Donaldson Company Announces First Quarter Results

FROM:
Padilla Speer Beardsley
224 Franklin Avenue West
Minneapolis, Minnesota 55404

FOR:
Donaldson Company, Inc.
P.O. Box 1299
Minneapolis, Minnesota 55440
(NYSE: DCI)

CONTACTS:
Tony Carideo
Padilla Speer Beardsley
612-872-3720

Rich Sheffer
952-887-3753

FOR IMMEDIATE RELEASE

Record first-quarter EPS at 43 cents, up 16 percent on strong gas turbine product sales, continued aggressive cost management

MINNEAPOLIS, November 26 — Donaldson Company, Inc. (NYSE: DCI), today reported first quarter revenue of $288.4 million for the quarter ended October 31, 2001, down 0.5 percent from $289.9 million in the same period last year. Net earnings were $19.7 million, up 17.4 percent from $16.8 million last year. Record diluted earnings per share of 43 cents were up 16.2 percent from 37 cents in the prior year.

Foreign currency translation reduced first quarter revenue by 0.6 percent; additionally, last year's second quarter exit from an unprofitable block of truck-related business reduced revenue by 0.9 percent. Net of these factors, first quarter revenue was up 1.0 percent.

"Our first-quarter results get us off to a good start in fiscal 2002," commented Bill Van Dyke, chairman, president and chief executive officer. "Our gas turbine filter business turned in another strong performance, and we saw modest growth in our disk drive filter business despite a difficult market. These performances offset the weakness in industrial capital spending, while sales to original equipment manufacturers in our diesel engine-related business ran about even with this time last year."

Van Dyke added that all areas of the company's operations have continued to focus on aggressive cost management in the face of difficult economic conditions.

"We have been working aggressively to structure Donaldson for lower costs," he said. "Our work over the past 18 months in plant rationalization, while on-going, has already delivered improved gross margins. This work, including one plant closure announced this quarter and our continued progress toward opening new plants with lower cost structures, will help us stay ahead of the curve in the face of continuing price pressures. We are maintaining a firm grip on operating expense management, with an eye towards improving ROI throughout our business. Our strong cash flow has served to reduce short-term debt and, coupled with declining interest rates, has allowed us to significantly reduce interest expense from last year's levels."

Income Statement Discussion

The impact of foreign currency translation, mainly due to the weakness of the Yen and the South African Rand against the U.S. Dollar offset by a strengthening Euro, resulted in a decrease in net sales of $1.8 million and virtually no impact to net earnings. On a local currency basis, revenues outside the U.S. were flat. Using last year's foreign exchange rates, total worldwide revenue would have been flat versus the reported decrease of 0.5 percent.

Gross margin was 30.6 percent, up from 29.7 percent in the same period in the prior year. The year-over-year improvement was attributable to improved product mix and the realized benefits of last year's plant rationalization efforts, partially offset by on-going plant rationalization efforts costing 2 cents per share in the quarter.

Operating expenses were 20.5 percent of sales, up slightly from 20 percent last year. Included in last year's operating expenses were $1.0 million of goodwill amortization and the positive impact from a warranty settlement of $1.7 million. Excluding these two adjustments, operating expenses were 20.2 percent of sales last year.

Interest expense was $2.4 million, down from $3.1 million last year, reflecting lower short-term debt levels from a year ago and lower short-term interest rates.

Other income was $0.7 million in the quarter, an improvement of $1.5 million from last year's $0.8 million expense. Other income benefited from the return of joint venture income to normal levels following the prior year's decline.

The income tax rate was 28 percent, which was reduced in the third quarter last year from 30 percent. The company anticipates maintaining the 28 percent tax rate going forward.

Cash generated by operations was $43.9 million, an improvement of $42.2 million from last year, primarily driven by improvements in receivables and inventory levels compared to last year's increases in those levels. EBITDA for the quarter was a record $37.5 million compared with $36.9 million in the first quarter of last year.

Backlog

Total backlog of $331 million was up 5 percent relative to the same period last year and down 7 percent from the prior-quarter end. In the Industrial Products segment, total backlog increased 6 percent from the same period last year but decreased 11 percent from the prior-quarter end. In the Engine Products segment, total backlog increased 4 percent from the same period last year but decreased 2 percent from the prior-quarter end.

The 90-day backlog was $176 million, down 4 percent from the same period last year and down 2 percent from the prior-quarter end. In the Industrial Products segment, hard-order backlog decreased 7 percent from the same period last year and decreased 1 percent from the prior-quarter end. In the Engine Products segment, hard-order backlog decreased 1 percent from the same period last year and 4 percent from the prior-quarter end.

Industrial Products Segment

The continued strength of gas turbine sales drove another good quarter for Industrial Products, with sales in the first quarter of $131.9 million, an increase of 7.5 percent from $122.7 million in the prior year.

Gas turbine product sales for the first quarter were $57.2 million, an increase of 66.3 percent from $34.4 million last year. Gas turbine sales grew in all major geographic regions as the multi-year ramp up in gas turbine power plant additions continued into the current quarter, and Donaldson continues to be the supplier of choice for air inlet filtration systems.

Dust collection product sales for the first quarter were $48.2 million, a decrease of 19.3 percent from $59.8 million last year. As U.S. industrial production recorded its 13th consecutive monthly decrease and capacity utilization fell to its lowest levels since June 1983, U.S. manufacturers capital spending remained at recession-like levels. Caution in capital spending levels is spreading to other geographic regions, particularly Europe. These factors have created a difficult operating environment for industrial dust collection equipment sales.

Sales of special application products in the first quarter were $26.4 million, a decrease of 7.2 percent from $28.5 million last year. Sales were weak for aircraft cabin air filtration and photolithography filtration, offsetting a modest increase in disk drive filter sales.

Engine Products Segment

Engine Product sales for the first quarter were $156.5 million, a decrease of 6.4 percent from $167.1 million last year. U.S. economic weakness and the previously-mentioned currency weakness of the Yen and Rand against the U.S. Dollar were contributing factors to the decline.

As expected, the company experienced a difficult year-over-year comparison in on-road medium- and heavy-duty truck products with sales in the first quarter of $21.6 million, a decrease of 8.5 percent from $23.7 million last year. Excluding last year's second quarter exit from a block of business due to unfavorable commercial terms, sales were up 3.4 percent. Truck build data continues to show that NAFTA build rates have stabilized, albeit at dramatically lower levels than a year ago.

Worldwide sales of off-road products in the first quarter were $45.9 million, a decrease of 1.1 percent from $46.5 million last year. Excluding the effects of currency translation, results were essentially flat. Stronger defense product sales were offset by weak conditions in markets for construction and light industrial equipment.

Aftermarket product sales in the first quarter were $88.9 million, a decrease of 8.3 percent from $97.0 million last year. North American and European freight volumes and vehicle utilization rates continue to be weak, negatively affecting aftermarket product sales.

Outlook

Within the Industrial Products segment, the company expects continued strength in gas turbine sales throughout calendar year 2002, although the year-over-year growth rates are expected to level off from the recent high levels. The difficult operating conditions for dust collection product sales and portions of special applications products, as discussed above, are expected to persist for at least the next quarter. Within the Engine Products segment, the company anticipates continued weak economic conditions, but easing year-over-year comparisons should begin following last year's second quarter slowdown in the end markets for Engine Products.

Recognizing the difficult economic conditions for many of the end markets, the company will continue to focus on managing its cost structure through continued discretionary expense controls, lower spending for plant rationalization efforts compared to the prior year, and other initiatives designed to increase the operating efficiencies of the business.

About Donaldson Company, Inc.

Donaldson Company, Inc., headquartered in Minneapolis, Minn., is a leading worldwide provider of filtration systems and replacement parts. Founded in 1915, Donaldson is a technology-driven company committed to satisfying customer needs for filtration solutions through innovative research and development. Donaldson serves customers in the industrial and engine markets including dust collection, power generation, specialty filtration, off-road equipment and trucks. More than 8,200 employees contribute to the company's success at 40 manufacturing locations around the world. In fiscal year 2001, Donaldson reported record sales of more than $1.1 billion and achieved its 12th consecutive year of double-digit earnings growth. Donaldson is a member of the S&P MidCap 400 Index and Donaldson shares are traded on the New York Stock Exchange under the symbol DCI. Additional company information is available at www.donaldson.com.

Forward-Looking Statements:

The company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is making this cautionary statement in connection with such safe harbor legislation. This earnings release, the Annual Report to Shareholders, any Form 10-K, 10-Q, Form 8-K or press release of the company or any other written or oral statements made by or on behalf of the company may include forward-looking statements which reflect the company's current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "plan," "project," "should" and similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All forecasts and projections are "forward-looking statements" and are based on management's current expectations of the company's near-term results, based on current information available pertaining to the company, including the risk factors noted below.

The company wishes to caution investors that any forward-looking statements made by or on behalf of the company are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and other risk factors include, but are not limited t risks associated with currency fluctuations, commodity prices, world economic factors, political factors, international operations, highly competitive markets, changes in product demand and changes in the geographic and product mix of sales, acquisition opportunities and integration of recent acquisitions, facility and product line rationalization, research and development expenditures, including ongoing information technology improvements, and governmental laws and regulations, including diesel emissions controls. For a more detailed explanation of the foregoing and other risks, see Exhibit 99, which is part of the company's Form 10-K filed with the Securities and Exchange Commission. The company wishes to caution investors that other factors may in the future prove to be important in affecting the company's results of operations. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or a combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Investors are further cautioned not to place undue reliance on such forward-looking statements as they speak only to the company's views as of the date the statement is made. The company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

CONDENSED STATEMENTS OF CONSOLIDATED EARNINGS

DONALDSON COMPANY, INC. AND SUBSIDIARIES

(Thousands of dollars, except per share amounts)

	(Unaudited)	
	Three Months Ended	
	October 31	
	2001	2000
Net sales	$288,429	$289,869
Cost of sales	200,111	203,913
Gross margin	88,318	85,956
Operating expenses	59,270	58,047
Operating income	29,048	27,909
Other (income) expense	(731)	805
Interest expense	2,384	3,098
Earnings before income taxes	27,395	24,006
Income taxes	7,671	7,202
Net earnings	$19,724	$16,804
Weighted average shares outstanding	44,252,026	44,560,523
Diluted shares outstanding	45,502,725	45,456,932
Net earnings per share	$.45	$.38
Net earnings per share assuming dilution	$.43	$.37
Dividends paid per share	$.075	$.070
Capital expenditures	$10,954	$6,387
Depreciation and amortization	$7,921	$10,012
EBITDA	$37,491	$36,851

DONALDSON COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars)
(Unaudited)

	October 31 2001	July 31 2001
ASSETS		
Cash and cash equivalents	57,530	36,136
Accounts receivable – net	221,253	230,046
Inventories – net	105,296	112,634
Prepaid expenses and other current assets	35,960	28,411
TOTAL CURRENT ASSETS	420,039	407,227
Other assets and deferred taxes	95,536	91,945
Property, plant and equipment – net	211,730	207,658
TOTAL ASSETS	727,305	706,830
LIABILITIES AND SHAREHOLDERS' EQUITY		
Trade accounts payable	100,766	100,287
Employee compensation and other liabilities	60,678	57,576
Notes payable	57,958	59,393
Income taxes payable	2,522	-
Current maturity long-term debt	23	23
TOTAL CURRENT LIABILITIES	221,947	217,279
Long-term debt	101,415	99,259
Other long-term liabilities	73,814	71,199
TOTAL LIABILITIES	397,176	387,737
EQUITY	330,129	319,093
TOTAL LIABILITIES & EQUITY	727,305	706,830

DONALDSON COMPANY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of Dollars)

(Unaudited)

	Three Months Ended October 31 2001	2000
OPERATING ACTIVITIES		
Net earnings	$19,724	$16,804

Adjustments to reconcile net earnings to net		
provided by operating activities:		
Depreciation and amortization	7,921	10,012
Changes in operating assets and liabilities	17,667	(24,895)
Other	(1,375)	(156)
Net Cash Provided by Operating Activities	43,937	1,765
INVESTING ACTIVITIES		
Net expenditures on property and equipment	(10,954)	(6,387)
Net Cash Used in Investing Activities	(10,954)	(6,387)
FINANCING ACTIVITIES		
Purchase of treasury stock	(8,358)	(8,891)
Net change in debt	438	19,625
Dividends paid	(3,329)	(3,126)
Other	266	395
Net Cash Provided by (Used in) Financing Activities	(10,983)	8,003
Effect of exchange rate changes on cash	(606)	(1,378)
Increase in cash and cash equivalents	21,394	2,003
Cash and Cash Equivalents-Beginning of Year	36,136	32,017
Cash and Cash Equivalents-End of Period	$57,530	$34,020

11/26/2001