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FINAL TRANSCRIPT

Q2 2018 Donaldson Company Inc Earnings Call

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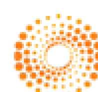

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PRESENTATION

Operator

Good morning. My name is Virgil, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Donaldson Second Quarter 2018 Earnings Conference Call. (Operator Instructions) Brad Pogalz, you may begin your conference.

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Thanks, Virgil. Good morning. Thank you for joining Donaldson's Second Quarter 2018 Earnings Conference Call. With me today is Tod Carpenter, Chairman, CEO and President of Donaldson; and Scott Robinson, Chief Financial Officer. This morning, Tod and Scott will provide an overview of our recent performance and fiscal 2018 outlook, along with an update on some of our strategic priorities.

During today's call, we may reference non-GAAP metrics such as adjusted tax rate and adjusted earnings per share. You can find a reconciliation of GAAP to non-GAAP metrics within the schedules attached to this morning's press release.

I want to remind everyone that any forward-looking statements made during this call are subject to risks and uncertainties, the most important of which are described in our press release and SEC filings.

Now I'll turn the call over to Tod Carpenter. Tod?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Thanks, Brad. Good morning, everyone. At the halfway point in our fiscal year, we have excellent sales traction and support of market conditions around the world. Second quarter sales increased in every business unit, and the sales for both segments were up in every major region. These results highlight the broad nature of the recovery.

We expect momentum to continue, so we increased the midpoint of our full year sales guidance by 2%. The new midpoint for fiscal '18 is 14% above last year and $200 million above our previous sales record of $2.5 billion.

As market conditions support our drive towards a new revenue record, they are also giving way to increased pressure on gross margin. We are seeing inflation across the business from raw materials like steel and media to wages, as we compete for talent.

Mix of sales is also a headwind. Products for OE customers generally have lower margins, and they are currently the fastest-growing part of our portfolio.

High demand, combined with capacity constraints, is also affecting gross margin. Meeting our customers' needs is our top priority, so we are choosing to invest a portion of our gross margin to maintain service levels as demand spikes.

At the same time, we know we need leverage, so we are pursuing additional cost reduction and pricing initiatives to address these pressures. Scott will discuss this topic later in the call, so let me now turn to a recap of our second quarter sales performance.

Total sales of $665 million were 21% above last year and ahead of our forecast. Currency translation added nearly 5% to the year-over-year

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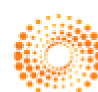
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increase. Growth in the Engine segment continues to lead the company, and the segment is being led by our OE businesses. Total Engine sales increased 22%, while On-Road and Off-Road were up 51% and 37%, respectively.

In On-Road, there are a few items driving the growth. In the U.S., which drove more than half the sales increase, we are benefiting from an easy comp in the prior year and a rebound in heavy-duty truck production. Additionally, our growth in On-Road reflects incremental benefits from new program wins. For example, Asia Pacific On-Road sales grew more than 60% due to a fivefold sales increase in China. We have a small share of China's massive market, so we are encouraged by the interest that local OEs are showing in our high technology products.

Sales of Off-Road Products reflect strength across end markets and geographies, and this business is also benefiting from past program wins. For example, fuel products that leverage our innovative Synteq XP media grew more than 60% in the quarter. It's a small base, but these sales are nearly all incremental to Donaldson. Off-Road sales are still well below peak levels, so we think our technology and favorable market conditions provide a long runway for growth.

We remain very pleased with the results in our Aftermarket business, which grew 18% last quarter. Since bottoming out 2 years ago, total Aftermarket sales are up 40%, and both the OE and independent channels have grown every quarter since. Consistent with the past several quarters, growth appears to be driven by demand versus restocking, and both channels are benefiting from higher levels of equipment utilization around the world. Specific to the independent channel, customers exposed to mining and energy markets continue to grow at above-average rates. The macro factors driving Aftermarket sales are compounded by benefits from our strategic initiatives, including thoughtful acquisitions and innovative technology. Hy-Pro, which we acquired last year, added 3% to Aftermarket's growth last quarter. Additionally, our liquid offering continues to perform very well. Aftermarket sales of hydraulic, fuel and lube filters were all up around 20% last quarter. For fuel and lube, that's on top of a 20% increase last year. The fuel and lube business now represents more than 20% of total Engine sales after growing meaningfully over the past several years. Our customers continue to see the benefits from our high-performing products, so we expect growth in our liquid portfolio will remain strong.

Sales of PowerCore products also remain strong. Aftermarket sales of these filters grew in the mid-20% range last quarter, and they continue to achieve new record levels. In fact, Aftermarket PowerCore products have grown sequentially in each of the past 8 quarters. The long track record of success with this product highlights the power of using innovative technology to secure first-fit wins and drive Aftermarket growth. It's evidence that our "razor-to-sell-razor blade" strategy works.

Rounding out the Engine segment, Aerospace and Defense sales increased 2% last quarter as growth in Aerospace offset a modest decline in ground defense equipment.

Turning to the Industrial segment. We are pleased with the strong growth rate last quarter, which was in line with our forecast. Total sales grew 18%, or 12% without FX impact. Sales of gas turbine systems increased 56%, which was also in line with our forecast. An easy comparison last year, timing of projects and strong growth of replacement parts drove the increase. Looking past the year-over-year number, market conditions for GTS are relatively unchanged. Two years after modifying our go-to-market strategy, sales of replacement parts remain strong, while the market for large turbine projects is still under extreme pressure. Based on these dynamics, we remain confident in our strategic decision to be much more selective in the projects we pursue.

Market conditions in our Industrial Filtration Solutions business are far more encouraging. The total increase of 13% last quarter was led by a 20% increase in sales of new equipment. As markets improve, customers appear to be more interested in moving forward with medium and large projects for dust collectors. To build on the momentum, we are further expanding best practices in our selling model, while also leveraging innovative technology to meet the emerging demand. Our LifeTec filters, which launched in late 2016, are another bright spot in our IFS business. Although it's still early, sales of these filters are growing rapidly as they gain traction in the food and beverage market. The favorable response from customers has us excited about LifeTec's long-term value.

In Special Applications, sales of disk drives, membranes and venting products all contributed to the total increase of 11%. The market for disk drive filters is being influenced by increasing demand from cloud storage and other nearline capacity needs, helping to offset the decline from PCs. Our longstanding focus on growing content per drive and developing new technology puts us in an excellent position to leverage

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the temporary market strength. We also continue to leverage this technology into new and adjacent markets like venting solutions for automotive.

Across the company, we have seen evidence that consistent execution of our strategy over many years can build on market strength. Last quarter, sales of both first-fit and Aftermarket Products were up meaningfully in the quarter. Our innovative product portfolio continues to expand, and we are investing to accelerate this growth. I'll talk more about those investments after Scott provides an update on our second quarter results and full year guidance. Scott?

Scott J. Robinson ***Donaldson Company, Inc. - VP & CFO***

Thanks, Tod. Good morning, everyone. I want to start with a quick overview of the impact from the Tax Cuts and Jobs Act, which resulted in a charge of $109.7 million in the second quarter. The majority of this charge reflects our provisional estimate of total tax on repatriation of foreign earnings, and the results of a small write-down of our deferred tax assets. These charges reduced second quarter GAAP EPS by $0.83, resulting in a net loss in the quarter of $0.40 per share.

Longer term, we estimate our effective tax rate will be 24% to 28%, which is below our historic range of 27% to 29%. Roughly 35% of our profit today comes from the U.S, so the 14-point reduction in the corporate tax rate is muted by our global operations.

Overall, we believe tax reform is positive for Donaldson. In addition to the benefits from a lower tax rate, we are particularly encouraged by the increased flexibility in how we deploy our cash. We are still in the process of analyzing legislation and exploring our options, but nothing about our strategy or capital deployment priorities will change. We remain a returns-focused company, and we invest first on growth-driving initiatives, then dividends, and finally share repurchase.

I'll now turn to a brief recap of our second quarter key metrics. As Tod outlined, sales were strong across the company. Total sales were up 21%, which we converted to a 23% increase in adjusted EPS.

Our second quarter operating margin was 12.3% compared with 12.6% in the prior year. Strong expense leverage only partially offset the pressures on gross margin. Higher raw material costs reduced gross margin by more than half a point. As expected, costs for our largest inputs, steel and media, were both up versus last year.

Another half a point of pressure came from mix. Sales to OE customers, which typically have lower margins, grew much faster than Aftermarket. The mix pressure is amplified by the annual price downs that are common in OE contracts.

Finally, our commitment to meeting our customers' needs while facing capacity constraints is also pressuring margin. To support high demand for innovative air and liquid products, we added shifts, incurred overtime and in some cases, suboptimized the supply chain. We view these actions as making investments in our customer relationships that create long-term value for Donaldson.

Our segment level profitability highlights these challenges. The second quarter profit margin for Engine was 120 basis points below last year, while the industrial margin was up 160 basis points. Engine is dealing with more acute pressure from all the items I referenced: inflation, mix and demand-related costs. Conversely, capacity is less of an issue in the industrial segment, and the project nature of many of those businesses addresses inflation with real-time pricing.

Strong operating expense performance offset a portion of the gross margin headwinds. As a rate of sales, operating expenses decreased 90 basis points, driven primarily by leverage on increasing sales and retiming our stock option expense. We also had incremental spend of about $4 million on our strategic investments, which includes growth in R&D spend, investments in e-commerce and the expense portion of capacity investments.

Moving down the P&L, a small expense and other income and expense compares with income in the prior year of $1.7 million, reflecting a net loss on FX last quarter. Our second quarter adjusted tax rate declined to 25.7% from 29.8% last year, reflecting benefits from stock option accounting and the lower U.S. corporate tax rate. Our balance sheet remains healthy with our leverage ratio in line with our long-term target of 1.5x. Predictably, working capital increased with higher sales and FX translation, but we continue to work on opportunities to optimize

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levels of inventory and receivables. Finally, we returned $44 million to shareholders last quarter, which was split between dividends and share repurchase.

Looking at the full year, we increased our sales projection, and the midpoint of our adjusted EPS guidance range is flat with the prior forecast. We now expect total sales growth between 13% and 15% versus 10% to 14% on prior guidance. Comparing the midpoints of these ranges, we added about $50 million to our full year projection, driven entirely by our first-fit Engine businesses.

We now project Engine sales will grow 17% to 19% with both On-Road and Off-Road up in the mid-20% range. That compares with our previous forecast for growth in the mid-teens, and we continue to believe we are outpacing the relative markets.

Our projections across the rest of our businesses are consistent with what we outlined last quarter. Engine Aftermarket sales will be up in the mid-teens, including a benefit of about 2% from the acquisitions of Hy-Pro and Partmo. And Aerospace and Defense sales are forecasted to grow in the low single-digit range.

Industrial segment sales are forecasted to grow 5% to 7%, led by an increase in the high single to low double-digit range for Industrial Filtration Solutions. Sales of Special Applications are expected to grow in the low single digits. And gas turbine system is expected to decline in the high single-digit range.

One note on GTS. We do expect a sharp drop in the back half. The large increase in the second quarter, which benefited from a soft comp, was factored into our forecast. We are expecting third and fourth quarter sales will be more in line with first quarter.

Additional gross margin pressure drove our operating margin forecast down 30 basis points to a range of 13.8% to 14.2%. At the midpoint, we still expect modest improvement from last year as expense leverage offsets gross margin declines.

I also want to touch on a few discrete items in the forecast. We still expect to make incremental investment of $10 million to $15 million. Consistent with what we outlined at the beginning of the year, we plan to invest in technology development, e-commerce and capacity expansion. Additionally, we still expect incentive compensation will be a few million dollars above last year.

Specific to gross margin, we see little relief from items that affected our second quarter performance: inflation, mix and incremental demand-related costs. There could also be incremental pressure from tariffs on steel and aluminum. But the situation is still evolving, and as such, those are not yet reflected in our forecast.

Looking ahead, we expect to mitigate a portion of these margin pressures. Leaders across the company are identifying additional opportunity to reduce cost for efficiency gains, and we know we have work to do on pricing. We raised prices earlier this calendar year, which was a first step in our process. Given continued pressure from inflation and annual OE price-downs, we are taking a multistep approach. In the independent channel, we are enacting additional price increases across businesses and regions over the balance of this fiscal year. We are also in the process of recovering some of the inflationary pressure with our largest OE customers that have indexing arrangements. Both of these efforts take time. Customers typically require a 90-day lead time, so the steps we've taken will take a little while to flow into our results. Our objective is to get in front of inflation, so we will continue to refine our pricing estimates over the coming months.

In terms of other guidance metrics, there are a handful of changes to call out. We reduced our other income forecast by $2 million, driven primarily by the performance in the second quarter. This impact is offset by a lower tax rate. Our new forecast of 26.5% to 28.5% is down about 1 point from the prior range, reflecting the net benefit from tax reform.

Please keep a couple of things in mind. First, the tax rate guidance excludes the onetime charges we took in the second quarter. Second, the new range includes a partial year benefit from the U.S. rate reduction that is largely offset by other aspects of tax reform such as withholding tax.

We raised the bottom end of our capital expenditure forecast to $90 million as we continue to invest in the business. And our cash conversion

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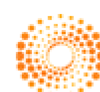

forecast is now 60% to 75%. The decline in our conversion reflects the higher level of working capital, largely due to demand.

Our share repurchase target of 2% is unchanged, and we are halfway to that goal after the second quarter.

All together, we expect adjusted earnings per share of $1.93 to $2.01. The midpoint of $1.97 is consistent with our prior guidance and reflects growth from last year's GAAP and adjusted EPS of 13.2% and 16.6%, respectively. The onetime charges from tax reform will leave full year GAAP EPS about $0.83 below adjusted EPS.

In terms of the back half of fiscal '18, we expect sales, operating margin and EPS will all show sequential improvement in each of the last 2 quarters. So third quarter will be better than second for these metrics, and fourth quarter will be better than third.

Before turning the call back to Tod, I want to reiterate a point I made to many of you. We remain committed to delivering incremental levels of profit on increasing sales. Nothing has changed about this commitment. So we are balancing the priorities of meeting demand, investing for the future and managing cost. I am confident that we can deliver against these priorities while positioning ourselves for long-term success.

Now I'll turn the call back to Tod for his closing commentary. Tod?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Thanks, Scott. We are encouraged by the market conditions, and we remain on track to deliver record sales and adjusted EPS this year. While we understand that the level of incremental margin is perhaps a disappointment, we are not willing to significantly lower our customer service levels or defer investments in long-term growth as a means of offsetting short-term gross margin pressure. However, we will implement off-cycle price increases, further manage discretionary expenses and explore other cost-saving measures to mitigate this pressure without compromising our customer service or strategic agenda.

Our agenda this year includes $10 million to $15 million of incremental investment in R&D, e-commerce and the expense portion of capacity expansion. We're making excellent progress on our e-commerce site, which has been in pilot phase for the past 4 months. We've now processed more than $10 million in orders from hundreds of customers in 45 countries, and we're very excited about the official launch later this fiscal year.

We have also made progress on capacity expansion, but these investments have a longer timeline. We doubled the size of our European distribution center, and we are adding new lines and new square footage around the world. The production investments are centered on PowerCore, engine liquid, process filtration and dust collection, all the businesses that are contributing to our strong growth right now. As new capacity comes online over the course of this calendar year, we expect some of the demand-related margin pressure will moderate.

Another critical portion of our investment plan is new technology development. We are on a multiyear journey to increase R&D spend by about 1% of sales. We are investing to strengthen our materials science capabilities and advance our offering of connected solutions. These new technologies are largely geared towards penetrating further into new and adjacent market or enhancing the role we play in an existing market. We also expect these technologies will bolster company profitability, with many of them having above-average margin rates.

Like many of you, we are focused on the long-term success of our company. The excellent sales traction, which is supported by how we have positioned ourselves as a technology leader in filtration, is giving us increased capacity to drive future growth. We are very encouraged by this opportunity, but we do not take the responsibility lightly. I am confident that we can deliver on our objectives by executing against the set of key priorities: meeting our customers' needs, getting our pricing more in line with costs, getting costs more in line with the unexpectedly strong demand and investing for the future.

Before closing, I sincerely want to thank our employees. They have shown incredible resilience as we dealt with the unexpectedly steep recovery, and their commitment to our company is truly inspiring. I am grateful to have the opportunity to work with them as we drive towards our goal of leading the world in filtration solutions. Now I'll turn the call back to Virgil to open the line for questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Brian Drab from William Blair.

Kyle William Dicke *William Blair & Company L.L.C., Research Division - Associate*

This is Kyle Dicke on for Brian Drab. Just looking at that -- at gross margin, and we appreciate all that color on the puts and takes, it looks like some of these pressures are going to continue in the second half. But I guess, are you able to provide any more color on how much you expect to alleviate in the back half of the year? I know you said some on the supply chain comps look like they might come down a little bit. But can you provide any more color there?

Scott J. Robinson *Donaldson Company, Inc. - VP & CFO*

Yes. Sure. I'll start. So first-off, we're working on pricing, right? We have increasing costs, and we have to work to pass that on to our customers, and we've been doing that. In many cases, it takes time for the price to actually layer in because notification periods or existing orders in the system we have to work through. So we're working on increasing our pricing to offset the cost. And as that comes in, we'll see an improvement in margin. We expect margins to improve in the back half. So it will get better as we go forward. But we do expect there's going to be costs that are continuing to pressure us, both raw material, freight and excess demand. So you really have many factors that are driving the equation, both from the pricing and the cost side, and working to normalize our operations and get the true cost of our product being reflected in the price.

Kyle William Dicke *William Blair & Company L.L.C., Research Division - Associate*

Okay. And then just to clarify on that, when you say margin improvement in back half, that would be kind of from a sequential level, from the Q2 level, not on a year-over-year basis?

Brad Pogalz *Donaldson Company, Inc. - Director of IR*

Sequential. This is Brad. Sequential, yes, and if you take the midpoint of our operating margin guidance range, we're up pretty meaningfully, about a half point from the prior year. So we certainly expect to get some traction with expense leverage in the back half as well. And gross margin, as Scott pointed out, will be a little bit more tame, but in the neighborhood of the prior year.

Kyle William Dicke *William Blair & Company L.L.C., Research Division - Associate*

Okay. And then looking at the Off-Road business, looks like you're seeing broad-based growth there. But could you -- are there any specific end markets that you would call out that improved more than you would have expected over the last 3 months?

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Sure. This is Tod. Two. Mining, but mining is coming from a very, very low bottom. But mining is clearly outpacing the average as well as energy-related type of activities is also outpacing the average.

Kyle William Dicke *William Blair & Company L.L.C., Research Division - Associate*

Okay. And then just looking at -- given the top line growth, when you think about capacity, do you think you're in a good place right now for the next 12 -- to meet demand over the next 12 months? Or you having to expand investment even more than you had planned maybe a few months ago?

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Our capacity is kind of a mixed story. On the industrial side of our company, our capacity is fine. We have a number of opportunities for growth where we can just continue to execute quite well. On the Engine side, we're a bit more pressured. And so therefore, we're adding capacity throughout the company. Specifically, on the liquid initiative, we're doing quite well. We'll add new liquid capacity that will come online later this calendar year as well as PowerCore. PowerCore capacity is being added in multiple regions in the world, and that will come online also later this year. Additionally, we did accelerate an investment whereby we will be doubling the size of our Poland plant. And that was an investment we thought we would need in about 2 years, and we are launching that this quarter.

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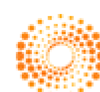

Operator

Your next question comes from Jim Giannakouros from Oppenheimer.

James Giannakouros *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

So just tacking on to that last point. Is that -- the accelerated investment, the plant in Poland, is that basically the incremental investments that you have hitting the FY '18 plan relative to your original? And if there's other ones, can you please outline those, and how we should be thinking about level of investment overall, I guess, for FY '19 and '20, if you have the line of sight?

Scott J. Robinson *Donaldson Company, Inc. - VP & CFO*

Well, for FY '18, we increased the midpoint of the guidance slightly in CapEx. So -- we completed the Poland plant a while back. We are planning to add capacity there. And we are adding capacity around the world, not just specifically related to Poland, to meet kind of the current sales situation that we have. So there's several different initiatives underway, which was one -- if you remember at the beginning of the year was one of our original investments was to plan to add capacity as we could see demand coming. And so that's kind of spread around the world. Our goal is to meet local demand with local production as much as possible. And so we're spreading the capacity investments to meet the expected demand.

James Giannakouros *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Okay. And somewhat in related, just in meeting local demand, just trying to understand the working capital needs. Can you talk about specifically what's going on there? Is it from your larger customers? Or is it that smaller OEs that are playing catch-up that hadn't matched build rates to demand effectively? Or is it in Aftermarket? How should we be thinking about the working capital hit that you're taking?

Scott J. Robinson *Donaldson Company, Inc. - VP & CFO*

So working capital, we -- our growth has been broad based. So it's coming pretty well spread across the whole company. When I look at our AR, our days are up 2 since the end of the year. And if I look at our turns since the end of last year on a 3-month trailing, we were 6.1, and now we're 5.4. So there's been a spike in demand, and we have to work to improve our metrics as things normalize. And we are making investments in the supply chain and in inventory builds to account for future expected demand. But it's kind of everyday work for us, and we have to continue to manage that the best we can.

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Maybe I'll just add a little bit in the fact that, Jim, this is all part of what we consider to be very important, that investment portion to keep that customer relationship long term. We have a number of customers out there. They've talked within their quarters things such as saying sales were moderated by their supply chain issues. That's not Donaldson causing those items, just simply because the strategic actions that we're taking. And we're using the power of our balance sheet to make sure that we keep those long-term relationships solid, and so you'll see that from a working capital standpoint of view.

James Giannakouros *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

That's helpful. And one more if I may. You guys continue to outpace relative. I think you said you're gaining share, and I missed it if it was an OE comment or an OE and Aftermarket comment. What do you attribute your share gains on the Engine side? Is it more in liquid? Is it new product intros that are more broad-based? How should we be thinking about your share gains?

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Sure. So number one, it is liquid. Liquid is doing really quite well across the liquid portfolio. We're now over 600 million within our liquid initiative. And really, our growth rates there have been quite strong this year. PowerCore also has grown very nicely within the quarter, and so you start to see the whole proprietary first-fit to help drive the Aftermarket is really helping the share gain, and so it's really just good execution of our strategy overlaid by the fact that we do have an end market lift coming onboard.

Operator

Your next question comes from Charley Brady from SunTrust Robinson Humphrey.

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Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Just want to go back and clarify the commentary on the gross margin in the second half. Just trying to make sure I'm very clear on that. You're expecting improvement sequentially, but not year-over-year, or both?

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Gross -- this is Brad. Gross margin improves sequentially. Year-over-year, it will be in the neighborhood of last year's. Operating margin is up year-over-year, pretty meaningfully in the back half, and again, sequentially.

Scott J. Robinson ***Donaldson Company, Inc. - VP & CFO***

So we're going to get better expense leverage to drive the majority of that improvement on increasing revenues.

Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. That's helpful. And just switching gears here, so on Aftermarket, two questions related to that. On the GTS business, can you tell us how much of that business today is in the Aftermarket versus the OE mix? And what's the growth rate on the Aftermarket piece of that?

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Charley, this is Brad again. The split is a little more than 60% of the total GTS revenue that's going towards replacement parts. And that was up in the 50-ish percent range in the quarter.

Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. And then Aftermarket Engine, can you give us a little more granularity about the separate parts of Engine where you're seeing the Aftermarket growth? Is it just strong right across the board or is it one area that you're seeing a lot more growth than the others? I assume Off-Road and On-Road, like the OE businesses, are probably the strongest pieces of Aftermarket as well.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Charley, it's very broad based geographically. However, within the U.S., I would suggest that the oil and gas portion is really coming through. And then worldwide, mining is also showing strength. So it's very broad based.

Operator

Your next question comes from the line of Alexander from Jefferies.

Nicholas Cecero ***Jefferies LLC, Research Division - Equity Associate***

This is Nick Cecero on for Laurence. You called out large turbine market is still under pressure. I am just wondering are there any adjacent markets where you could leverage that technology to relieve some of the pressure?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Nick, this is Tod. No, not really. That is a very specialized project-based business that really can be filtering ambient air of up to 1.2 million cubic feet a minute. And so it's very unique and it's project-based sale, particularly for peak and base loads. That is the portion of the business where we strategically changed our focus about 2 years ago in taking a look forward just to see this downturn. And our strategic change has surely been right in step with what the business has done and what the end market has done. So we're very happy with that change that we made, but we do not see adjacencies that's very -- from that project-based business.

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Nick, this is Brad. I might turn the question around too. And one thing to point out and a benefit from our technology portfolio is there are aspects of the technology that we can use in the gas turbine business to expand the offering. So there are filters that maybe go into Pacific Northwest where there is more moisture in the air, where we use Synteq XP media to wrap the filter. So this notion of diversification through technology that we've done across the business can help enhance our offerings in some of these businesses.

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Nicholas Cecero ***Jefferies LLC, Research Division - Equity Associate***

Okay, it's very helpful. And just one more. I was wondering if you could provide some color on demand trends by region. Are you seeing any areas where demand is accelerating or decelerating?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

It's very broad based, Nick. There's not one particular geography that's standing out from the other. We are gaining traction in China, but -- and we're doing very, very well as we highlighted that very large growth rate that we had within the quarter. But regionally, it's pretty straightforward. That's just share gain on our part and excellent execution, just a very broad-based geographic recovery.

Operator

There are no further questions at this time. I will turn the call back over to Tod Carpenter for closing remarks.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

That concludes today's call. I want to thank everyone for listening and for their time and interest in Donaldson Company. Have a great day. Goodbye.

Operator

This concludes today's call, and you may now disconnect.

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