Donaldson Company Announces Record Third-Quarter and Nine-Month Results

MINNEAPOLIS--(BUSINESS WIRE)--May 28, 2002--

Record third-quarter EPS at 47 cents, up 21 percent;
record nine-month EPS at $1.35, up 16 percent;
focusing on cost management and ROI improvements

Donaldson Company, Inc. (NYSE:DCI), today reported record net earnings of $21.5 million for the third fiscal quarter ended April 30, 2002, up 20.5 percent from $17.8 million last year. Record diluted earnings per share of $0.47 were up 20.5 percent from $0.39 last year. Revenue was $269.4 million, flat with $269.7 million last year. Foreign currency translation reduced revenue by 1.8 percent.

For the nine-month period, net earnings totaled a record $62.0 million, up 17.5 percent from $52.7 million last year. Record diluted earnings per share of $1.35 were up 16.4 percent from $1.16 last year. Revenue was $822.1 million, down 2.0 percent from $839.2 million last year. Foreign currency translation reduced revenue by 1.3 percent.

"Donaldson is well positioned to deliver its 13th consecutive year of double-digit earnings growth," said Bill Van Dyke, chairman, president and chief executive officer. "Through nine months, we have again delivered strong financial results despite the difficult economic headwinds faced to date. Continued strength in our gas turbine business has mostly offset flat-to-declining end markets in almost all of our business units so far this year, and total revenue is down 2 percent. Yet, EPS is up over 16 percent year-to-date, and return on investment continues to run at a healthy 19 percent. The Donaldson people have done a great job of managing our entire business -- not just the revenue line -- and continue to produce consistent, superior earnings."

Income Statement Discussion

The impact of foreign currency translation, mainly due to the continued weakness of the Euro, Yen and the South African Rand against the U.S. dollar, decreased net sales by $4.9 million from the third quarter last year and decreased net earnings by $0.3 million. Year-to-date, foreign currency translation has decreased net sales by $11.2 million and net earnings by $0.5 million. On a local currency basis, revenues outside the U.S. increased 7.5 percent in the quarter and increased 2.7 percent year-to-date. In constant currency, total worldwide revenue would have increased 1.7 percent in the quarter and decreased 0.7 percent year-to-date.

Gross margin for the quarter improved to 31.5 percent versus 29.4 percent last year. Ongoing efforts to reduce product costs and improve manufacturing infrastructure continued to drive margin improvements. No costs were incurred for continuing plant rationalization in the quarter and $0.03 per share year-to-date, versus $0.01 per share in last year's third quarter and $0.12 per share during the first nine months last year. Year-to-date, gross margin improved to 31.0 percent versus 30.0 percent last year.

Third-quarter operating expenses increased by a modest $0.4 million over last year, to 20.4 percent of sales from 20.2 percent last year. During last year's third quarter, the company implemented expense reduction initiatives, which reduced the number of contractors and temporary employees and managed discretionary spending levels. These expense reduction initiatives are still in effect. For the year, operating expenses declined to 20.3 percent of sales from 20.4 percent last year, despite the lower sales volume.

Interest expense was $1.4 million, down from $3.1 million last year. The 54.3 percent decrease was driven by the reduction in total debt by $44.1 million from a year ago and lower interest rates. Year-to-date, interest expense was $5.0 million, down 46.9 percent from $9.4 million last year.

Other income totaled $0.8 million, down from $1.9 million last year but essentially flat compared to the first and second quarters of this year. Year-to-date, other income was $2.5 million, a slight decrease from $2.7 million last year.

The income tax rate remained at the second quarter's 27.0 percent, down from 28.0 percent a year ago. The company anticipates maintaining the current 27.0 percent tax rate going forward.

Cash generated by operations in the quarter was $31.6 million, an improvement of $9.3 million from last year. The company continued to improve working capital in the quarter. Year-to-date, cash generated by operations was $105.9 million, an improvement of $57.5 million from last year.

Backlog

Total backlog of $335 million was down 2 percent from the prior-quarter end and 7 percent from the same period last year. In the Industrial Products segment, total backlog decreased 9 percent from the prior-quarter end and 15 percent from the same period last year. In the Engine Products segment, total backlog increased 6 percent from the prior-quarter end and 1 percent from the same period last year.

The 90-day backlog was $195 million, up 11 percent from the prior-quarter end and up 2 percent from the same period last year. In the Industrial Products segment, 90-day backlog increased 18 percent from the prior-quarter end but decreased 1 percent from the same period last year. In the Engine Products segment, 90-day backlog increased 4 percent from the prior-quarter end and 7 percent from the same period last year.

Industrial Products Segment

Strong gas turbine results offset most of the weakness from anemic industrial capital spending, generating Industrial Product sales in the third quarter of $117.4 million, a decrease of 2.5 percent from a record $120.4 million in the prior year. Year-to-date, Industrial Products sales were $373.9 million, a decrease of 2.7 percent from a record $384.2 million in the prior year.

Gas turbine product sales for the third quarter were a record $52.6 million, an increase of 28.8 percent from a record $40.9 million last year. Sales in both North America and Europe increased at double-digit rates again this quarter. Year-to-date, gas turbine product sales were a record $162.3 million, up 27.7 percent from a record $127.1 million last year.

Dust collection product sales in the third quarter were $37.6 million, a decrease of 25.1 percent from $50.2 million last year. The pace of recovery in the U.S. manufacturing economy remained slow as manufacturers continued to deal with historically high levels of excess capacity. International business conditions improved modestly during the quarter as sales decreases were in the single-digits in both Europe and Asia. Year-to-date, dust collection product sales were $129.9 million, down 21.9 percent from a record $166.3 million last year.

Sales of special application products in the third quarter were $27.2 million, a decrease of 7.5 percent from a record $29.4 million last year. Disk drive filter sales were flat year over year, while photolithography filtration sales and aircraft cabin air filtration sales remained sharply down, reflecting the weakness in the semiconductor and aircraft markets. Year-to-date, special application product sales were $81.8 million, a decrease of 10.0 percent from a record $90.8 million last year.

Engine Products Segment

Engine Products sales for the third quarter were $152.0 million, an increase of 1.8 percent from $149.3 million last year. Engine Product sales have now increased for two consecutive quarters, after four consecutive quarterly decreases. Year-to-date, revenues were $448.2 million, a decrease of 1.5 percent from $455.1 million last year.

The North American truck market is in the midst of what appears to be a demand bubble as orders are pulled ahead of the October 2002 diesel emission regulations. Results were also strong in both Europe and Asia, with double-digit sales increases in both regions. For the quarter, truck sales were $24.1 million, an increase of 18.6 percent from $20.3 million last year. Year-to-date, sales were $65.3 million, an increase of 9.3 percent from $59.8 million last year.

Worldwide sales of off-road products in the quarter were $47.4 million, an increase of 2.3 percent from $46.3 million last year. Strength in U.S. defense and European construction markets offset flat conditions in other off-road markets, such as non-residential construction and agriculture. Year-to-date, sales were $137.4 million, level with $136.9 million last year.

Aftermarket product sales in the quarter were $80.5 million, a decrease of 2.6 percent from $82.7 million last year. Inventory replenishment at parts dealers and distributors helped provide a positive sequential quarter result, although freight volumes and vehicle utilization rates remain below historical norms. Year-to-date, sales were $245.5 million, a decrease of 5.0 percent from $258.4 million last year.

Outlook

Within the Industrial Products segment, the company expects gas turbine sales to remain strong through the fourth fiscal quarter before beginning to decline in early fiscal 2003, as public comments from gas turbine manufacturers suggest order decreases of 20 percent to 50 percent in calendar 2003 compared to calendar 2002. The company expects difficult year-over-year comparisons to persist for dust collection sales into fiscal 2003, although sales are expected to begin increasing on a sequential quarter basis starting in the fourth quarter. Conditions are expected to begin improving for disk drive filtration as the industry is forecasting a PC refresh cycle during the second half of this calendar year. Within the Engine Products segment, the company expects market conditions to remain strong for on-road trucks through the fiscal 2003 first quarter due to the emissions prebuy now under way. Off-road markets are expected to remain steady until a rebound in non-residential construction spending commences. Sales growth in engine aftermarket products is expected to begin rebounding later this calendar year as freight volumes and vehicle utilization rates are forecasted to begin recovering.

Facing a decreasing gas turbine business while other businesses are still operating below normalized levels, Donaldson remains committed to maximizing the operating efficiencies of the business until the economy improves, focusing on product cost reductions, manufacturing infrastructure improvements and discretionary expense controls.

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, industrial compressors and trucks. More than 8,100 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.

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 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 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," "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.

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 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, 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 might 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 April 30		Nine Months Ended April 30	
	2002	2001	2002	2001
Net sales	$269,423	$269,721	$822,133	$839,221
Cost of sales	184,447	190,541	567,565	587,769
Gross margin	84,976	79,180	254,568	251,452
Operating expenses	54,953	54,571	167,199	171,461

Operating income	30,023	24,609	87,369	79,991
Other (income) expense	(810)	(1,868)	(2,496)	(2,653)
Interest expense	1,417	3,104	4,991	9,401
Earnings before income taxes	29,416	23,373	84,874	73,243
Income taxes	7,942	5,547	22,916	20,508
Net earnings	$21,474	$17,826	$61,958	$52,735
Weighted average shares outstanding	44,196,624	44,317,697	44,190,547	44,388,211
Diluted shares outstanding	45,728,376	45,409,996	45,768,766	45,480,057
Net earnings per share	$.48	$.40	$1.40	$1.19
Net earnings per share assuming dilution	$.47	$.39	$1.35	$1.16
Dividends paid per share	$.080	$.075	$.230	$.220
Capital expenditures	$10,659	$11,730	$35,774	$26,985
Depreciation and amortization	$7,904	$8,744	$23,862	$27,375
EBITDA	$38,532	$35,023	$113,102	$109,279

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

	April 30 2002	July 31 2001
ASSETS		
Cash and cash equivalents	$70,771	$36,136
Accounts receivable - net	205,841	230,046
Inventories - net	104,404	112,634
Prepaid expenses and other current assets	32,321	28,411
TOTAL CURRENT ASSETS	413,337	407,227
Other assets and deferred taxes	102,598	91,945
Property, plant and equipment - net	219,504	207,658
TOTAL ASSETS	$735,439	$706,830
LIABILITIES AND SHAREHOLDERS' EQUITY		
Trade accounts payable	$94,116	$100,287
Employee compensation and other liabilities	58,659	57,576
Notes payable	41,975	59,393
Income taxes payable	744	--

Current maturity long-term debt	52	23
TOTAL CURRENT LIABILITIES	195,546	217,279
Long-term debt	99,502	99,259
Other long-term liabilities	76,621	71,199
TOTAL LIABILITIES	371,669	387,737
EQUITY	363,770	319,093
TOTAL LIABILITIES AND EQUITY	$735,439	$706,830

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

	Nine Months Ended April 30	
	2002	2001
OPERATING ACTIVITIES		
Net earnings	$61,958	$52,735
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	23,862	27,375
Changes in operating assets and liabilities	25,491	(22,153)
Other	(5,452)	(9,638)
Net cash provided by operating activities	105,859	48,319
INVESTING ACTIVITIES		
Net expenditures on property and equipment	(35,774)	(26,985)
Net cash used in investing activities	(35,774)	(26,985)
FINANCING ACTIVITIES		
Purchase of treasury stock	(9,882)	(10,297)
Net change in debt	(16,561)	10,625
Dividends paid	(10,178)	(9,767)
Other	1,484	927
Net cash used in financing activities	(35,137)	(8,512)
Effect of exchange rate changes on cash	(313)	(1,216)
Increase in cash and cash equivalents	34,635	11,606
Cash and cash equivalents-beginning of year	36,136	32,017
Cash and cash equivalents-end of period	$70,771	$43,623

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5/28/2002