



## Donaldson Reports First Quarter Results

Donaldson Company, Inc. (NYSE:DCI) announced its financial results for its fiscal 2014 first quarter. Summarized financial results are as follows (dollars in millions, except per share data):

|                  | Three Months Ended |        |        |
|------------------|--------------------|--------|--------|
|                  | October 31         |        |        |
|                  | 2013               | 2012   | Change |
| Net sales        | \$599              | \$589  | 2%     |
| Operating income | 92                 | 74     | 25%    |
| Net earnings     | 62                 | 54     | 14%    |
| Diluted EPS      | \$0.41             | \$0.36 | 14%    |

"We had a good start to our new fiscal year as we delivered record operating results on a modest sales increase in our first quarter," said Bill Cook, Donaldson's CEO. "We believe that many of our first-fit equipment end markets have stabilized, while demand for our replacement filters continues to grow. Our Engine Products' sales increased 7 percent in local currency from last year, driven by our Engine Aftermarket and Aerospace and Defense businesses, which were up 9 and 20 percent, respectively. Our Industrial Products' sales decreased 4 percent in local currency. Consistent with our earlier guidance, Gas Turbine shipments decreased 27 percent but were partially offset by our Industrial Filtration Solutions and Special Applications businesses, which were up 2 and 5 percent, respectively. Geographically, excluding our Gas Turbine sales, our Company's local currency sales growth was widespread across all of our major regions."

"Both our operating income of \$92 million and operating margin of 15.3 percent were first quarter records. Over the last year, we have worked to align our manufacturing and operating expenses with current Customer demand while generating savings from our ongoing *Continuous Improvement* initiatives."

"Our updated outlook for FY14 is consistent with our original outlook from August. Overall, we are expecting our full year sales to increase between \$25 and \$100 million in FY14. We will maintain our focus on operational excellence through our *Continuous Improvement* initiatives. We continue to invest in our Strategic Business Systems project. The combination of our sales and operational performance should deliver FY14 EPS of between \$1.65 and \$1.85 per share."

### Financial Statement Discussion

The impact of foreign currency translation decreased sales by \$6.8 million, or 1.2 percent, during the first quarter. The impact of foreign currency translation decreased reported net earnings by \$0.5 million, or 0.8 percent.

Restructuring expenses in the quarter were \$1.7 million of which \$0.6 million was included in gross margin, \$0.2 million in operating expense, and \$0.9 million in other expense. These expenses were primarily related to two initiatives: a facility downsizing and a facility sale – both in Germany.

Gross margin was 35.8 percent, compared to 33.7 percent in last year's first quarter. The year-over-year increase is primarily attributable to improved fixed cost absorption due to an increase in our production volumes and the positive mix impacts from higher aftermarket sales. We also benefitted from our ongoing *Continuous Improvement* initiatives.

Operating expenses for the quarter were \$122.6 million, down 1.7 percent from last year's \$124.8 million. As a percent of sales, operating expenses were 20.5 percent compared to last year's 21.2 percent. Our ongoing cost containment actions and operating leverage offset higher expenses from incentive compensation and our Strategic Business Systems project.

Our effective tax rate for the quarter was 32.2 percent, compared to a prior year rate of 29.4 percent. The current quarter included \$2.1 million of tax expense primarily related to an intercompany dividend.

As part of our ongoing share repurchase program we repurchased 339,000 shares, or 0.2 percent of our diluted outstanding shares, for \$12.1 million during the quarter.

### FY14 Outlook

- We project our Company's sales to be between \$2.45 and \$2.55 billion, or an increase of 1 to 5 percent. Our forecast is based on the Euro at US\$1.36 and 98 Yen to the US\$.
- Our full-year operating margin forecast is 14.2 to 15.0 percent. Included in this forecast is approximately \$30 million in operating expense increases for both incentive compensation and our Strategic Business Systems project.
- Our FY14 tax rate is anticipated to be between 29 and 31 percent.
- We forecast our full year FY14 EPS to be between \$1.65 and \$1.85.
- Cash generated by operating activities is projected to be between \$320 and \$350 million. Our capital spending is estimated to be approximately \$90 million.

**Engine Products:** We forecast FY14 sales to increase 3 to 9 percent, including the impact of foreign currency.

- Our On-Road OEM Customers are planning to build more heavy- and medium-duty trucks in FY14. Demand from our Off-Road OEM Customers is anticipated to be mixed: build rates of agriculture equipment are forecasted to remain steady, build rates of construction equipment are expected to slowly improve in North America and Europe but remain soft in Asia, and the build rates of new mining equipment are expected to remain at current low levels.
- We are anticipating improving growth for our Engine Aftermarket business. Utilization rates for off-road equipment and on-road heavy truck fleets in the field are expected to improve. We should also benefit from our continued expansion into emerging economies, the increasing number of first-fit systems installed in the field with our innovative proprietary filters, and through expansion of our product portfolio.
- We forecast steady sales for our Aerospace and Defense business compared to last year as the continued slowdown in U.S. military activity should be offset by growth from our commercial aerospace sales.

**Industrial Products:** We forecast sales to be consistent with FY13, including the impact of foreign currency.

- Our Industrial Filtration Solutions' sales are projected to increase 5 to 11 percent. We assume general manufacturing activity and investments will increase moderately in the Americas and Asia, while activity in Europe has stabilized with a gradual improvement expected during the second half of our fiscal year.
- We anticipate our Gas Turbine sales will decrease 18 to 24 percent from our record sales in FY13 due to the slowdown in large turbine power generation projects by our Customers this year.
- Special Applications' sales are forecasted to increase 3 to 9 percent due to improved market demand for our semiconductor and venting products.

### **About Donaldson Company**

Donaldson is a leading worldwide provider of filtration systems that improve people's lives, enhance our Customers' equipment performance, and protect our environment. We are a technology-driven Company committed to satisfying our Customers' needs for filtration solutions through innovative research and development, application expertise, and global presence. Our approximately 12,400 employees contribute to the Company's success by supporting our Customers at our more than 140 sales, manufacturing, and distribution locations around the world.

Donaldson is a member of the S&P MidCap 400 and Russell 1000 indices, and our shares trade on the NYSE under the symbol DCI. Additional information is available at [www.donaldson.com](http://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 announcement contains forward-looking statements, including, without limitation, forecasts, plans, trends, and projections relating to our business and financial performance and global economic conditions, which involve uncertainties that could materially impact results. All statements other than statements of historical fact are forward-looking statements. These statements do not guarantee future performance.

The Company wishes to caution investors that any forward-looking statements are subject to uncertainties and other risk factors that could cause actual results to differ materially from such statements, including but not limited to risks associated with: world economic factors and the ongoing global economic uncertainty, the reduced demand for hard disk drive products with the increased use of flash memory, the potential for some Customers to increase their reliance on their own filtration capabilities, currency fluctuations, commodity prices, political factors, the Company's international operations, highly competitive markets, governmental laws and regulations, including the impact of the various economic stimulus and financial reform measures, the implementation of our new information technology systems, failure or breach of information technology and trade secret security, potential global events resulting in market instability including

financial bailouts and defaults of sovereign nations, military and terrorist activities, health outbreaks, natural disasters, and all of the other risk factors included in our Annual and Quarterly Reports. We undertake 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 share and per share amounts)  
(Unaudited)

|  | Three Months Ended<br>October 31 |             |
|--|----------------------------------|-------------|
|  | 2013                             | 2012        |
| Net sales                                | \$ 599,384                       | \$ 588,947  |
| Cost of sales                            | 384,990                          | 390,654     |
| Gross profit                             | 214,394                          | 198,293     |
| Operating expenses                       | 122,647                          | 124,756     |
| Operating income                         | 91,747                           | 73,537      |
| Other income, net                        | (1,654)                          | (5,812)     |
| Interest expense                         | 2,614                            | 2,671       |
| Earnings before income taxes             | 90,787                           | 76,678      |
| Income taxes                             | 29,195                           | 22,565      |
| Net earnings                             | \$ 61,592                        | \$ 54,113   |
| Weighted average shares Outstanding      | 147,323,138                      | 149,149,429 |
| Diluted shares outstanding               | 149,360,875                      | 151,524,125 |
| Net earnings per share                   | \$ 0.42                          | \$ 0.36     |
| Net earnings per share assuming dilution | \$ 0.41                          | \$ 0.36     |
| Dividends paid per share                 | \$ 0.130                         | \$ 0.090    |

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

|  | October 31<br>2013 | July 31<br>2013 |
|--|--------------------|-----------------|
| <b>ASSETS</b>                                      |                    |                 |
| Cash, cash equivalents, and short-term investments | \$ 383,429         | \$ 323,888      |
| Accounts receivable, net                           | 420,883            | 430,766         |
| Inventories, net                                   | 242,918            | 234,820         |
| Prepays and other current assets                   | 73,696             | 66,188          |
| Total current assets                               | 1,120,926          | 1,055,662       |

|                                     |                    |                    |
|-------------------------------------|--------------------|--------------------|
| Other assets and deferred taxes     | 271,328            | 268,614            |
| Property, plant, and equipment, net | <u>427,671</u>     | <u>419,280</u>     |
| Total assets                        | <u>\$1,819,925</u> | <u>\$1,743,556</u> |

#### LIABILITIES AND SHAREHOLDERS' EQUITY

|   |                    |                    |
|---|--------------------|--------------------|
| Trade accounts payable                      | \$ 182,555         | \$ 186,460         |
| Employee compensation and other liabilities | 186,420            | 182,121            |
| Short-term borrowings                       | 5,084              | 9,190              |
| Current maturity long-term debt             | <u>98,088</u>      | <u>98,664</u>      |
| Total current liabilities                   | 472,147            | 476,435            |
| Long-term debt                              | 102,500            | 102,774            |
| Other long-term liabilities                 | <u>81,934</u>      | <u>79,160</u>      |
| Total liabilities                           | 656,581            | 658,369            |
| Equity                                      | <u>1,163,344</u>   | <u>1,085,187</u>   |
| Total liabilities and equity                | <u>\$1,819,925</u> | <u>\$1,743,556</u> |

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

|   | Three Months Ended<br>October 31 |                |
|---|----------------------------------|----------------|
|   | <u>2013</u>                      | <u>2012</u>    |
| <b>OPERATING ACTIVITIES</b>   |                                  |                |
| Net earnings  | \$ 61,592                        | \$ 54,113      |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                  |                |
| Depreciation and amortization   | 16,267                           | 16,026         |
| Changes in operating assets and liabilities   | 20,481                           | 1,910          |
| Tax benefit of equity plans   | (3,408)                          | (5,527)        |
| Stock compensation plan expense   | 1,936                            | 1,476          |
| Loss on sale of businesses  | 905                              | ---            |
| Other, net  | <u>1,146</u>                     | <u>(3,935)</u> |
| Net cash provided by operating activities   | 98,919                           | 64,063         |
| <b>INVESTING ACTIVITIES</b>   |                                  |                |
| Net expenditures on property and equipment  | (20,530)                         | (21,404)       |
| Net change in short-term investments  | <u>(33,402)</u>                  | <u>12,868</u>  |
| Net cash used in investing activities   | (53,932)                         | (8,536)        |
| <b>FINANCING ACTIVITIES</b>   |                                  |                |
| Purchase of treasury stock  | (12,132)                         | (50,731)       |
| Net change in debt and short-term borrowings  | (4,141)                          | (28,703)       |
| Dividends paid  | (19,000)                         | (13,292)       |
| Tax benefit of equity plans   | 3,408                            | 5,527          |
| Exercise of stock options   | <u>7,460</u>                     | <u>5,576</u>   |
| Net cash used in financing activities   | (24,405)                         | (81,623)       |

|  |                  |                  |
|--|------------------|------------------|
| Effect of exchange rate changes on cash          | <u>2,810</u>     | <u>5,077</u>     |
| Increase/(Decrease) in cash and cash equivalents | 23,392           | (21,019)         |
| Cash and cash equivalents – beginning of year    | <u>224,138</u>   | <u>225,789</u>   |
| Cash and cash equivalents – end of period        | <u>\$247,530</u> | <u>\$204,770</u> |

SEGMENT DETAIL  
(Thousands of dollars)  
(Unaudited)

|                                  | <u>Engine<br/>Products</u> | <u>Industrial<br/>Products</u> | <u>Corporate &amp;<br/>Unallocated</u> | <u>Total<br/>Company</u> |
|----------------------------------|----------------------------|--------------------------------|--|--------------------------|
| 3 Months Ended October 31, 2013: |                            |                                |  |                          |
| Net sales                        | \$389,116                  | \$210,268                      | ---                                    | \$ 599,384               |
| Earnings before income taxes     | 62,073                     | 31,143                         | (2,429)                                | 90,787                   |
| 3 Months Ended October 31, 2012: |                            |                                |  |                          |
| Net sales                        | \$370,660                  | \$218,287                      | ---                                    | \$ 588,947               |
| Earnings before income taxes     | 47,424                     | 32,562                         | (3,308)                                | 76,678                   |

NET SALES BY PRODUCT  
(Thousands of dollars)  
(Unaudited)

|  | Three Months Ended<br>October 31 |                   |
|--|----------------------------------|-------------------|
|  | <u>2013</u>                      | <u>2012</u>       |
| Engine Products segment:                 |                                  |                   |
| Off-Road Products                        | \$ 89,213                        | \$ 90,997         |
| On-Road Products                         | 32,489                           | 34,756            |
| Aftermarket Products                     | 238,872                          | 221,293           |
| Aerospace and Defense Products           | 28,542                           | 23,614            |
| Total Engine Products segment            | <u>\$ 389,116</u>                | <u>\$ 370,660</u> |
| Industrial Products segment:             |                                  |                   |
| Industrial Filtration Solutions Products | \$ 131,431                       | \$ 128,576        |
| Gas Turbine Products                     | 34,640                           | 47,243            |
| Special Applications Products            | 44,197                           | 42,468            |
| Total Industrial Products segment        | <u>\$ 210,268</u>                | <u>\$ 218,287</u> |
| Total Company                            | <u>\$ 599,384</u>                | <u>\$ 588,947</u> |

RECONCILIATION OF NON-GAAP FINANCIAL MEASURES  
(Thousands of dollars, except per share amounts)  
(Unaudited)

|   | Three Months Ended<br>October 31 |             |
|---|----------------------------------|-------------|
|   | <u>2013</u>                      | <u>2012</u> |
| Net cash provided by operating activities | \$ 98,919                        | \$ 64,063   |

|   |                  |                  |
|---|------------------|------------------|
| Net capital expenditures  | (20,530)         | (21,404)         |
| Free cash flow  | <u>\$ 78,389</u> | <u>\$ 42,659</u> |
| Net earnings  | \$ 61,592        | \$ 54,113        |
| Income taxes  | 29,195           | 22,565           |
| Interest expense, net   | 2,157            | 1,754            |
| Depreciation and amortization                                     | 16,267           | 16,026           |
| EBITDA  | <u>\$109,211</u> | <u>\$ 94,458</u> |
| Prior year net sales  | \$588,947        | \$608,295        |
| Change in net sales, excluding foreign currency translation       | 17,225           | (2,489)          |
| Foreign currency translation                                      | (6,788)          | (16,859)         |
| Current year net sales  | <u>\$599,384</u> | <u>\$588,947</u> |
| Prior year net earnings   | \$ 54,113        | \$ 68,553        |
| Change in net earnings, excluding foreign currency translation    | 7,933            | (13,119)         |
| Foreign currency translation                                      | (454)            | (1,321)          |
| Current year net earnings   | <u>\$ 61,592</u> | <u>\$ 54,113</u> |
| Net earnings  | \$ 61,592        | \$ 54,113        |
| Restructuring charges, net of tax                                 | 1,443            | ---              |
| Net earnings, excluding special items                             | <u>\$ 63,035</u> | <u>\$ 54,113</u> |
| Net earnings per share assuming dilution                          | \$ 0.41          | \$ 0.36          |
| Restructuring charges per share, net of tax                       | 0.01             | ---              |
| Net earnings per share assuming dilution, excluding special items | <u>\$ 0.42</u>   | <u>\$ 0.36</u>   |

Although free cash flow, EBITDA, net sales excluding foreign currency translation, and net earnings excluding foreign currency translation are not measures of financial performance under GAAP, the Company believes they are useful in understanding its financial results. Free cash flow is a commonly used measure of a company's ability to generate cash in excess of its operating needs. EBITDA is a commonly used measure of operating earnings less non-cash expenses. Both net sales and net earnings excluding foreign currency translation provide a comparable measure for understanding the operating results of the company's foreign entities excluding the impact of foreign exchange. A shortcoming of these financial measures is that they do not reflect the company's actual results under GAAP. Management does not intend these items to be considered in isolation or as a substitute for the related GAAP measures.



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