



Donaldson Company, Inc. 2014 SHAREHOLDERS' LETTER

"We do know the economy will ultimately improve. Only the timing is in question...We will continue to expand our technology base, our markets served, and our product lines. We aim to use our existing strengths to insure an expanding future."

— Frank Donaldson, Jr.

DEAR SHAREHOLDERS,

As we prepare for our Company's Centennial, we proudly reflect not only on our almost 100 years of success but also on our past challenges and "lessons learned." The above quote from Frank Jr. 30 years ago captures the essence of the global environment we face again today. Our approach, once again, is to not sit back and wait for conditions to improve but to rather aggressively "make our own luck" — to profitably grow our business today and into the future.

We entered last year with economic conditions in many of our end markets mixed — some improving, some stable, and a few weakening. In FY14, two "heroes" were our Engine and Industrial Aftermarket businesses. As general industrial economic activity began improving, there was increased utilization of the existing equipment in the field — whether a truck, excavator, or dust collector. As equipment utilization increases it needs to be maintained, including the regular replacement of our filters. At the same time, we also realized *additional* growth from the solid execution of our strategies. For example, in our Engine Aftermarket business, we focused on building closer relationships with our OEM and Independent Distribution Customers. We added 2,600 new parts *and* 300 new Distributors. As a result, our Engine Aftermarket sales were up 11% over the prior year. In our Industrial Aftermarket business, we introduced a number of new products and significantly increased our end user contact efforts. For example, our U.S. Dust Collection Aftermarket business now has a database of 70,000 Customers who are regularly contacted through our proactive selling efforts. This business was up 9% over the prior year. Both are great examples of how "we *can* make our own luck" and grow our sales significantly faster than the underlying market growth rates.

Those of you who have followed our Company over the past 25 years know that we have used our technology



Our Aguascalientes, Mexico, air filter plant earned our Chairman's Cup award in our 1st quarter by having the highest scores on our key operating metrics

and international beachheads to build a portfolio of global technology-based filtration businesses. This diversification strategy has created a Company in which our individual filtration businesses are linked via common technology and operational investments while providing different end market and regional cyclical exposures. Each year we expect that some of our end markets or regions will be cycling up while others will not. Combining this diversification model with our relentless focus on superior operational execution has resulted in top-line growth in 22 of the past 25 years, while *doubling* our operating margin and delivering long-term superior value to you, our Shareholders.

As we have always done, we will continue to:

- Use our technologies to help our Customers succeed,
- Execute *Continuous Improvement* initiatives to improve our efficiency,
- Invest wisely to remain the leader in our target markets, and
- Deploy our capital to provide superior Shareholder returns.

To briefly summarize our FY14 results, we grew our sales by 2%, improved our operating margin by 30 basis points, and delivered Record EPS of \$1.76. We also returned \$362 million (164% of our free cash flow) to our Shareholders via our share repurchases and dividend payouts.

Investing in Our Future

We have initiatives under way that will help us grow over time, regardless of the economic environment. One initiative focuses on the growth opportunities we see in emerging



Our Donaldson® Torit® Downflo® Oval Dust Collector at a titanium grinding operation

economies such as Latin America, China, India, Southeast Asia, and Eastern Europe. In these targeted markets, we are:

- Increasing sales resources in the field,
- Expanding our product offerings,
- Adding new OEM Customers and more Distributors in under-served markets and in emerging regions, and
- Building our own distribution capabilities.

Our expansion of our Latin American Distribution Center in Aguascalientes, Mexico, provided the foundation for the 14% Engine Aftermarket growth we enjoyed in Latin America. This year, we will open four more distribution centers — one in Peru, one in Slovakia, and two in Colombia.

An additional initiative focuses on the opportunities we see in our Global ERP Project. This multi-year project was launched two years ago and will standardize our worldwide processes and IT systems for the first time. It is critical to achieving our Strategic Growth Plan and will provide the same ordering processes, part numbers, quality, product availability, and on-time delivery metrics across our Company. This project will further improve our efficiency and cost structure, while providing us with an easily scalable system. During the year, we began implementing the new platform in the Americas where we are now more than 70% complete. We will complete the remaining Americas installations this fall and will then begin to install this platform in Europe.



Our R&D investment expands our capabilities to test our filters' performance under various "real-life" environmental conditions



Our Donaldson Blue™ air and liquid replacement filters feature our best filtration technology across a wide range of diesel engine and bulk fuel applications

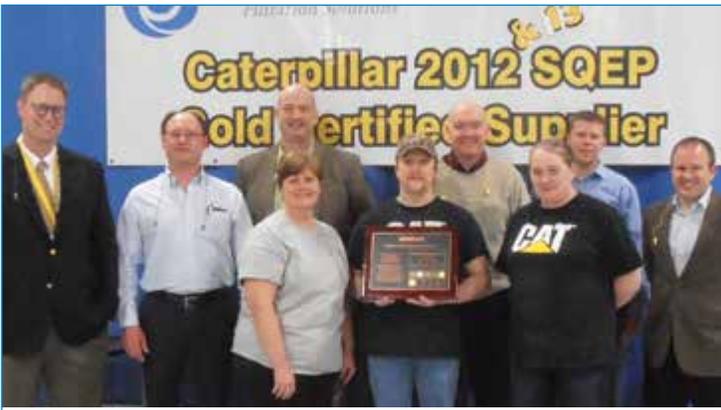
We also continue to make the long-term capital investments needed to support our sales targets of \$3 billion and \$5 billion as outlined in our Strategic Growth Plan. Our new filter plant in Skarbimierz, Poland, will support our long-term plans for Eastern Europe. Our \$10 million R&D lab expansion on our Bloomington, Minnesota, campus enhances our state-of-the-art testing capabilities, which advances our air and liquid filtration technology leadership positions.

Our PowerCore® filtration technology is a great example of our continual flow of new product breakthroughs. Our original PowerCore and 2nd generation PowerCore G2 filters are now the leading air filtration technologies for our Engine OEM Customers' on-road and off-road equipment platforms in the Americas, Europe, and Asia. We have also leveraged this technology in our Industrial Products segment, where we have introduced PowerCore into a series of dust collection platforms. Whether in Engine or Industrial, our PowerCore products offer our Customers improved filtration performance in significantly smaller designs — saving space, weight, and cost while reducing our Customers' maintenance costs and protecting their aftermarket. In FY14, our total PowerCore sales were \$168 million, up 15% from the prior year.

We are achieving similar success in building our liquid filtration business — specifically focused on diesel fuel and hydraulic fluids. We are using our breakthrough



Our Wuxi, China, disk drive filter plant received the "Dock to Stock Award" from Seagate Technology



Our Dixon, Illinois, plant received the Gold Certified Supplier Award from Caterpillar Inc. for both 2012 and 2013



The Grand Opening ceremony with our Peruvian Customers for our new Distribution Center in Lima, Peru

filtration media Synteq XP™ in our new SELECT™ Fuel product line and in our 2nd generation Duramax® hydraulic filters to capture harmful microscopic contaminants while protecting our Customers' high performance engines. Our Liquid Filtration business had a record year with sales of over \$500 million — up 11% from last year. And we have now won over 250 new fuel and hydraulic OEM platforms, which will be going into production in the next several years.

We will soon begin production of a number of new product lines, including a new range of dust collectors (the Downflo Evolution®), our new PowerPleat™ engine air filters, and many new liquid filters utilizing our Synteq XP filtration media.

FY15 and Our 100-Year Anniversary

As we begin our new year, economic conditions remain mixed in many of our markets. For example, while we see significantly improving conditions in our Gas Turbine business, we see weakening in the agricultural equipment sector. Regardless, we have our Plan and will focus on

those things that we can control and leverage our many strengths to grow. As a result, we project record sales in FY15 of about \$2.6 billion with Record EPS of between \$1.81 and \$2.01.

As we prepare to celebrate our 100th Anniversary, our sights remain focused on our long-term objectives of \$3 billion in revenues and then \$5 billion. We are making the key strategic investments to achieve our sales and earnings growth objectives. We are blessed to be in a superior position in the large and growing filtration market, and our opportunities to build the next 100 years of Donaldson's history remain limitless.

Thanks

I thank my fellow Employees for their relentless dedication to serving our Customers. Each of you plays a key part in our success every day.

I also thank our Customers for the continued opportunities to satisfy your filtration needs and help add value to your products. We sincerely appreciate the opportunity and know we have to earn your business each and every day.

And finally, I thank you, our Shareholders, for your continued confidence and support.

Sincerely,

Bill Cook,
Chairman, President, and CEO



Founded by Frank Donaldson, Sr. in 1915, we will celebrate our 100th anniversary in FY15

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, 2014

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

	2014	2013	2012	2011	2010
Operating Results					
Net sales	\$2,473	\$2,437	\$2,493	\$2,294	\$1,877
Gross margin percentage	35.5%	34.8%	35.0%	35.5%	35.1%
Operating income percentage	14.4%	14.1%	14.6%	13.7%	12.7%
Net earnings	\$ 260	\$ 247	\$ 264	\$ 225	\$ 166
Return on average shareholders' equity	24.9%	24.8%	28.7%	26.8%	23.2%
Return on investment	21.4%	21.5%	23.5%	21.0%	17.1%

Shareholder Information (adjusted for splits)

Net earnings per share - Assuming Dilution	\$ 1.76	\$ 1.64	\$ 1.73	\$ 1.43	\$ 1.05
Dividends paid per share	\$0.575	\$0.410	\$0.320	\$0.268	\$0.235
Shares outstanding (millions)	140.3	146.0	147.5	150.6	152.7
Common stock price range, per share					
High	\$43.74	\$39.36	\$38.89	\$31.52	\$24.11
Low	\$34.60	\$30.90	\$23.19	\$20.43	\$16.30

BOARD OF DIRECTORS

F. GUILLAUME BASTIAENS, 71
Retired Vice Chairman
Cargill, Inc., Minneapolis, MN

JEFFREY NODDLE, 68
Retired Executive Chairman
SUPERVALU INC., Minneapolis, MN

TOD E. CARPENTER, 55
Chief Operating Officer
Donaldson Company, Inc.

WILLARD D. OBERTON, 56
Chairman and CEO, Fastenal Company,
Winona, MN

ANDREW CECERE, 54
Vice Chairman and CFO
U.S. Bancorp, Minneapolis, MN

JAMES J. OWENS, 50
President and CEO
H.B. Fuller Company, St. Paul, MN

WILLIAM M. COOK, 61
Chairman, President and CEO
Donaldson Company, Inc.

AJITA G. RAJENDRA, 62
Chairman, President and CEO
A.O. Smith Corporation, Milwaukee, WI

JANET M. DOLAN, 64
President, Act 3 Enterprises, LLC,
Minneapolis, MN

JOHN P. WIEHOFF, 53
Chairman and CEO
C.H. Robinson Worldwide, Inc.,
Minneapolis, MN

MICHAEL J. HOFFMAN, 59
Chairman and CEO
The Toro Company, Minneapolis, MN

**Independent Registered
Public Accounting Firm
PricewaterhouseCoopers LLP,
Minneapolis, MN**

PAUL DAVID MILLER, 72
Retired Chairman and CEO
Alliant Techsystems, Inc., Arlington, VA

BILL VAN DYKE (1945 - 2014)



Bill had a remarkably successful 30-year career with our Company, serving 8 years as our CEO and 9 years as Chairman.

Under Bill's leadership, we continued our transformation into a portfolio of diversified global businesses and delivered outstanding financial results to our Shareholders:

- 9 more consecutive years of record earnings growth
- Averaging 13 percent per year, and
- Providing Shareholders with a compound annual return of 22 percent.

During that time, our Company's sales grew from \$833 million to \$1.6 billion.

In addition to being a strong leader, Bill was also a good friend and a great mentor. He will be greatly missed but will never be forgotten—his legacy with our Company and with each of us lives on.



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

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

www.donaldson.com