Kennametal Inc. (KMT)

$28.12 (As of 06/15/20)

Price Target (6-12 Months): **$30.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/26/20) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: A | Growth: C | Momentum: D	**3-Hold** VGM:B

Summary

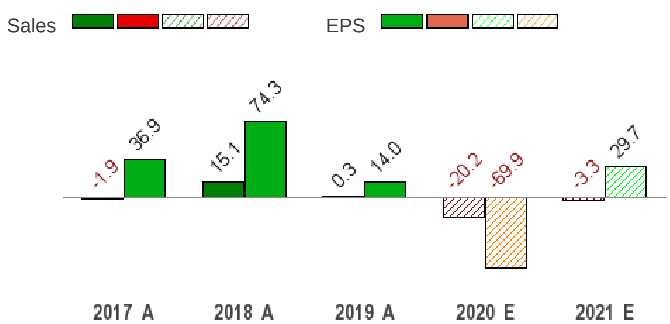
Kennametal is poised to benefit from its diversified business structure, solid liquidity position and innovation capabilities. Its simplification/modernization activities are predicted to yield annualized savings of $30-$35 million in fiscal 2020 and $65-$75 million in fiscal 2021. Also, its policy of rewarding shareholders with dividends bodes well. However, the company is wary of the adverse impacts of the pandemic and it, therefore, suspended its financial projections for fiscal 2020. Notably, its cost-saving measures might be of help in the quarters ahead. In addition, weakness in gross and operating margins as well as forex woes might prove challenging. Year to date, the company's shares have underperformed the industry. Also, its earnings estimates have declined for fiscal 2020 and fiscal 2021 in the past 30 days.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$38.73 - $14.45**
20 Day Average Volume (sh)	**781,655**
Market Cap	**$2.3 B**
YTD Price Change	**-23.8%**
Beta	**2.37**
Dividend / Div Yld	**$0.80 / 2.8%**
Industry	**Manufacturing - Tools & Related Products**
Zacks Industry Rank	**Top 23% (59 out of 253)**
Last EPS Surprise	**43.8%**
Last Sales Surprise	**-5.7%**
EPS F1 Est- 4 week change	**-1.5%**
Expected Report Date	**08/03/2020**
Earnings ESP	**-32.4%**
P/E TTM	**17.2**
P/E F1	**30.9**
PEG F1	**3.7**
P/S TTM	**1.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	419 E	464 E	500 E	453 E	1,833 E
2020	518 A	505 A	483 A	390 E	1,896 E
2019	587 A	587 A	597 A	604 A	2,375 A

EPS Estimates

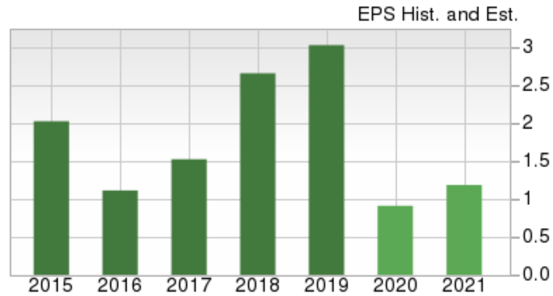
	Q1	Q2	Q3	Q4	Annual*
2021	$0.08 E	$0.25 E	$0.55 E	$0.48 E	$1.18 E
2020	$0.17 A	$0.17 A	$0.46 A	$0.12 E	$0.91 E
2019	$0.70 A	$0.71 A	$0.77 A	$0.84 A	$3.02 A

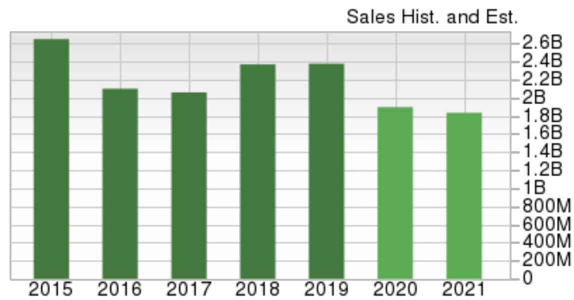
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/15/2020. The reports text is as of 06/16/2020.

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 2019 (ended June 2019), it had approximately 10,400 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** (54% of revenues generated in third-quarter fiscal 2020): The 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** (8.8%): The 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** (37.2%): The 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.

Reasons To Buy:

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.

- In the quarters ahead, Kennametal anticipates gaining from simplification/modernization activities (discussed below), innovation capabilities and solid liquidity position. Recently, the company communicated that it will undertake cost-saving actions — including lowering of salaried employees' compensation by 10-20% and a 20% reduction in cash compensation for the board of directors — to deal with the pandemic woes. The actions will be implemented from Jul 1, 2020. Also, actions like furloughs and others initiated earlier for salaried employees will be stopped. The company will also opt for production reduction at manufacturing facilities and temporary shutdowns to deal with the difficult environment.

- 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 15 cents per share in the third quarter. Also, it anticipates the second phase of simplification/modernization to yield annualized savings of $30-$35 million (down from $35-$40 million mentioned earlier) by the end of fiscal 2020. Savings in fiscal 2021 are now anticipated to be $65-$75 million, higher than $25-$30 million mentioned earlier. The revision stems from an acceleration in the company's structural cost-reduction actions.

- Kennametal remains committed to rewarding its shareholders through dividend payments. In the first nine months of fiscal 2020, it distributed dividends totaling $49.7 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.

Reasons To Sell:

- Year to date, Kennametal's shares have moved down 23.8% compared with the industry's decline of 20.6%. In first-quarter 2020, the company's earnings decreased 40.3% from the year-ago quarter on weak sales and margin results. It is wary about the impacts of end-market challenges due to the coronavirus outbreak. It suspended financial projections for fiscal 2020. In the past 30 days, its earnings estimates have declined 1.1% for fiscal 2020 and 1.7% for fiscal 2021. This makes us cautious about the stock.

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.

- Weakness in gross and operating profits can be dragging for Kennametal. In third-quarter fiscal 2020, the company recorded a 24.5% year-over-year decline in gross profit, while gross margin was down 230 basis points (bps). Also, adjusted operating income dipped 30.8% year over year on a decline in organic sales, negative impacts of simplification/modernization actions, restructuring changes and lower absorption of costs (including fixed and volume-related labor costs). Notably, charges related to simplification/modernization initiatives (pre-tax) were $6 million or 6 cents per share in the fiscal third quarter. For fiscal 2020, the company predicts incurring pre-tax restructuring charges of $55-$60 million, while that for fiscal 2021 to amount to $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 1% on revenues and 3 cents per share on earnings in third-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 third-quarter fiscal 2020, Kennametal's long-term debt stood at $593.6 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 3.2x at the end of the third quarter, lower than 4.6x 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.

Last Earnings Report

Kennametal Beats Q3 Earnings Estimates, Withdraws View

Quarter Ending	03/2020
Report Date	May 04, 2020
Sales Surprise	-5.74%
EPS Surprise	43.75%
Quarterly EPS	0.46
Annual EPS (TTM)	1.64

Kennametal reported better-than-expected results for third-quarter fiscal 2020 (ended Mar 31, 2020), with earnings surpassing estimates by 43.75%. However, the quarterly sales lagged the consensus mark by 5.74%.

This machinery company's adjusted earnings in the reported quarter were 46 cents, surpassing the Zacks Consensus Estimate of 32 cents. However, the bottom line decreased 40.3% from the year-ago figure of 77 cents on weak sales and margin results.

Revenue Details

Kennametal generated revenues of $483.1 million, declining 19% year over year. While organic sales fell 17% in the quarter, forex woes had an impact of 1% and divestitures hurt results by 1%. The quarterly results suffered from the slowdown in global manufacturing activities due to the pandemic.

Kennametal's top line lagged the Zacks Consensus Estimate of $512.5 million.

On a geographical basis, the company generated revenues of $242.4 million from America operations, decreasing 20% year over year. Sales in Europe, the Middle East and Africa (EMEA) were down 19% to $146.8 million, while the same from the Asia Pacific dropped 166.9% to $93.8 million.

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

Industrial revenues of $260.7 million were down 18% year over year. The results were adversely impacted by a 17% decline in organic revenues and a 2% impact from forex woes, partially offset by a 1% positive impact from business days.

WIDIA revenues were $42.7 million, reflecting a decline of 16% year over year. The results were negatively impacted by an organic sales decline of 16% and forex woes of 1%, partially offset by a positive impact of 1% from business days.

Infrastructure revenues totaled $179.6 million, declining 21% year over year. The results were affected by 1% from forex woes, a 17% decline in organic sales and a 3% adverse impact of divestitures.

Margin Profile

Kennametal's cost of goods sold in the reported quarter dipped 16.2% year over year to $326.1 million. It represented 67.5% of revenues compared with 65.2% in the year-ago quarter. Gross profit deteriorated 24.5% year over year to $157 million, wherein margin contracted 230 basis points (bps) to 32.5%. Operating expenses summed $98.5 million in the quarter under review, decreasing 18% year over year. As a percentage of revenues, operating expenses were 20.4% compared with 20.1% a year ago.

Adjusted operating income in the reported quarter slumped 30.8% year over year to $59.1 million. Notably, the downside is caused by a decline in organic sales, the negative impacts of simplification/modernization actions, lower absorption of costs (including fixed and volume-related labor costs) and restructuring charges. However, the adverse impacts were to partly offset by the benefits of simplification/modernization actions, and a fall in variable compensation and raw material costs. Adjusted operating margin slipped 210 bps to 12.2%.

Adjusted effective tax rate was 28.5% in the quarter, up from 19.8% in the prior year.

Balance Sheet and Cash Flow

Exiting the fiscal third quarter, Kennametal had cash and cash equivalents of $85.2 million, decreasing 19% from $105.2 million at the end of the last reported quarter. Long-term debt and capital leases inched up 0.1% sequentially to $593.6 million.

In the first nine months of fiscal 2020, the company generated net cash of $146.1 million from operating activities, declining 7.2% from the year-ago period. Capital invested in purchasing property, plant and equipment came in at $206.1 million, above $145.9 million in the year-earlier period. Free cash outflow was $57.2 million compared with an inflow of $15.1 million in the first nine months of fiscal 2019.

During the first nine months of fiscal 2020, the company distributed dividends of $49.7 million.

Restructuring Actions

In July 2019, the company announced that it is undertaking certain measures as part of its simplification/modernization initiatives, which are likely to help it streamline the business structure, improve efficiency and boost shareholder value. The restructuring moves are likely to be completed within the next two years.

The suggested restructuring actions will likely yield annualized savings of $30-$35 million (down from $35-$40 million mentioned earlier) in fiscal 2020 (ending June 2020). Pre-tax charges associated with the efforts will be $55-$60 million (versus the previously stated $$55-$65 million).

The company predicts that facility closures scheduled for fiscal 2021 will lead to annualized savings worth $25-$30 million. Pre-tax charges in the year will be $55-$65 million.

Outlook

In the quarters ahead, Kennametal anticipates gaining from simplification/modernization activities, solid liquidity position and cost-reduction actions. However, end-market challenges will likely persist due to the coronavirus outbreak.

The company withdrew its financial projections for fiscal 2020.

Recent News

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.

Dividend

On **May 27, 2020**, Kennametal paid a quarterly cash dividend of 20 cents per share to its shareholders of record as of May 12, 2020.

Valuation

Kennametal shares are down 23.8% and 12.3% 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 20.6% and 14.2% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 5.5% and 7.1%, respectively.

The S&P 500 Index has moved down 5.6% in the year-to-date period and increased 5.2% in the past year.

The stock is currently trading at 24.01x forward 12-month earnings per share, which compares to 21.37x for the Zacks sub-industry, 21.34x for the Zacks sector and 21.92x for the S&P 500 index.

Over the past five years, the stock has traded as high as 25x and as low as 8.68x, with a 5-year median of 16.32x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $30 price target reflects 25.21x 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	24.01	21.37	21.34	21.92
	5-Year High	25	21.37	21.34	22.11
	5-Year Low	8.68	12.5	12.55	15.23
	5-Year Median	16.32	16.61	16.66	17.49
EV/EBITDA F12M	Current	9.75	10.67	19.13	13.44
	5-Year High	11.79	11.65	20.65	14.17
	5-Year Low	5.19	5.77	10.6	9.01
	5-Year Median	8.53	8.94	14.15	10.96
EV/Sales F12M	Current	1.56	1.62	3.15	3.21
	5-Year High	2.06	1.96	3.4	3.51
	5-Year Low	0.86	0.95	1.76	2.28
	5-Year Median	1.42	1.45	2.32	2.83

As of 06/15/2020

Industry Analysis **Zacks Industry Rank:** Top 23% (59 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
Allegheny Technologies Incorporated **(ATI)**	Neutral	3
Colfax Corporation **(CFX)**	Neutral	3
SPX FLOW, Inc. **(FLOW)**	Neutral	3
IDEX Corporation **(IEX)**	Neutral	3
Ingersoll Rand Inc. **(IR)**	Neutral	2
MSC Industrial Direct Company, Inc. **(MSM)**	Neutral	2
Sandvik AB **(SDVKY)**	Neutral	3
Stanley BlackDecker, Inc. **(SWK)**	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	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	C	C	D
Market Cap	2.33 B	3.28 B	21.70 B	3.39 B	11.51 B	20.87 B
# of Analysts	5	6.5	14	10	7	10
Dividend Yield	2.85%	1.79%	1.95%	0.00%	1.31%	2.04%
Value Score	A	-	-	C	D	D
Cash/Price	0.04	0.09	0.06	0.11	0.05	0.05
EV/EBITDA	6.30	10.05	12.55	13.98	18.22	13.14
PEG Ratio	3.92	3.52	2.96	4.58	3.28	4.66
Price/Book (P/B)	1.79	2.80	2.99	1.02	5.16	2.80
Price/Cash Flow (P/CF)	6.37	11.23	11.61	6.18	22.23	11.23
P/E (F1)	32.67	27.96	21.21	23.70	32.76	24.94
Price/Sales (P/S)	1.10	1.42	2.26	0.98	4.67	1.47
Earnings Yield	3.24%	3.58%	4.43%	4.22%	3.05%	4.01%
Debt/Equity	0.48	0.41	0.76	0.79	0.45	0.63
Cash Flow ($/share)	4.42	3.14	7.01	4.64	6.87	12.06
Growth Score	C	-	-	B	A	D
Hist. EPS Growth (3-5 yrs)	18.05%	9.32%	10.87%	8.44%	13.62%	8.77%
Proj. EPS Growth (F1/F0)	-69.93%	-37.02%	-10.58%	-48.07%	-19.63%	-35.38%
Curr. Cash Flow Growth	10.92%	4.61%	5.46%	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	2.52	2.52	1.29	1.93	3.51	1.06
Debt/Capital	32.59%	29.09%	45.06%	44.24%	30.94%	34.23%
Net Margin	3.10%	6.81%	10.54%	-13.62%	16.92%	6.46%
Return on Equity	10.16%	11.65%	16.08%	8.89%	19.89%	16.40%
Sales/Assets	0.81	0.72	0.55	0.40	0.65	0.66
Proj. Sales Growth (F1/F0)	-20.18%	-14.86%	-2.59%	-20.67%	-10.97%	-14.86%
Momentum Score	D	-	-	D	C	B
Daily Price Chg	1.15%	1.15%	0.98%	0.91%	0.09%	3.27%
1 Week Price Chg	-8.22%	-8.71%	-7.25%	-9.84%	-8.79%	-10.60%
4 Week Price Chg	9.08%	7.14%	5.45%	3.69%	-1.24%	12.20%
12 Week Price Chg	85.37%	48.75%	39.81%	91.20%	33.21%	87.95%
52 Week Price Chg	-12.32%	-3.85%	-4.47%	13.99%	-4.48%	-3.85%
20 Day Average Volume	781,655	54,861	2,587,370	1,295,407	466,186	1,739,125
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-1.52%	0.00%	0.00%	-0.09%	0.00%	8.02%
(F1) EPS Est 12 week change	-30.86%	-36.98%	-15.39%	-43.40%	-17.53%	-36.98%
(Q1) EPS Est Mthly Chg	-8.97%	15.19%	0.00%	21.21%	0.00%	418.68%

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	A
Growth Score	C
Momentum Score	D
VGM Score	B

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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