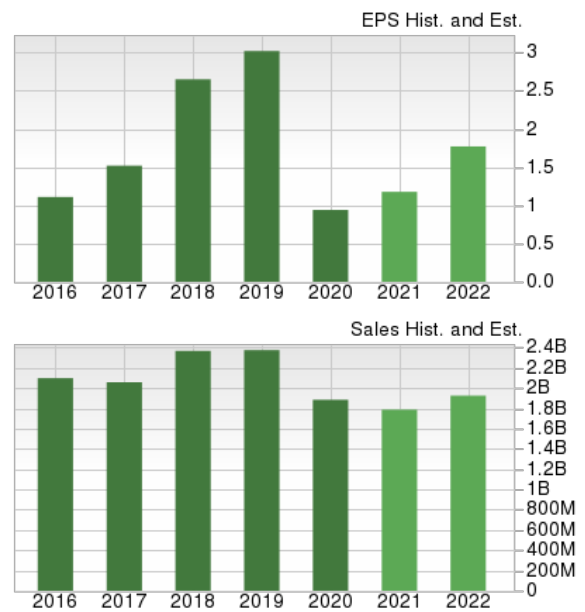
- **WIDIA** (8.4%) segment provides metal cutting solutions (both customized and standard) in the energy, general engineering, aerospace and transportation end markets.

The main product brands under the segment are WIDIA Hanita, WIDIA and WIDIA GTD.

- **Infrastructure** (40.1%) segment serves end users in the energy, general engineering and earthworks markets. These players, in turn, support mining, oil and gas, petrochemical, process, aerospace, packaging, and other industries.

The main product brand offered under the segment is Kennametal.

The company informed that it will combine the results of its Industrial and WIDIA segments into a new segment — Metal Cutting. The other segment, Infrastructure, retains its structure. This change is effective Jul 1, 2020.



Reasons To Buy:

- ▲ In the past three months, Kennametal's shares have gained 21.2% compared with the industry's growth of 10.3%. In fourth-quarter fiscal 2020, the company's earnings surpassed estimates by 25%. In the quarters ahead, the company anticipates gaining from simplification/modernization activities (discussed below), innovation capabilities, and solid product offerings. Also, its ongoing cost-saving actions — including lowering of salaried employees' compensation by 10-20% and a 20% reduction in cash compensation for the board of directors — will likely help in effectively deal with the pandemic woes. These actions have been implemented from Jul 1, 2020. Also, actions like furloughs and others initiated earlier for salaried employees have been stopped. In addition, production reduction at manufacturing facilities and temporary shutdowns to deal with the difficult environment are other cost-saving measures.
- ▲ Kennametal's three initiatives — including growth, modernization and simplification — have been proving advantageous. The growth initiative is helping boost the company's sales through improvement in commercial execution. The simplification initiative is improving operational efficiency and reducing costs. The modernization initiative is in progress now and is contributing to strong operating leverage. Compared with the year-ago quarter, the initiatives boosted the company's bottom line by 14 cents per share in the fourth quarter. It stated that its simplification/modernization resulted in savings of \$33 million in fiscal 2020. For fiscal 2021, it expects savings of \$65-\$75 million from these initiatives, higher than \$25-\$30 million mentioned previously.
- ▲ Kennametal remains committed to rewarding its shareholders through dividend payments. In fiscal 2020, it distributed dividends totaling 80 cents per share or \$66 million to its shareholders. Also, the company's diversified customer base in various end markets enables it to avoid customer concentration risks. Prime end-markets served include aerospace, automotive, and machine tool and farm machinery industries as well as manufacturers and suppliers in the highway construction, coal mining, quarrying, and oil and gas exploration industries.

Kennametal is well-positioned to gain from simplification/modernization activities, diversified business structure, cost-saving measures and innovations capabilities. Its shareholder-friendly policies might also aid.

Reasons To Sell:

- ▼ In fourth-quarter fiscal 2020, Kennametal's earnings decreased 82.1% from the year-ago quarter on a 37% fall in sales and margin results. It is wary about the impacts of end-market challenges due to the coronavirus outbreak. It refrained from providing projections for fiscal 2021.
- ▼ Weakness in gross and operating profits can be dragging for Kennametal. In fourth-quarter fiscal 2020, the company recorded a 52.5% year-over-year decline in gross profit, while gross margin was down 860 basis points (bps). Also, adjusted operating income dipped 64.9% year over year on a decline in organic sales, restructuring charges and lower absorption of costs (including fixed and volume-related labor costs). Notably, charges related to simplification/modernization initiatives (pre-tax) were \$18 million or 17 cents per share in the fiscal fourth quarter. For fiscal 2020, the company incurred pre-tax restructuring charges of \$54 million, while that for fiscal 2021 is likely to be \$90-\$100 million, higher than the previously mentioned \$55-\$60 million.
- ▼ Kennametal's business is exposed to risks related to foreign currency translation, given its strong presence in international markets. Though international diversity increases business scope, it also exposed the company to risks arising from unfavorable movements in foreign currencies and geopolitical issues. In this regard, foreign currency translation had an adverse impact of 2% on revenues and 3 cents per share on earnings in fourth-quarter fiscal 2020. Fluctuations in foreign exchange rates may continue to affect the company's top and bottom lines in the quarters ahead. At the end of fourth-quarter fiscal 2020, Kennametal's long-term debt stood at \$594.1 million, reflecting growth of 0.1% from the previous quarter. It is the company's ability to repay its financial obligations (not its debts) that are more concerning presently. Its times interest earned was 1.1x at the end of the fourth quarter, lower than 3.2x in the previous quarter. We believe that further rise in debts as well as worsening ability to repay debts might be dragging in the quarters ahead.

Challenging end-market conditions caused by the pandemic remain concerning for Kennametal. Also, restructuring charges and forex woes might be dragging in the quarters ahead.

Last Earnings Report

Kennametal Q4 Earnings Beat Estimates, Decline Y/Y

Kennametal reported mixed results for fourth-quarter fiscal 2020 (ended Jun 30, 2020). Its earnings in the quarter surpassed estimates by 25%, while sales lagged the same by 3.47%.

The machinery company's adjusted earnings in the reported quarter were 15 cents, surpassing the Zacks Consensus Estimate of 12 cents. However, the bottom line decreased 82.1% from the year-ago figure of 84 cents on weak sales and margin results.

For fiscal 2020, the company's adjusted earnings were 94 cents per share, below the previous year's \$3.02. However, the fiscal year's earnings surpassed the Zacks Consensus Estimate of 91 cents.

Quarter Ending 06/2020

Report Date	Aug 03, 2020
Sales Surprise	-3.47%
EPS Surprise	25.00%
Quarterly EPS	0.15
Annual EPS (TTM)	0.95

Revenue Details

Kennametal generated revenues of \$379.1 million, declining 37% year over year. While organic sales fell 33% in the quarter, forex woes had an impact of 2% and divestitures hurt results by 2%. The quarterly results suffered from the adverse impacts of the pandemic.

Kennametal's top line lagged the Zacks Consensus Estimate of \$393 million.

On a geographical basis, the company generated revenues of \$179.4 million from America operations, decreasing 41.8% year over year. Sales in Europe, the Middle East and Africa (EMEA) were down 36.6% to \$110.3 million, while the same from the Asia Pacific dropped 26.8% to \$89.4 million.

The company reports revenue results under three segments, including Industrial, WIDIA and Infrastructure. Its segmental performance for the fiscal fourth quarter is briefly discussed below:

Industrial revenues of \$195.1 million were down 39% year over year. The results were adversely impacted by a 36% decline in organic revenues, a 2% impact from forex woes and a 1% negative impact from business days.

WIDIA revenues were \$31.9 million, reflecting a decline of 35% year over year. The results were negatively impacted by an organic sales decline of 32%, forex woes of 2% and a negative impact of 1% from business days.

Infrastructure revenues totaled \$152.1 million, declining 36% year over year. The results were affected by 2% from forex woes, a 29% decline in organic sales and a 4% adverse impact of divestitures. Also, business days' impact was a negative 1%.

For fiscal 2020, the company's revenues were \$1,885.3 million, declining 21% year over year. While organic sales were down 18%, forex woes had an adverse impact of 2% and divestiture's impact was 1%.

Margin Profile

Kennametal's cost of goods sold in the reported quarter dipped 28.9% year over year to \$277.6 million. It represented 73.2% of revenues compared with 64.6% in the year-ago quarter. Gross profit deteriorated 52.5% year over year to \$101.5 million, wherein margin contracted 860 basis points (bps) to 26.8%. Operating expenses summed \$68.2 million in the quarter under review, decreasing 41.3% year over year. As a percentage of revenues, operating expenses were 18% compared with 19.2% a year ago.

Adjusted operating income in the reported quarter slumped 64.9% year over year to \$33.5 million. Notably, the downside is caused by a decline in organic sales, lower absorption of costs (including fixed and volume-related labor costs) and restructuring charges. However, the adverse impacts were partly offset by the benefits of simplification/modernization actions, gains from cost-reduction actions, and a fall in variable compensation and raw material costs. Adjusted operating margin slipped 700 bps to 8.8%.

Adjusted effective tax rate was 51.2% in the quarter, up from 21% in the prior-year quarter.

Balance Sheet and Cash Flow

Exiting the fiscal fourth quarter, Kennametal had cash and cash equivalents of \$606.7 million, increasing from \$85.2 million at the end of the last reported quarter. Long-term debt and capital leases inched up 0.1% sequentially to \$594.1 million.

In fiscal 2020, the company generated net cash of \$223.7 million from operating activities, declining 25.5% from the previous year. Capital invested in purchasing property, plant and equipment came in at \$244.2 million, above \$212.3 million reported in fiscal 2019. Free cash outflow was \$17.8 million against an inflow of \$11.2 million in fiscal 2019.

Restructuring Actions

The company noted that it will cease operations in its Johnson City, TN-based manufacturing facility by the end of fiscal 2021 (ending June 2021). The action is part of the footprint rationalization initiative under its ongoing restructuring program for fiscal 2021.

The company predicts annualized savings of \$65-\$75 million from its restructuring actions in fiscal 2021, higher than \$25-\$30 million mentioned previously. Pre-tax charges in the year will be \$90-\$100 million, higher than \$55-\$60 million stated earlier.

In addition, restructuring actions for fiscal 2020 resulted in savings of \$33 million and pre-tax expenses of \$54 million.

Outlook

In the quarters ahead, Kennametal anticipates gaining from simplification/modernization activities, solid product offerings and cost-reduction

actions. However, end-market challenges will likely persist due to the coronavirus outbreak.

The company noted that it will combine the results of its Industrial and WIDIA segments into a new segment — Metal Cutting. The other segment, Infrastructure, retains its structure. This change is effective Jul 1, 2020.

The company refrained from issuing financial projections for fiscal 2021 due to the uncertainties related to the pandemic. However, it did mention that capital spending will be \$110-\$130 million in fiscal 2021.

Recent News

Dividend

On **Aug 3, 2020**, Kennametal announced that its board of directors approved the payment of a quarterly cash dividend of 20 cents per share to its shareholders of record as of Aug 11, 2020. The dividend will be paid out on Aug 25.

Restructuring Plans & Cost Actions

On **Jun 9, 2020**, Kennametal provided an update on its simplification/modernization initiatives meant for simplifying the business structure, improving efficiency and boosting shareholder value. Also, the company revealed its cost-saving actions to deal with the pandemic-induced financial crisis.

As noted, structural cost-reduction actions — part of Kennametal's simplification/modernization initiatives — have been accelerated. With the move, the company expects to be done with the restructuring of 10% employees (salaried) in the first half of fiscal 2021 (ending December 2020).

The suggested restructuring actions are anticipated to boost the company's savings in fiscal 2021 (ending June 2021) — with annualized savings now predicted to be \$65-\$75 million versus \$25-\$30 million mentioned earlier. Pre-tax charges are now expected to be \$90-\$100 million in the year.

Additionally, the company's cost-saving actions to combat some of the adverse impacts of the pandemic include a 20% reduction in cash compensation for the board of directors and lowering of salaried employees' compensation by 10-20%. Notably, actions initiated earlier (furloughs and others) for salaried employees will be stopped. The actions will be implemented from Jul 1, 2020, and will hold good through the first half of fiscal 2021.

Production reduction at manufacturing facilities and temporary shutdowns are other actions, which will be considered by the company to deal with the difficult environment.

Valuation

Kennametal shares are down 24.6% and 9.9% year to date and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are down 24.9% and 6.5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 9.7% and up 7.5%, respectively.

The S&P 500 Index has moved up 2.6% in the year-to-date period and 14.9% in the past year.

The stock is currently trading at 22.39x forward 12-month earnings per share, which compares to 16.82x for the Zacks sub-industry, 21.38x for the Zacks sector and 22.58x for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.07x and as low as 8.68x, with a 5-year median of 16.57x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$29 price target reflects 23.51x forward 12-month earnings per share.

The table below shows summary valuation data for KMT.

Valuation Multiples - KMT					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	22.39	16.82	21.38	22.58
	5-Year High	31.07	21.45	21.53	22.58
	5-Year Low	8.68	12.49	12.55	15.25
	5-Year Median	16.57	16.8	17.15	17.55
P/S F12M	Current	1.28	1.21	2.82	3.61
	5-Year High	1.82	1.52	2.82	3.61
	5-Year Low	0.59	0.84	1.52	2.53
	5-Year Median	1.23	1.19	2.03	3.04

As of 08/05/2020

Industry Analysis Zacks Industry Rank: Top 9% (23 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Sandvik AB (SDVKY)	Outperform	2
Stanley BlackDecker, Inc. (SWK)	Outperform	1
Allegheny Technologies Incorporated (ATI)	Neutral	4
Colfax Corporation (CFX)	Neutral	3
SPX FLOW, Inc. (FLOW)	Neutral	3
IDEX Corporation (IEX)	Neutral	3
Ingersoll Rand Inc. (IR)	Neutral	3
MSC Industrial Direct Company, Inc. (MSM)	Neutral	3

Industry Comparison Industry: Manufacturing - Tools & Related Products				Industry Peers		
	KMT	X Industry	S&P 500	CFX	IEX	SWK
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Outperform
Zacks Rank (Short Term)	2	-	-	3	3	1
VGM Score	C	-	-	C	C	D
Market Cap	2.31 B	2.42 B	22.93 B	3.69 B	12.55 B	25.12 B
# of Analysts	7	6	14	10	7	10
Dividend Yield	2.88%	1.52%	1.76%	0.00%	1.20%	1.75%
Value Score	B	-	-	C	C	C
Cash/Price	0.04	0.08	0.07	0.11	0.06	0.04
EV/EBITDA	6.17	12.94	13.16	14.71	19.60	15.35
PEG Ratio	4.72	4.73	2.99	5.16	3.47	5.22
Price/Book (P/B)	1.82	2.97	3.20	1.11	5.55	2.97
Price/Cash Flow (P/CF)	24.89	15.21	12.45	6.72	24.19	13.05
P/E (F1)	23.58	23.63	21.78	26.67	34.67	22.75
Price/Sales (P/S)	1.22	1.82	2.47	1.07	5.26	1.84
Earnings Yield	4.24%	4.24%	4.33%	3.75%	2.88%	4.39%
Debt/Equity	0.47	0.44	0.77	0.79	0.46	0.55
Cash Flow (\$/share)	1.12	2.38	6.94	4.64	6.87	12.06
Growth Score	D	-	-	B	B	D
Hist. EPS Growth (3-5 yrs)	18.05%	8.18%	10.46%	8.44%	13.05%	7.27%
Proj. EPS Growth (F1/F0)	25.22%	-17.59%	-7.14%	-49.83%	-17.36%	-17.68%
Curr. Cash Flow Growth	-74.54%	3.69%	5.47%	27.59%	4.80%	4.61%
Hist. Cash Flow Growth (3-5 yrs)	2.02%	6.22%	8.55%	3.20%	7.29%	6.22%
Current Ratio	1.60	1.99	1.32	1.93	3.48	1.26
Debt/Capital	31.89%	30.48%	44.59%	44.24%	31.60%	31.86%
Net Margin	-0.30%	5.46%	10.15%	-13.62%	15.71%	5.88%
Return on Equity	6.01%	6.65%	14.46%	8.89%	18.15%	13.97%
Sales/Assets	0.70	0.68	0.51	0.40	0.61	0.62
Proj. Sales Growth (F1/F0)	-5.16%	-7.44%	-1.68%	-20.01%	-9.11%	-7.44%
Momentum Score	D	-	-	F	C	C
Daily Price Chg	6.92%	1.11%	0.59%	2.00%	0.67%	1.71%
1 Week Price Chg	0.60%	-1.00%	0.14%	-6.31%	-1.70%	0.27%
4 Week Price Chg	3.00%	8.48%	5.31%	9.10%	5.28%	12.94%
12 Week Price Chg	27.61%	32.57%	19.84%	31.90%	13.18%	53.63%
52 Week Price Chg	-9.91%	11.83%	2.73%	16.91%	5.08%	14.73%
20 Day Average Volume	709,610	239,645	2,098,555	922,519	375,180	1,078,496
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	9.45%
(F1) EPS Est 4 week change	0.00%	9.82%	1.10%	-3.39%	2.82%	27.40%
(F1) EPS Est 12 week change	-4.43%	0.94%	1.04%	-16.23%	2.82%	33.37%
(Q1) EPS Est Mthly Chg	-5.00%	6.51%	0.39%	2.90%	1.42%	36.50%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	D
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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