Donaldson Company Announces Record First Quarter Results

MINNEAPOLIS--(BUSINESS WIRE)--Nov. 20, 2002--

Record first quarter EPS at 50 cents, up 16 percent on strong engine

product sales, continued aggressive cost management; free cash flow

increases 17 percent on working capital improvements

Donaldson Company, Inc. (NYSE:DCI), today reported record net earnings of $22.8 million for the first quarter ended October 31, 2002, up 15.8 percent from $19.7 million last year. Record diluted earnings per share of 50 cents were up 16.3 percent from 43 cents in the prior year. Record revenue was $301.1 million, up 4.4 percent from $288.4 million in the same period last year.

"In the face of modest revenue growth, our people once again delivered impressive margin expansion and double-digit earnings growth," commented Bill Van Dyke, chairman, president and chief executive officer. "Overseas revenue was up 32 percent, delivering just under 50 percent of total first quarter sales, offsetting weaker than expected North American gas turbine sales. Sales in other North American businesses registered solid growth, led by North American heavy-duty truck, up 11 percent. While North American heavy-duty truck showed less of a surge than was commonly expected, orders were stronger and the backlog higher than expected heading into the second quarter. It seems clear that while the North American gas turbine environment has softened in the last three months, the outlook for heavy-duty trucks has substantially improved. Exclusive of gas turbine, consolidated incoming orders showed year-over-year increases for the third consecutive quarter. While those increases remain in the single digits, we have growing confidence that the bottom of the industrial cycle is behind us."

"Overseas first quarter sales showed broad strength, with off-road up 18 percent, heavy-duty truck up 25 percent, engine aftermarket up 10 percent, and gas turbine up 36 percent. These trends, along with the expected lift in North America from the new light diesel PowerCore(TM) programs and the new California diesel emissions retrofit opportunity announced last week, reinforce our expectation for strong organic growth outside of North American gas turbine - which is good because the North American gas turbine business is trending weaker than our outlook of three months ago. The North American power industry remains very volatile as forecasts by turbine producers continue to be revised downward. We now project that our global gas turbine revenues could be down as much as 30 to 35 percent, despite growth overseas and a double-digit increase in aftermarket sales."

"The recently-acquired ultrafilter business performed well in its first quarter as part of Donaldson. The business continued to grow during the quarter, and we were able to quickly capture savings from both manufacturing costs and operating expenses. We still project this business to be earnings neutral in fiscal 2003 as a number of integration issues remain, the costs of which will be directly expensed through operating earnings. However, there is upside potential if we can complete these steps faster than expected."

Van Dyke added that all areas of the company's operations have continued to focus on aggressive cost and cash management.

"Every business group has specific objectives for productivity improvements, product cost reductions, and infrastructure improvements. These efforts have manifested themselves in bottom line margin expansion and in a steadily improving gross margin, which came in at 31.5 percent this quarter. Added to this, our focus on working capital drove record first quarter free cash flow of over $38 million. This is net of a $10 million investment reducing ultrafilter's accounts payable. This means that our traditional businesses threw off just under $50 million in free cash flow in the quarter - a remarkable milestone."

Income Statement Discussion

Foreign currency translation, led by the strong Euro, resulted in an increase in net sales of $5.6 million and net earnings of $0.4 million. On a local currency basis, revenues outside the U.S. increased 30.8 percent in the quarter, or 7.8 percent exclusive of the impact of recently-acquired ultrafilter. Excluding foreign currency translation, worldwide revenue would have increased by 2.4 percent.

Gross margin improved to 31.5 percent versus 30.6 percent in the same period in the prior year, driven by ongoing efforts to reduce product costs and improve the manufacturing infrastructure. Current plant rationalization activities had no material impact on earnings in the quarter versus costing 2 cents per share in last year's first quarter.

Operating expenses were 21.0 percent of sales, up from 20.5 percent last year. The increase over last year is attributable to the addition of ultrafilter, which has a higher run-rate for operating expenses than the company's existing businesses.

Interest expense was $2.0 million, down from $2.4 million last year, reflecting lower short-term debt levels from a year ago and lower short-term interest rates. Other income was $1.6 million in the quarter, up from $0.7 million last year. Other income benefited from increased joint venture income and higher interest income.

The income tax rate remained at 27 percent, down from 28 percent a year ago. The company anticipates maintaining the 27 percent tax rate for the foreseeable future.

Free cash flow, operating cash flows less capital expenditures, totaled $38.6 million, up 17.1 percent from $33.0 million last year. Working capital improvements generated $17.8 million during the quarter, essentially equal to last year's strong $17.7 million improvement. EBITDA was $40.3 million, up 7.5 percent from $37.5 million last year.

Backlog

Total backlog of $318 million was down 4 percent, or $13 million, relative to the same period last year, reflecting a $20 million drop in North American gas turbine. In the Engine Products segment, total backlog increased 5 percent from the same period last year. In the Industrial Products segment, which includes gas turbine, total backlog decreased 13 percent from the same period last year.

The 90-day backlog of $165 million was down 6 percent, or $11 million, relative to the same period last year, reflecting a $19 million drop in North American gas turbine. In the Engine Products segment, hard-order backlog increased 4 percent from the same period last year. In the Industrial Products segment, hard-order backlog, excluding North American gas turbine and ultrafilter, was down 5 percent, reflecting the continued softness in industrial capital equipment.

Engine Products Segment

Engine Product sales for the first quarter were $167.0 million, up

- 6.7 percent from $156.5 million last year. All three product groups reported year-over-year revenue increases for the second consecutive quarter.

On-road truck sales in the first quarter were $26.7 million, an increase of 23.6 percent from $21.6 million last year. North American heavy-duty truck sales increased by 11 percent from last year, reflecting the North American Class 8 diesel emissions prebuy. North American light-duty vehicle sales more than tripled over last year, reflecting additional revenues from new PowerCore programs. Truck revenues increased by 25 percent internationally and were particularly strong in Asia.

Worldwide sales of off-road products in the first quarter were $48.3 million, an increase of 5.2 percent from $45.9 million last year. Weak North American market conditions in construction and agriculture were more than offset by strong results from Europe and Asia, which were up 17 percent and 20 percent, respectively.

Aftermarket product sales in the first quarter were $91.9 million, an increase of 3.3 percent from $88.9 million last year. Flat North American results were offset by strong revenue growth in Europe and Asia, both of which were up over 10 percent from last year.

Industrial Products Segment

Industrial Products sales in the first quarter were $134.1 million, an increase of 1.6 percent from $131.9 million in the prior year. Excluding revenues from ultrafilter, acquired at the end of fiscal year 2002, industrial revenues decreased 18.1 percent.

Gas turbine product sales for the first quarter were $38.6 million, a decrease of 32.6 percent from $57.2 million last year. Sales declined 48 percent in North America as the three-year demand bubble has ended. International revenues were up over 30 percent and replacement parts sales were up over 10 percent, softening the impact of the North American downturn.

Industrial air filtration sales for the first quarter were $42.8 million, a decrease of 11.2 percent from $48.2 million last year. North American business conditions weakened again in the quarter after slowly improving over the past six months. Sales in Europe were up slightly, but were offset by weak sales in Asia as the Japanese industrial economy continues to struggle.

Sales of special application products in the first quarter were $26.7 million, an increase of 0.9 percent from $26.4 million last year. Disk drive filter sales were down year over year, but were offset by strong membrane sales in Asia.

Sales from recently-acquired ultrafilter were $26.0 million.

Outlook

North American truck sales should be stronger than previously expected as truck manufacturers continue to build with pre-October 1 engines from their inventories. The company also expects to begin shipping new PowerCore systems for light-duty diesel truck programs late in the quarter, along with catalytic converter mufflers and Spiracle crankcase emissions systems for the California retrofit market. Order trends indicate continued strength in both Europe and Asia. Off-road sales are expected to remain steady, led by strong performances in international markets. Incoming orders for engine aftermarket products have improved for three consecutive quarters and market conditions have continued to improve. Overall, the company is expecting engine products year-over-year revenue growth in the high single digits in fiscal 2003.

The company expects global gas turbine sales to decrease 30 to 35 percent from last year's record $231 million. Strong business internationally and replacement parts growth are expected to soften the North American downturn. The company expects industrial air filtration markets to be stable near-term. In special applications products, order trends and backlogs indicate continued stable conditions in the various end markets. Compressed air products are expecting continued revenue growth.

With strong growth expected in our engine businesses, declining gas turbine sales, and other industrial businesses either stable or slowly improving, Donaldson remains committed to maximizing operating efficiency through product cost reductions, manufacturing infrastructure improvements, discretionary expense controls, and completing the integration of ultrafilter. Continued improvement in working capital will fund debt reduction and share repurchase. The company remains focused on delivering its 14th consecutive year of double-digit earnings growth in 2003.

About Donaldson Company, Inc.

Donaldson Company, Inc., headquartered in Minneapolis, 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, compressed air purification, off-road equipment, industrial compressors, and trucks. More than 9,000 employees contribute to the company's success at 40 manufacturing locations around the world. In fiscal year 2002, Donaldson reported sales of more than $1.1 billion and achieved its 13th 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.

SAFE HARBOR STATEMENT UNDER THE SECURITIES REFORM ACT OF 1995

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. This earnings release, the Annual Report to Shareholders, any Form 10-K, 10-Q or Form 8-K of the company or any other written or oral statements made by or on behalf of the company may include forward-looking statements, forecasts and projections which reflect the company's current views with respect to future events and financial performance, but involve uncertainties that could significantly impact results. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "outlook," "plan," "project," "should" and similar expressions are intended to identify "forward-looking statements" within the meaning of the Act.

The company wishes to caution investors that any forward-looking statements subject to uncertainties and other risk factors that could cause actual results to differ materially from such statements, including but not limited t risks associated with currency fluctuations, commodity prices, world economic factors, political factors, the company's substantial international operations including key disk drive filter production facilities in China, highly competitive markets, changes in capital spending levels by customers, changes in product demand and changes in the geographic and product mix of sales, acquisition opportunities and integration of recent acquisitions, including the acquisition of ultrafilter, 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, see exhibit 99 to the company's Form 10-K filed with the Securities and Exchange Commission. The company wishes to caution investors that 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.

CONDENSED STATEMENTS OF CONSOLIDATED EARNINGS
DONALDSON COMPANY, INC. AND SUBSIDIARIES
(Thousands of dollars, except per share amounts)
(Unaudited)

	Three Months Ended October 31	
	2002	2001
Net sales	$301,054	$288,429
Cost of sales	206,173	200,111
Gross margin	94,881	88,318
Operating expenses	63,180	59,270
Operating income	31,701	29,048
Other (income) expense	(1,581)	(731)
Interest expense	1,998	2,384

Ã $40,314 $37,491

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

	October 31 2002	July 31 2002
ASSETS		
Cash and cash equivalents	$58,052	$45,586
Accounts receivable - net	221,956	251,417
Inventories - net	109,798	117,691
Prepaid expenses and other current assets	38,777	41,790
Total current assets	428,583	456,484
Other assets and deferred taxes	153,619	152,734
Property, plant and equipment - net	244,795	240,913
Total Assets	$826,997	$850,131
LIABILITIES AND SHAREHOLDERS' EQUITY		
Trade accounts payable	$98,943	$115,299
Employee compensation and other liabilities	70,331	77,274
Notes payable	51,463	60,337
Income taxes payable	19,084	19,823
Current maturity long-term debt	57	57
Total current liabilities	239,878	272,790
Long-term debt	106,680	105,019
Other long-term liabilities	90,138	89,701
Total liabilities	436,696	467,510
Equity	390,301	382,621

Total liabilities & equity	$826,997	$850,131

DONALDSON COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of Dollars)
(Unaudited)

	Three Months Ended October 31	
	2002	2001
OPERATING ACTIVITIES		
Net earnings	$22,837	$19,724
Adjustments to reconcile net earnings to net provided by operating activities:		
Depreciation and amortization	7,672	7,921
Changes in operating assets and liabilities	17,813	17,667
Other	(157)	(1,375)
Net cash provided by operating activities	48,165	43,937
INVESTING ACTIVITIES		
Net expenditures on property and equipment	(9,537)	(10,954)
Acquisitions and investments in unconsolidated affiliates net of cash acquired	(1,259)	--
Net cash used in investing activities	(10,796)	(10,954)
FINANCING ACTIVITIES		
Purchase of treasury stock	(13,144)	(8,358)
Net change in debt	(14,154)	438
Dividends paid	(3,733)	(3,329)
Other	301	266
Net cash provided by (used in) financing activities	(30,730)	(10,983)
Effect of exchange rate changes on cash	5,827	(606)
Increase in cash and cash equivalents	12,466	21,394
Cash and cash equivalents-beginning of year	45,586	36,136
Cash and cash equivalents-end of period	$58,052	$57,530

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