



Donaldson
FILTRATION SOLUTIONS

Donaldson Company, Inc. 2009 SHAREHOLDERS' LETTER

"We must adapt, each one of us, a warm, welcoming attitude toward change."

— Frank Donaldson, Jr.

DEAR SHAREHOLDERS,

Our past year was certainly one of very unexpected "change" for our Company.

At this time last year, we had just reported another year of revenue growth, our 19th consecutive earnings record, and our future looked great. But then the situation changed dramatically. Incoming orders from our Customers suddenly declined, and we found ourselves facing a very serious recession.

Fortunately, we were much better prepared for an economic downturn this time – due in large part to a new business model that Frank Donaldson, Jr. started in the early 1980s, and we have relentlessly pursued to grow, strengthen, and diversify our Company.

Frank, Bill Hodder, and then Bill Van Dyke built a new business model after Donaldson lost 25% of its revenues in a matter of months in the early 1980s. In 1983, we lost money for the first time since the Great Depression.

That is what happened back then. But not what happened this time. While our Company lost 30% of its revenues during the second half of FY09, again in a matter of months, **we were able to consistently maintain our profitability.**

It wasn't just our business model or "a warm welcoming attitude" that made the difference this time. The financial results we achieved in FY09 were the result of the outstanding efforts and persistence of Donaldson employees to proactively "adapt" to the dramatic "changes" we faced.

While we didn't achieve our long-term targets, we still delivered a 9.1% operating margin and 14.2% return on investment. We also generated **record** free cash flow of \$231 million, which we used to reduce debt and build-up our cash reserves for future growth investments. We took care of our Customers and consistently delivered high



Bill Cook, Chairman, President and CEO

quality products on time. These results (and many others) were the culmination of thousands of different team initiatives and individual efforts by our employees around the world.

As Frank might say, we did a pretty good job of turning lemons into lemonade.

Weathering the Economic Storm

So what happened? While this global recession quickly affected most of our regions and end markets, it didn't hit all of them simultaneously. Consequently, thanks to our diverse business model we still had pockets of strength that helped us weather the storm. Our Aerospace and Defense and Gas Turbine Systems businesses are two such examples. We also had a number of regions (Mexico, Brazil, South Africa, Korea, and India) where sales grew over the prior year.

However, these pockets of strength were not sufficient to deal with the broad scale of this recession. We began implementing our contingency plans to balance our cost structure with much lower incoming Customer orders. Initially we established a hiring freeze and closely managed all discretionary expenses.

As the recession worsened, we had to quickly take many more actions to protect the health and future of our Company. Unfortunately, we had to significantly reduce the size of our work force. We also accelerated our margin



Rayong, Thailand, Disk Drive Filter Clean Room

improvement programs and cost reduction efforts, which were incredibly successful as they generated over \$45 million in savings and thankfully reduced the need for additional restructuring.

While we weren't able to do everything we had originally planned, we did continue several long-term projects per our Strategic Plan. We prioritized and picked the most important initiatives to continue investing in our future while preserving our short-term profitability and financial health.

Investments for Our Future

One example of investing for our future was a very key acquisition –Western Filter. This acquisition supported one of our strategic goals of building a significant position in liquid filtration. Western Filter is a leading supplier of liquid filtration systems for aerospace and military applications and very nicely complements our existing strong air filtration position in the same markets. We welcome the employees of Western Filter to Donaldson!

We also expanded our disk drive filtration operation in Rayong,Thailand. This expansion added capacity to support our long-term growth plans in disk drive and other high performance air filtration applications.

The expansion of our manufacturing plant in Gurgaon, India, is almost complete and will serve both our Indian Customers and our global OEMs as they grow their operations there.

We are also back in Brazil. We established our air filtration plant in Atibaia City, Brazil. Production has rapidly ramped up to support the growing local market.

Finally, we broke ground in April on a new Technical Center on our Leuven, Belgium, campus. This Tech Center will provide additional and faster new technology and product development support for our European-based Customers.

Commercializing Our New Technologies

We continued to promote our next generation advances in both air and liquid filtration technology.

In air filtration, our PowerCore® technology continues to set the standard. In our Engine business, we have already won 18 Customer platforms with our latest Generation 2 (or G2) technology. Many of these platform "wins" were market share gains which will pay big dividends for us as these Customer platforms go into production over the next several years.

In our Industrial business, we have already received orders for over 300 of our new Torit® PowerCore dust collection systems with an estimated 80% of these representing market share gains.

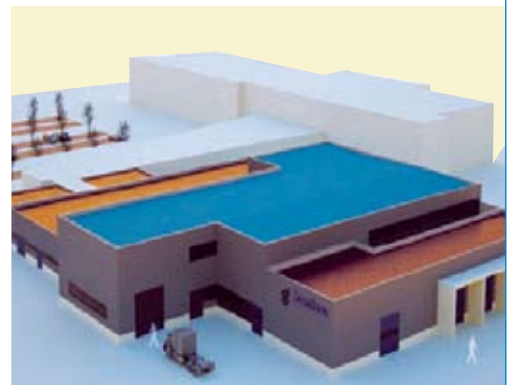
In liquid filtration, we are capturing new business with our next generation Duramax® hydraulic filters for both Industrial and Engine applications. Customers not only obtain higher performance, but our proprietary technology also allows our Customers to retain their replacement filter opportunity.



Gurgaon, India, Engine Filter Plant



Atibaia City, Brazil, Engine Filter Plant



Leuven, Belgium, European Technical Center



Donaldson's PowerCore® and PowerCore G2 filtration technology is used by leading on-road and off-road equipment manufacturers



Torit® PowerCore® installed on a mobile concrete mixing plant

Looking Forward

We anticipate a slow economic recovery, but there will be a recovery (as there always is). We expect that our sales will continue at the current pace through the first half of our FY10 and then begin a modest recovery during the second half of FY10.

Longer-term, the filtration market remains large and is growing so our opportunities within it remain great. The world continually needs more and better filtration products, and Donaldson has the best products and technology to fulfill many of these needs. As a result, we remain committed to our 10 to 12% annual sales growth target. And, we plan to grow through further diversification. While all the parts of our Company are important to our success, in the future we will become;

- even more international,
- more Industrial-oriented,
- more focused on liquid filtration, and
- an even bigger player in supplying replacement filters to our Customers.

Thanks

Over the past twenty-five years, we have "*adapted*" and dramatically "*changed*" our Company and our business model.

During the past year, we were severely tested with very dramatic "*changes*."

This year could have been a disaster for both our Company and our Customers. But it wasn't, and why not? A wise man once told me, "that while all companies are faced with very difficult crises over time, the true measure of a company is how they respond."

Our results are the evidence of our response. Our employees quickly "*adapted*" to the dramatic "*changes*" we faced and effectively dealt with them.

I would like to thank an incredible team of Donaldson employees, both past and current, for their contributions to making our Company better and stronger. Clearly, it wasn't an easy year, but I am very proud of our performance and to be a part of this great team.

Finally, I would like to thank you, our Shareholders, for your continued confidence and support. We wouldn't be here without you.

Sincerely,

Bill Cook, Chairman, President and CEO

Safe Harbor Statement

The Company desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the "Act") and is making this cautionary statement in connection with such safe harbor legislation. Some of the information provided in this annual report constitutes forward-looking statements which reflect the Company's current views with respect to future events and financial performance, but involve uncertainties that could significantly impact results. All forecasts and projections are "forward-looking" statements and are based on management's current expectations of the Company's near-term results. There can be no assurance that actual results will not differ materially from its expectations. For a more detailed explanation of the safe harbor statement and the risks, see the Company's Form 10-K filed with the SEC.

FIVE-YEAR COMPARISON OF RESULTS

July 31, 2009

(dollars in millions, except share and per share amounts)

	2009	2008	2007	2006	2005
Operating Results					
Net Sales	\$1,868.6	\$2,232.5	\$1,918.8	\$1,694.3	\$1,595.7
Gross margin percentage	31.6%	32.5%	31.5%	32.8%	31.7%
Operating income percentage	9.1%	11.0%	11.0%	11.4%	9.8%
Net earnings	\$ 131.9	\$ 172.0	\$ 150.7	\$ 132.3	\$ 110.6
Return on average shareholders' equity	18.5%	25.2%	25.7%	24.7%	20.6%
Return on investment	14.2%	20.6%	21.5%	20.8%	17.7%

Shareholder information (Adjusted for splits)

Net earnings per share - assuming dilution	\$ 1.67	\$ 2.12	\$ 1.83	\$ 1.55	\$ 1.27
Dividends paid per share	\$ 0.455	\$ 0.420	\$ 0.360	\$ 0.320	\$ 0.235
Shares outstanding (millions)	77.3	77.5	\$ 79.0	\$ 80.5	\$ 83.0
Common stock price range, per share					
High	\$ 49.00	\$ 52.33	\$ 38.97	\$ 36.00	\$ 34.45
Low	\$ 21.82	\$ 34.40	\$ 31.83	\$ 28.60	\$ 25.11

CORPORATE OFFICERS

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Senior Vice President, Global Operations

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Senior Vice President, Engine Products

TOD E. CARPENTER, 50
Vice President, Europe and Middle East

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Vice President, Disk Drive
and Microelectronics

DENNIS D. JANDIK, 55
Vice President, Global Engine OEM Sales

SANDRA N. JOPPA, 44
Vice President, Human Resources

JOSEPH E. LEHMAN, 54
Vice President, Global Engine Aftermarket

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Vice President, General Counsel,
and Secretary

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DAVID W. TIMM, 56
Vice President, Asia Pacific

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DEBRA L. WILFONG, 54
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Fastenal Company, Winona, MN

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Chairman and CEO
C. H. Robinson Worldwide, Inc.,
Minneapolis, MN

Independent Registered Public Accounting Firm PricewaterhouseCoopers LLP, Minneapolis, MN



Donaldson Company, Inc.
PO Box 1299
Minneapolis, MN
55440-1299

www.donaldson.com

Rich Sheffer
Director of Investor Relations
952.887.3753
richard.sheffer@donaldson.com