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Q3 2018 Donaldson Company Inc Earnings Call

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PRESENTATION

Operator

Good morning. My name is Denise, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Donaldson's Q3 Fiscal Year 2018 Conference Call.

(Operator Instructions)

Brad Pogalz, Director of Investor Relations, you may begin your conference.

Brad Pogalz *Donaldson Company, Inc. - Director of IR*

Thanks, Denise. Good morning, everyone. Thank you for joining Donaldson's Third Quarter 2018 Earnings Conference Call.

With me today are Tod Carpenter, Chairman, CEO and President of Donaldson; and Scott Robinson, our Chief Financial Officer. Tod and Scott will provide an overview of our recent performance and outlook, along with an update on some of our strategic priorities.

During today's call, we may reference non-GAAP metrics such as adjusted earnings per share. You can find a reconciliation of GAAP to non-GAAP metrics within the schedules attached to this morning's press release.

I want to remind everyone that any forward-looking statements made during this call are subject to risks and uncertainties, the most important of which are described in our press release and SEC filings.

Now, I'll turn the call over to Tod Carpenter. Tod?

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Thank you, Brad. Good morning, everyone.

We are pleased to have delivered another solid quarter for both sales and EPS, which grew 15% and 18%, respectively. We also saw year-over-year pressure on margin moderate to 10 basis points last quarter, and we were up 210 basis points from the prior quarter.

The strong sequential improvement was driven by both gross margin and expense control, but pressure on gross margin remains. We continue to face price inflation for steel and media, our two largest inputs. Mix of sales is also a headwind as demand for new equipment outpaces replacement parts. In addition to those factors, we are still adjusting our supply chain to accommodate the strong demand. We are committed to maintaining our position as a valued supplier, so we are choosing to make these customer-centric investments.

While we have made some progress on addressing these pressures, our work is not finished. Last quarter, we further focused our expense investments and we initiated price increases for products around the world. While it's still early, we are seeing positive traction from these efforts and we continue to pursue initiatives that drive incremental margin. Scott will provide more details later in the call so I will now turn to an overview of our third quarter sales performance.

Total sales grew 15% last quarter or 9% when you exclude the benefit from currency. We saw solid gains in both our Engine Products and Industrial Products segments led by first-fit sales and complemented by continued strength in sales of replacement parts. In Engine, total sales increased 16%, driven in part by another quarter of sharp growth in both the On- and Off-Road first-fit businesses.

Sales in On-Road grew 46%, driven primarily by growth in the U.S. and China. Continued strength in heavy-duty truck production is driving the U.S. and growth in China is primarily from new program wins. The wins in China are incremental to Donaldson and signal the evolving needs of local OEs. We are encouraged by the ongoing customer shift towards higher technology products and we believe we are well-positioned to capture this emerging opportunity in China's massive market.

Strong market conditions and program wins are also driving sales of Off-Road Products, which were up 30% last quarter. We saw strength across all end markets and all geographies and program wins within our advanced fuel filtration solutions are adding to our growth. Given those past wins, we believe that sales in Off-Road still have runway.

Past program wins also provide ongoing benefits to the Aftermarket business. Sales grew 13% last quarter, including a benefit of about 3% from the Hy-Pro acquisition and a modest headwind in Europe due to timing of orders for a larger OE. As expected, the pace of growth in Aftermarket is leveling off, but market conditions remain favorable for these products. We just booked our ninth quarter in a row of increasing sales in both the OE and independent channels.

We remain very pleased with performance of our innovative fuel, hydraulic and air applications. Sales of these innovative replacement filters had a combined increase of about 20%, including growth in the mid-teens for PowerCore. After more than 15 years in production, sales of PowerCore replacement filters continue to significantly outpace the rate of growth for legacy air products, further validating our razor-to-sell-razor-blade strategy. The independent channel was strongest in regions that are more exposed to energy markets, including the U.S., where oil and gas activity is increasing, and Australia with mining.

Closing out the Engine segment, third quarter sales of Aerospace and Defense were down 11%. We had declines across the business due in part to order timing within the Defense business.

Our Industrial segment sales were strong across the board last quarter, helped in part by currency. Total sales were up 12%, or 5% excluding the impact from FX. Given that a couple of our Industrial segment businesses were down in local currency, I will use local currency measures to discuss results for this segment.

Sales in our Industrial Filtration Solutions business or IFS were up 11%. Sales of new equipment grew the fastest with revenue up in the low teens as market conditions improved. We also had another strong quarter -- strong growth in sales of IFS replacement parts, which were up in the high single digits. Benefits from expanding and refining the most successful elements of our sales model are creating more traction for IFS replacement parts. Also within IFS, we are driving growth with new product offerings that further penetrate adjacent markets, including our LifeTec filters for food and beverage.

Sales in Gas Turbine Systems, or GTS, declined modestly in local currency. The third quarter performance was better than expected, driven primarily by project timing. Market conditions for large turbine projects remain under extreme pressure so third quarter results are simply reflecting the inherent lumpiness of the business. However, we remain pleased by the performance of replacement parts. Sales have been strong this year as we continue to amplify our focus on these products versus chasing low-margin, large turbine projects.

Sales in Special Applications were down 5% in local currency, including a modest decline in disk drive and mid-single-digit growth in sales of Venting Solutions. The disk drive business is still benefiting from unique market conditions. The secular pressure on hard disk drives is being largely offset by increasing demand for cloud storage and other near-line capacity needs. We are leveraging our strong customer relationships and product offering to capture benefits during this period of temporary market strength.

Overall, we're pleased with our company's performance last quarter. Evidence of how our strategy is working can be found in both segments, giving us confidence that we are heading in the right direction.

I'll talk about our plans to support future growth in a few minutes, but first, Scott will provide an update on our key financial metrics and forecast. Scott?

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

Thanks, Tod. Good morning, everyone.

Third quarter sales grew 15% to $700 million, including 6% from currency translation and about 1% from Hy-Pro. EPS was $0.53 in the quarter, up 18% from last year. As projected, we delivered strong sequential improvement in sales, operating margin and EPS. Sales are up 5%, operating margin grew 210 basis points and adjusted EPS was up 23% from second quarter. We have a favorable view of the sequential sales increase and associated profit metrics as it indicates typical seasonality in our business.

Digging into profit. Third quarter operating margin was 14.4% compared with 14.5% a year ago, reflecting a gross margin decline of 60 basis points that was mostly offset by expense leverage. Inflation is still the largest pressure on gross margin. Roughly two-thirds of the 60 basis point decline was attributable to higher raw material and supply chain costs.

In addition to the price increases we implemented in January, we raised prices another 4% to 15% last quarter to offset some of the pressure. It's too soon to quantify the total impact, but benefits from our recent actions will begin rolling through by the end of the fiscal year. Mix was also a headwind last quarter, but it was much more pronounced in Engine, given the relative strength of the OE businesses. Expense leverage offset a large portion of the gross margin decline. As a rate of sales, expenses dropped from 20.2% last year to 19.8% this year, which is one of our lowest quarterly rates since our prior sales peak in fiscal '12. The expense rate was helped in part by additional cost-cutting measures, which targeted discretionary spending categories. Our employees are rallying around this initiative, and we are encouraged by the global commitment to improving our margins.

At the same time, we are investing back into the company. We are growing our sales team to support new products, especially in the Industrial segment. Additionally, we increased R&D expense by 10% last quarter as we further strengthened our technical capabilities.

I also want to quickly touch on the corporate and unallocated bucket, which includes a handful of items like interest expense, gain or loss on FX and certain corporate overhead items. It's prone to variability so I want to point out that our current year-to-date corporate results are essentially flat after showing favorability last quarter.

Moving on, our tax rate increased 70 basis points to 29.4%. Benefits from the U.S. rate reduction and stock option accounting were more than offset by the mix of earnings and reformulated charges. The timing of our fiscal year-end makes 2018 a transition year so there are a lot of puts and takes in our effective rate.

Overall, we continue to view tax reform as positive for Donaldson. Our long-term effective tax rate will drop about 2% on average to somewhere between 24% and 28%. Another benefit is the increased flexibility in accessing or optimizing global cash, which will support our long-standing capital deployment priorities.

Investing back into our business is our top priority. Last quarter, we made capital expenditures of $27 million, well above last year and largely focused on new capacity to support revenue growth. We also made a discretionary contribution of $35 million to our U.S. pension plans last quarter, allowing us to take advantage of higher U.S. tax rates during our transition year.

Returning cash to shareholders is our other priority and, last quarter, we returned $68 million through dividends and share repurchase. We have paid a cash dividend every quarter for the past 62 years and we have been increasing it annually for more than 20. We are proud of this trend and last week's announcement that we are increasing our dividend by 6% keeps it going.

Maintaining a strong balance sheet is critical to executing these priorities, and we remain in a stable position. At the end of Q3, our debt-to-EBITDA ratio was 1.5x or 0.8x on a net basis. We believe that we are appropriately leveraged, giving us confidence that we are well-positioned to support the current and future business needs.

As we close out the quarter, we made some tweaks to our full year guidance, so I'll walk through a few of the highlights. We remain encouraged by market conditions so the sales forecast was moved up to the top end of the prior guidance range, which is up 15% last year. Included in the estimate are benefits from currency translation and acquisitions of 3% and 1%, respectively.

We also pushed the Engine forecast to the upper half of the range provided last quarter. Segment sales are projected to grow 18% to 19%, with the forecasted change driven by continued first-fit strength. On-Road is now expected to be up in the high 30% range, and Off-Road is projected in the low 30s. There was no change to Aftermarket, which is forecast up in the mid-teens, and we now expect sales for Aerospace and Defense to be down in the low single digits.

The Industrial segment is projected to grow 8% to 9% this year, up from prior guidance of 5% to 7%. We took forecast up across the segment, but our perspective on those markets is largely unchanged. IFS is expected to grow in the low double-digit range and we project a mid-single-digit increase for Special Applications. The GTS decline is expected to moderate into mid-single digits.

We still expect fiscal '18 operating margin between 13.8% and 14.2%, including an incremental $10 million for strategic investments. The midpoint of the range implies a fourth quarter rate of around 15%, up 70 basis points from the prior year and up 60 basis points from the third quarter.

We continue to project full-year interest expense of around $21 million and other income from $1 million to $5 million. Excluding the impact from tax reform charges, we project our full year tax rate will land between 26.7% and 28.7%.

We increased our capital expenditure forecast by $10 million, with full year CapEx between $100 million and $110 million. The change is primarily due to capacity investments, including some acceleration to get new capacity online as quickly as possible.

Cash conversion remains in the 60% to 75% range, excluding the impact of tax reform and our pension funding.

Altogether, we now project fiscal '18 adjusted EPS between $1.97 and $2.01, which is a couple of cents higher when comparing the midpoints of the current and prior ranges. Please also remember that year-to-date charges related to our provisional estimates of the impact from tax reform are negatively affecting GAAP by $0.83.

I also want to share a few things we are contemplating in our fiscal '19 plan. Please keep in mind that we will provide more details when we release fourth quarter earnings, so our discussion today will be very limited on this topic as we are early in the planning process.

In terms of revenue projections, it seems very likely that market conditions remain supportive through at least the first half of our next fiscal year. We do, however, expect that the pace of growth may moderate in our key end markets, but they still look to grow. We also expect that past program wins with innovative products, new product offerings and continued expansion into new and adjacent markets remain additive to overall market conditions. I realize that's vague, but again, it's early in our process. We want to emphasize is that we are not contemplating a scenario where revenues go down next year. Similarly, we are not contemplating a scenario where operating margins decline next year.

Our commitment to increasing our level of profitability on increasing sales remains intact and we are engaging the entire organization in this effort. There are, however, several puts and takes to consider. The first and likely the largest is inflation. While magnitude is uncertain, we expect higher costs for raw materials and transportation. Incremental pricing actions taken this year will help and we will also generate benefits from our Continuous Improvement programs and improved analytics from our ERP to drive optimization. To further leverage the ERP, we formed a new financial shared services team with existing employees. This team will harvest benefits from the ERP as they globalize, standardize and optimize our processes. I am excited about the contribution they will make to Donaldson in the years ahead. We will continue making strategic investments in fiscal '19, including growth in R&D spend and capacity investments. Finally, incentive compensation should be a modest tailwind in '19 with the annual reset of bonus plans.

The net effect from these items is an expected year-over-year improvement in both total and incremental operating margin. As we move through the planning process, we are focused on first supporting our customers and then balancing the priorities of meeting demand, investing in the future and managing our costs. I am confident that we are striking the appropriate balance and believe we are positioning ourselves well for a strong finish to '18 and positive momentum in '19.

Now, I'll turn the call back to Tod. Tod?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Thanks, Scott.

We are on pace to deliver record sales and adjusted EPS in fiscal 2018. Since fiscal 2016, we have added $0.5 billion in sales at a much faster pace than we predicted. While we enjoy the benefits from the sharp acceleration on the top and bottom lines, we are also facing margin headwinds from a variety of factors, including inflation.

Company-wide engagement in improving our margin is critical to offsetting these pressures and I'm proud of the urgency shown by our employees. Pursuing price increases and expense discipline is standard work for us so we are executing our plans and continue to make progress. There are, however, aspects of the current demand challenges that bode well for our long-term success. Our ability to demonstrate that we are a top-tier supplier during this period of heightened demand only strengthens our decades-long relationships with many of the world's largest OEs.

We view the choice to temporarily suboptimize our supply chain as an investment in these relationships, and we also view it as necessary to maintain momentum of our strategy to grow the business with new first-fit wins. We've been actively planting seeds with new program wins for many years now. As the market turns, we are seeing an outsized benefit from those past wins. And most importantly, we are still winning. Those first-fit wins with innovative products come with the usual start-up expenses like engineering and new tooling, but they create a stream of Aftermarket revenue that extends for many years.

Given the strength in our win rates around the globe, we expect the past, present and future investments in new programs will create long-term value for all our stakeholders. In addition to our long track record of investing in new programs, we are on pace this year to invest an incremental $10 million of expense and $40 million CapEx in support of several other strategic initiatives.

Increased R&D spending and new capacity are the 2 primary drivers of incremental spending. We're making good progress on several key R&D initiatives to deepen our capabilities in existing markets while gaining further access to adjacent markets. These markets place a high value on technology so we expect our innovative products will carry above-average gross margins.

Current and projected demand for our innovative air and liquid products are driving our capacity needs. We are making investments around the world, including new production lines and square footage. There are several lines that will come online in the next few quarters and new square footage will be available throughout the next year or so.

We are also expanding our distribution capabilities. We recently held the grand opening of our newly expanded distribution facility in Brugge, Belgium and we are upgrading our facility in Rensselaer, Indiana. Both are high-volume distribution centers and these investments give us an opportunity to provide even better support to our customers.

Strength in distribution capabilities will also support our new e-commerce platform. Our customer transition to the new platform is well underway. To-date, we have recorded $45 million in revenue from 750 customers in 76 countries. We are pleased with the progress so far and expect a full rollout later this year.

Looking ahead to fiscal '19, our plans include further investment back into the company. Like this year, capacity expansion and technology development will top the list. We will also be investing in our sales teams to drive growth of innovative products in new and adjacent markets. We will grow our operating profit faster than sales next year. It is likely that inflation will remain a headwind, but our surgical approach to expense planning and efforts related to operational efficiency should more than offset these pressures.

I want to thank our employees around the world for their commitment to our customers and future success. We continue to make great progress on our goal of leading the world in filtration solutions and I am confident we will have a strong finish to 2018 and are well-positioned for success in our next fiscal year and beyond.

Now, I'll turn the call back to Denise to open the line for questions. Denise?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Nathan Jones from Stifel.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

I'd like to start on the price increases you guys announced during the quarter. I think the press release said you had instituted global price increases ranging from 5% to 14% during the quarter. I know you talked about that rolling through kind of by the end of the fiscal year.

A couple of questions on this. Can you talk about what the expected realization from that 5% to 14% price increase would be? Typically, historically, how much do you get through? How much of those price increases stick? And then, could you maybe talk about how the realization of those price increases roll out? I don't imagine you put out a press release saying you're raising 5% to 14% and prices all go up the next day. Just how that should roll through the model as we go forward.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Nathan, this is Tod. So first, when we announced the price increases, what happens in the independent aftermarket, contractually, we have 90 days before those prices take effect. So we have about one quarter ahead of us. So therefore -- and that's the shortest cycle where we can get effectiveness. So therefore, in our third quarter results, we do not have any pricing benefits.

We will -- we have baked into our fourth quarter outlook the beginning of some of those pricing benefits, but that's in our aftermarket opportunity. So on the OE side, it's usually over a multiple-quarter type of implementation as we work across the world and implement really on a selective basis at the OE sector.

As far as how much sticks, it's usually different in each case. We are clearly off the normal cycle of implementing price increases. So therefore, we're really not prepared to talk about how much we would expect all of that to hold. We'll be better informed here in about 90 days, and we'll bake all of that into next year's guidance.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Okay. That certainly helps on the rollout there. Could you comment maybe on historically how much of those price increases stick or you just don't want to get into that here?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

We really don't want to get into that at this point. Because this one is off cycle, it's really a bit dicey to try to link it back to previous behaviors.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Okay. I understand. And have competitors responded with price increases of their own? Is the market behaving rationally here? Are you out on an island with these price increases? Any commentary on how the market is reacting to this?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

It's still early in the game. Market's still -- rationally, we have had some competitors go out with activity. We're still waiting and keeping our ear to the ground to better understand that.

Operator

Your next question comes from Charley Brady from SunTrust Robinson.

Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Tod, I just want to talk to your commentary about the margin outlook in 2019 without going too deep, obviously, into guidance for '19. I'm just wondering, what kind of incrementals are you kind of assuming as you go into there? Because it seems like you've got a lot of headwinds, but you're expecting still growing enough profit faster than sales. And that's on a pretty tough sales comp obviously going into fiscal '19. So just trying to get a sense of how you're overcoming that beyond just kind of the pricing that's going to kind of work its way through over the next 12 months or so? And how much of that do you get from operating efficiency? And just trying to gain your level of confidence, I guess, to see those margins go up year-on-year?

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

Yes, I'll start. This is Scott. So as I said, we're working through our planning process right now. If you look at our new guidance, you can see that our incrementals are improving in the fourth quarter. As Tod mentioned, we have implemented price increases. We are working very hard on our expense budgets for next year. And we've set targets for ourselves and we remain committed to the concept of increasing levels of profitability on increasing sales. And when we look at where we sit and the Continuous Improvements that we have and where we are in our planning process, we think we can offset the headwinds that we faced next year and are committed to doing so, both with Continuous Improvement, with discretionary expense management and with price increases.

Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. Fair enough. And just on the Aerospace and Defense business, you talked about the mix of timing on some orders there. Can you just expand on that a little bit? Did those hit in Q4 or does that go into fiscal '19?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Sure. They do not repeat in Q4. It's really a Q3 phenomenon. It's related to ground-based vehicles whereby we have lumpy demand from U.S. allies on retrofit kits for the ground-based vehicles segment. And so we had a large order come through last year and, therefore, it gets the tough comps. And that's the primarily driver.

Charles Damien Brady ***SunTrust Robinson Humphrey, Inc., Research Division - MD***

Okay. So it's not as though orders you expect to hit in Q3 have pushed. It's a question of the year-over-year comparison.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Right.

Operator

Your next question comes from Brian Drab with William Blair.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Congrats on a continuation of great year. And I think this is the first time in a decade I've asked you on a call about the share count, but it looks like it ticked up sequentially about 1.3 million shares. I'm just wondering, is it just the timing of options and buyback? And directionally, should we start to see it tick down in the fourth quarter and then in '19 again?

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

Yes. This is Scott. So we continue with our share buyback program. The timing fluctuates year-to-year, quarter-to-quarter. I'm looking at our income statement here and our diluted share count is 131.9 million, down from 134.1 million last year. So we're down year-over-year. You get some quarterly fluctuations and you also have to factor in the dilutive impact of the stock prices. The stock price rises, less shares become anti-dilutive and that increases the share count.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Right. Right. Okay. And then for fiscal '19, are you expecting the typical seasonality where, of course, down sequentially in the first quarter, soft in the -- relatively soft in the second quarter and then strong in the second half or just kind of the strength of the end markets and just the tailwinds that you're enjoying kind of disrupt some of that typical seasonality in fiscal '19?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

So Brian, we're going to come out with guidance here on the next call. It's a little bit early to try to parce that down to that level of specificity, but I would suggest that across our customer base, as you continue to look at the On-Road and the Off-Road people in particular, they would suggest that will have momentum going throughout the balance of this calendar year.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Got it. Okay, Tod. And then, did you comment on China this call? Can you kind of comment on percent of sales in the quarter from China and the trends there and outlook?

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Brian, this is Brad. The specifics around your question, the total sales in China, it grew to about 8% of total Donaldson revenue in third quarter versus roughly 7% last year. The more exciting change in (inaudible) on the On-Road is that China as a percent of On-Road sales jumped up to about 16% versus about 4% last quarter -- last year. So clearly, the wins are taking hold and we see that in the performance. For the quarter, China was up more than 40%.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

And just to add a little bit, Brian, on the driver of that, so we continue to get inroads to what was traditionally a very low share for Donaldson Company and the On-Road market in China. And China is now seeing a technology shift. And so we are actually winning programs, for example, with PowerCore in China. And it's a very exciting time for us.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Great. And Brad said China was up 40, 4-0, percent in the third quarter? Is that...

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

That's total China, with On-Road business going up something like 5x what it was last year.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

I see. Right. And then, any thoughts on M&A, close to closing any transactions in the next couple of quarters?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Clearly, we don't comment on speculative deals or a question of that kind. I would suggest that our M&A outlook and our strategy and our approach to it has not changed from prior quarters.

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Okay. I wasn't looking for the names of the companies, Tod.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Yes, but I'm also not going to signal to anyone if we had any activity going on, right?

Brian Paul Drab ***William Blair & Company L.L.C., Research Division - Partner & Analyst***

Yes. All right.

Operator

Your next question comes from George Godfrey with CL King.

George James Godfrey ***CL King & Associates, Inc., Research Division - Senior VP & Senior Research Analyst***

I wanted to ask about the organic growth rate baked into your assumption for Q4 in '18. It looks like based on total revenue growth of 15% for the full year, that implies 9% growth for the Q4. What are you assuming for currency acquisitions or just organic growth?

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

The FX is 3% and the acquisition is about 1%.

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

That's for the full year.

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

Full year.

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

This is Brad.

George James Godfrey ***CL King & Associates, Inc., Research Division - Senior VP & Senior Research Analyst***

Your fourth quarter rate...

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

Yes. Go ahead.

George James Godfrey ***CL King & Associates, Inc., Research Division - Senior VP & Senior Research Analyst***

So I saw that in the press release. For the full year, it's 3% and 1%. Do you have -- what are the assumptions just for Q4?

Brad Pogalz ***Donaldson Company, Inc. - Director of IR***

There is no -- this is Brad again. There is no incremental benefit from acquisitions. We lapped Hy-Pro. We acquired it right at the beginning of fourth quarter last year. And then, FX will moderate to get to the 3% for the full year.

Operator

Your next question from Laurence Alexander with Jefferies.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

It's actually Dan on for Laurence. You mentioned that the technology shift in China leads to On-Road sales. I assume that can be attributed to just the environment to push this going -- that's occurring across the board in the country and it should likely continue for multi years. Is that accurate or does that seem fair?

Scott J. Robinson ***Donaldson Company, Inc. - Senior VP & CFO***

You are speaking with regards to the technology -- the new technology requirements in China?

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Yes.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

So we first have to factor in the fact that we have very low share in China, especially for our new technology-based products. And so we are very excited about the fact that we are winning at China and Chinese-based national companies more than just the multinational type of corporations that we've enjoyed business with in the past and we're winning with technology. And so when we win a platform in China with the Chinese national-based companies, we look for that to have recurring revenue over many years.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then, you mentioned in the prepared comments that there was some capacity addition to meet the growth initiatives and some of the revenue that is expected. I mean, how are you set with when it comes to capacity utilization, what's expected for in the next few years? Is it going to be another like capacity ramp as needed between now and the end of the decade? Or are you where you think you are? I'm just wondering if you could provide some color on that.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Sure, Dan. When we announced our Poland expansion last quarter, we had also said that we were pulling that expansion in roughly by 2 years. We continue to look at our capacity utilization at this point. I would suggest to you that our air-based capacities are roughly in the 80% to 90% range. Our liquid-based capacities are 90% or more and we are addressing that with additional lines and square footage. And then across our industrial-based sector, our capacities are probably in the 70% to 75% range, although we are addressing some efficiencies with additional square footage and line optimization across Industrial.

That's where we sit today. It's the reason why we talk about we'll bring on additional capacity here in the year -- in the next year with a major influx of liquid ability here within the next 2 quarters or so. And we continue to look at our current 3- to 5-year capacity plan. And we'll talk about further capacity expansions as we guide into 2019 and finalize our capital use.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then final question, you mentioned that you got $45 million in revenue from your e-commerce -- your new e-commerce platform and then a full rollout is expected by -- I think it was later in the year. I was just wondering if you could quantify, or just provide color of what a full rollout would entail, what it means in terms of revenue.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

So Dan, when we're looking at on that $45 million, you have to look at both segments who would use that particular investment very differently. On the Engine side, which is most of that $45 million worth of revenue, it's looking for the efficiency of that tool globally. So we had a previous e-comm in a couple of regions. We are now are replacing that with a modernized e-comm. And we're taking our distribution partners through that e-comm, therefore, that's really more of an efficiency gain rather than a direct to end user type of a model.

When you roll over to the Industrial side, it's actually both. It's a bit of the efficiency gain. They've never had e-commerce on that side of the company. They now have it. We are putting the distributors on that slowly, bringing them up for the first time, so that's the efficiency gain, but we will also open that, depending upon the business, direct to end user and, therefore, we look for that to be able to give us a revenue bump.

As far as total usage, we'll get into that after the full rollout and we'll try to give you some projections of what kind of revenue. We'll go through that here in the quarters ahead.

Operator

There are no further questions at this time.

I'll turn the call back over to Tod Carpenter.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

That concludes today's call. I want to thank everyone listening for their time and interest in Donaldson. Thanks again. Goodbye.

Operator

This concludes today's conference call. You may now disconnect.