DONALDSON COMPANY, INC.

Moderator: Brad Pogalz
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Tim: Please stand by we're about to begin. Good day, and welcome to the Donaldson First Quarter Fiscal Year 2016 conference call. Today's call is being recorded. At this time I'd like to turn the conference over to Brad Pogalz. Please go ahead.

Brad Pogalz: Thanks, Tim. Good morning everyone and welcome. With me today are Tod Carpenter, Donaldson's President and CEO, and our CFO, Jim Shaw. This morning Tod and Jim will cover our first-quarter performance, review our outlook for fiscal 2016 and provide an update on some of our strategic initiatives. I want to remind everyone that any statements made during the call that are not historical facts should be considered forward-looking statements. Our results could differ materially from the forward-looking statements made today as they may be affected by many factors including risks and uncertainties identified in our press release our SEC filings. Now I'll turn the call over to Tod Carpenter. Tod?

Tod Carpenter: Thanks, Brad. Good morning everyone. Before discussing our financial performance I want to comment on our recent revenue recognition issue within our European Gas Turbine business. It was clearly disappointing that this issue occurred within our company. As we do in every case where we have an opportunity we are taking action. Across our company we are reemphasizing our core value of integrity, respect and commitment while also mitigating the risk of this issue happening again. For example, we've already provided additional training across the globe on our revenue recognition practices, and we are enhancing our control processes within our gas turbine business. While the impact was immaterial to our financial results we are leveraging this experience to strengthen our controls and become a stronger company and I am confident that we will be successful in those efforts. Now I will provide a brief update on our first-quarter sales.

Note that I will refer to local currency results when discussing year-over-year performance. For reference a schedule is available on our investor relations website summarizing results by business unit and region, with and without the impact from currency translation.

In our first-quarter we generated total sales of $538 million, which included a headwind from foreign currency translation of about $37 million, or 6%. Excluding this impact, total sales declined 3.6% from last year. First-quarter sales were below our expectations with the shortfall split fairly evenly between the Engine and Industrial segment. The results were somewhat mixed across the globe, but the Americas contributed to the majority of the mix.

Within Engine, Off-Road and Aftermarket drove the local currency sales decline of 5.4% and they were also the largest drivers of our missed expectations. Our Off-Road business declined about 20% in the first quarter. Mining and agricultural end markets have remained particularly weak, and perspectives from some of our largest OEM customers suggest that build rates are unlikely to rebound in the near term.

The 3% sales decline in our Aftermarket business was driven by the Americas and reflects softness in both the OE and independent channels. In the OE channel, which represents about 40% of our total aftermarket sales, we continue to experience uneven ordering patterns. While we saw some destocking activity, the trend stabilized a bit from the back half of last year, resulting in a low single-digit sales decline. Sales through the independent channel declined between 4% and 5% in the first quarter, driven by softness in the US and Latin America.

In the U.S., sales to customers who have more exposure to mining and oil and gas end market experienced the most significant year-over-year decline, whereas sales to customers who are more exposed to transportation were better than the average.

In Latin America we see a cautious inaudible given the economic uncertainty in Brazil. On the positive side of the engine we still have momentum in our on road business which grew more than 2% on top of a 17% increase in the first quarter of last year. We also experienced a 4% increase in aerospace and defense driven almost entirely by aerospace.

Turning to our Industrial segment, sales were flat to last year, reflecting a 4% increase in Industrial Filtration Solutions and a decrease in Gas Turbine sales of 16%. The year-over-year Increase in Industrial Filtration Solutions was given by strong first bit project sales while sales of replacement parts were below expectations in the quarter. However, we believe the softness in replacement parts sales is more timing related versus a new trend.

In our Gas Turbine business, small turbine related project sales drove the majority of the year-over-year decline. For context, small turbines are typically used in the oil and gas industry and they represent between 20% and 30% of our GPS sales. In the large-turbine portion of this business, some projects moved out of the quarter, which were the primary driver of our lower performance versus our own forecast. It is important to note that these projects have not been canceled, but—as you all know—this business is lumpy by quarter.

The sales performance in the first quarter, combined with an increasingly tepid outlook for near and midterm, prompted us to lower our fiscal '16 guidance and take additional restructuring actions in October. With regard to our restructuring actions, we adjusted areas where our level of expense was not supported by current and projected demands for that respective market. These decisions are not made lightly, but we recognize the need to actively monitor external conditions and adjust when necessary. These actions, which included headcount reductions and the elimination of certain open positions, will generate annual savings of $25 million, with roughly 75% of those savings being realized in fiscal 2016.

Executing our strategic plan requires us to pursue both operational efficiency and opportunities to drive growth. I'll provide an update on these efforts after Jim discusses first-quarter results and fiscal 2016 guidance. Jim?

Jim: Thanks, Tod. Good morning everyone. First-quarter GAAP EPS was 29 cents, which included four cents related to restructuring actions and one cent from costs related to the investigation into revenue recognition within our European Gas Turbine business. Excluding these two items, we delivered adjusted earnings per share of 34 cents in the first quarter, which was somewhat below our expectations mainly as a function of softer-than-expected sales.

Our first-quarter operating margin of 10.3% included a few noteworthy items, with the combined impact from restructuring and investigation costs being the most significant. Together, these items reduced operating margins by 190 basis points with about 130 basis points affecting operating expense, and the balance affecting gross margin. For simplicity, my comments that follow on rate performance will exclude the impact from these items.

Our first-quarter adjusted operating margin was 12.2%, or 70 basis points below last year, reflecting a 130 basis point decline in gross margin that was partially offset by savings and operating expenses. Almost half of the gross margin decline in the first quarter was related to the transactional impact from FX. While we attempt to produce goods locally whenever possible, the U.S. is still a net exporter a product. Given the strength of the U.S. dollar compared with last year, we did see a gross margin headwind, but it was largely as expected. Outside of the transactional impact, our *Continuous Improvement* efforts partially offset the gross margin pressure created by softer-than-expected sales and slightly unfavorable mix.

Turning to our expense rate, we incurred higher-than-typical warranty costs in the period. These costs, which added about 60 basis points to the rate, were associated with actual or anticipated product replacement and rework of specific projects or programs. However, the warranty issues are not broad-based or individually significant. Despite the headwind from these charges, we still delivered year-over-year operating expense rate favorability of 60 basis points. We're pleased with our operating expense performance in the quarter, which reflected the benefits from prior restructuring action and disciplined management of discretionary expenses across the organization.

Turning to our other operational metrics first-quarter, free cash flow was $36 million, resulting in a cash conversion rate of about 95%. We made some progress toward reducing our receivables in the quarter, but we still have opportunity to improve both receivables and inventory balances. Our first quarter CapEx was $21.5 million, which included several strategic investments. For example, we're making very good progress in the expansion of liquid production and our new polling facility. We will begin producing liquid filters there later this fiscal year, which will help us mitigate some of the transactional impact on gross margin from FX.

Another critical investment is our ERP system. Since the beginning of this fiscal year we've gone live in additional locations in Europe and we've also started going live in parts of Asia Pacific. As of today, roughly 80% of our revenue is being transacted on this new system, and we continue to target the end of this fiscal year for completion of the roll-out.

In addition to investments in our business, we paid $23 million in dividends and we repurchased approximately 1.5% of our outstanding shares during the quarter for $68 million.

I will now turn to our updated outlook for fiscal '16. The sales pressure that Tod outlined is reflected in our revised guidance, which is about $120 million below the midpoint of prior guidance. At a segment level, about two-thirds of the sales reduction was attributable to Engine, and the remaining one-third was Industrial. We're now forecasting full-year sales will decline between 3% and 7% from last year, which translates to a range of $2.2 to $2.3 billion.

At the midpoint of the guidance, we expect the first half of fiscal 2016 will be down roughly 10%, and the back half will decline slightly from last year. Our sales guidance includes an incremental contribution of $15 to $20 million from the acquisitions we close in the past year including Northern Technical, IFIL USA and EPC. However, guidance excludes the Industrias Partmo acquisition, because this transaction has not yet closed.

We still expect that currency translation will be a meaningful top-line headwind this fiscal year, resulting in an $80 million reduction of sales from last year. Rates remain volatile, and periodic strength in the euro and yen have been offset by weakness in other currencies, such that the net impact from FX is approximately the same as our prior guidance. Excluding the FX impact, we forecast total sales will be flat to down 4% from last year, with Engine Products being flat to down 4% and sales of Industrial Products in a range of between 3% decline and a 1% increase.

As I mentioned a moment ago, Engine accounted for roughly 2/3 of the reduction in sales, driven primarily by the Off-Road and Aftermarket businesses. In Off-Road, our perspective on the mining and Ag equipment markets is relatively unchanged and generally pessimistic. We still expect a further decline and mining of 5% to 10%, and our exposure to high horsepower Ag equipment suggest that our Ag business will go down another 10 to 20% for fiscal '15.

Since our last update, our outlook for the construction equipment market has worsened. We now expect that sales will be flat to down 5% compared with a more stable outlook in our prior guidance. Sales of construction related products represent about half of our Off-Road business so the weakening in this market has an outside effect on our results.

Turning to aftermarket, we've seen a downward pressure from construction emerge. Within the independent channel we're seeing incremental pressure from off-road markets, including oil and gas-related markets. The combination of these factors results in a forecasted sales decline for aftermarket products. Although our expectations for On-Road first-fit business is in line with the prior forecast, I do want to offer some clarification on our outlook.

The anticipated slowdown and heavy-duty North American truck production next year is well documented, and we have been including that in our forecast. However, given that our fiscal year began on August 1, we are also factoring in the benefit from strong backlogs and consequently higher production through the balance of this calendar year. As we look beyond this calendar year we expect that North American build rates will slow on a year-over-year basis, but we also see opportunity outside the U.S.

While variability in the timing and magnitude of the anticipated slowdown in North America will affect our performance versus forecast, we do expect that we can see modest growth in full-year On-Road sales.

Now I'll turn to our Industrial segment, which accounted for about one-third, or roughly $40 million, of the reduction to total sales guidance.

The majority of the change to our outlook in this segment was driven by our Industrial Filtration Solutions business. We now expect sales to decline between 2% and 6% from last year, compared with prior guidance for an increase in the low single digits. The primary driver of our revised estimate is a lower rate of growth in the U.S., combined with the reluctance to make new capital investments.

Our gas turbine business was another, albeit smaller, portion of the change to our guidance. We previously expected a sales decline of 9% to 13%, but we now expect sales to decline between 11% and 15%. As we look ahead, we still expect market declines for our gas turbine business in Europe and Asia-Pacific, particularly in China. However, based on backlog, visibility of projects, and customer input, we anticipate Q1 being our weakest closer of the year.

Turning to operating margin, we have been able to offset the loss leverage from the unexpected sales decline through our restructuring actions and expense control. We expect to deliver adjusted operating margins between 12.9% and 13.7%. At the midpoint, our forecast is 40 basis points above last year's adjusted operating margin despite a year-over-year sales decline. There are several puts and takes in the forecast. In terms of the benefits to margins, we now expect to capture 30 million of savings from our fiscal year '15 restructuring action and an additional $15 to $20 million of savings from the restructuring actions taken in October. Versus prior guidance, the impact of variable compensation expense is moderate, as we adjust to a lower level of sales and earnings versus our plan. We now expect a year-over-year negative impact of approximately $11 million from compensation-related increases, which is below our initial estimate of about $20 million.

Consistent with our prior forecast and compared with last year, we still expect $8 to $12 million of net transactional impact from FX, and incremental expense of about $2 million from our ERP implementation.

We've also revised our tax guidance. We now expect the consolidated tax rate to be between 26% and 28%, down about 50 basis points from our prior guidance as a result of the changes to the projected global mix of earnings. Our CapEx forecast for fiscal 2016 is between $80 and $90 million, which is consistent with prior guidance. As a reminder, this level of CapEx is below last year by roughly $10 million at the midpoint, due in part to a lower mix of capital for our ERP implementation. Our reduced sales and earnings resulted in free cash flow of between $175 and $225 million, which translates to a cash conversion rate between 90% and 110%.

Finally, as a result of the lower-than-expected earnings, our leverage ratio at the end of Q1 was about 1.8 times growth debt to EBITDA, which is above our long-term target of 1.5 times. By the end of the fiscal year we expect to bring the ratio more in line with the 1.5 times target.

Altogether we are now expecting adjusted EPS of between $1.49 and $1.69, reflecting a one-cent increase at the midpoint compared with last year's adjusted EPS. The sales cadence I mentioned earlier, combined with back-half improvements in our operating margin as we leverage within a more stable sales environment, is expected to drive an adjusted EPS improvement in the back half of fiscal 2016.

Fiscal '16 GAAP EPS is expected to be about six cents below adjusted EPS, which includes the restructuring and investigation-related costs incurred in the first quarter, combined with about one cent of expected restructuring charges in the second quarter. These additional charges are related to actions already initiated including the final steps in closing our Grinnell, Iowa facility. Now, I'll turn the call back to Tod for his closing remarks. Tod?

Tod Carpenter: Thanks, Jim. Our company culture is one where we always put our customers first, we execute to our strategy, and we look to control what we can control. During these uncertain times operating efficiency comes to the forefront of our actions and we adjust our company to geographic and end market opportunities. Across Donaldson, we're aligning the production levels with projected demands, minimizing the impact of the sales decline on operating margins, and we are also controlling discretionary expenses.

In addition to enhancing operational efficiency, we maintained focus on executing our strategic growth initiatives, which include:

- Expansion of our core business through first fit program wins and aftermarket growth
- Continued geographic expansion and
- Disciplined execution of our acquisition strategy.

Our strategy to develop and leverage innovative technology to secure first fit program wins, driving higher retention of aftermarket continues to enhance current and future company performance.

Our most significant example of this strategy continues to be PowerCore, which generated sales of roughly $46 million in the first quarter. Once again, sales of Engine PowerCore significantly outpaced the first-fit and aftermarket averages. Total first-fit sales of our off- and on-road business combined were down almost 18%, while sales of first-fit PowerCore was flat to last year. We saw similar delta in aftermarket, with PowerCore growing 6% versus 2015, or 15 percentage points better than the company average. Customers continue to seek out this innovative technology, which is reflected in our consistent ability to secure future market share through first fit program wins.

On our “must win” programs in Engine air, which are defined as having a 10-year value of at least $5 million in sales, we maintain a win-rate of above 75%. Importantly, all but of few of these programs were one with proprietary technology, and the majority of the total value is incremental to Donaldson. On average we have won a new program every day for the past year, and we currently estimate these wins will contribute nearly half a billion dollars of future revenue.

Our liquid platform remains strong as well. We continue to win first-fit programs with our innovative Synteq XP offering, adding wins in China, India and Brazil as well as developed markets in the past quarter. Additionally we are actively pursuing opportunities worth nearly $1.3 billion of sales.

Turning to geographic expansion, operations began at two new distribution facilities in Colombia during the quarter, further strengthening our position in Latin America. We remain very excited about the growth potential of this market.

In Europe, we have recently begun producing air products at our new facility in Poland, and we will begin producing liquid filters there later this fiscal year. Choosing to accelerate our liquid production in this facility will help us meet the growing customer demand in this region and it will also help us mitigate some margin pressure from exchange rate fluctuations.

In our Industrial segment, our new dust collection product Downflo Evolution, or DSE, helps to expand our core product offering, but as of this fiscal year it is now helping Donaldson to expand geographically. We began selling this innovative technology in the U.S., and we recorded orders of $11 million in nine months as customers saw the benefit of a smaller footprint, enhanced performance and reduced maintenance. Following our North American success we are now selling this product around the world and have booked orders in multiple countries in Asia as well as in Latin America.

In China, which represents roughly 6% of our total sales, we see growth opportunities. Sales in local currency increased slightly in the first quarter, with both Engine and Industrial segment sales performing better than company averages. There's still work to be done to refine our sales model and better penetrate Chinese national OE's, but the efforts we took to right-size our cost base, moderate the pace of investment and refocus on the Customer, position us well to capture market share in China.

In terms of non-organic growth, we remain excited about the acquisitions we've announced in the past year. In the first quarter we registered incremental sales of $4 million from these acquisitions. These acquisitions are products of our consistent and disciplined approach of accelerating organic growth plans to through bolt-ons

Our dual priorities of increasing operational efficiency while executing our strategic growth plans are driving our day-to-day actions, but it is not new, and it is *not* a product of the soft environment. I am confident that when end markets rebound we will benefit from the seeds we have planted for future growth, exiting this cycle a stronger company. In the meantime, we will continue to always put our customers first, execute our strategy and focus on those aspects of our businesses that are within our control. Now I'll turn the call back to Tim to open the lines for questions. Tim?

Tim: At this time to ask a question please press star than the number one on your telephone keypad. Once again that's *1 to ask a question. We'll go first to Charles Brady with SunTrust Robinson Humphrey.

Charles Brady: Hi thanks. Good morning, guys.

Tod Carpenter: Good morning.

Charles Brady: Can we just talk about the cadence of sales given that you're on in October quarter end. As you would do that three-month of cadence of sales and particularly in the industrial filtrations business.

Jim Shaw: Hey Charlie. It's Jim. Within the quarter, especially on the project side of our dust collector business, we entered with a pretty strong backlog, so those are typically a couple of months in advance in terms of when we get that order. So the delivery of those orders was pretty consistent throughout the quarter, but what we did see is that our order intake slowed as we got towards the latter half of the quarter, and that was one of the considerations when we looked at our guidance is that we entered the year with a fairly healthy backlog, but as the quarter went on that began to get depleted even though we were shipping fairly strongly throughout the quarter. So as we ended the quarter we were left optimistic, particularly in the U.S. with regards to the project-related sales, and I think that's the biggest difference since three months ago.

Charles Brady: Right. And so on that charge for the Iowa facility being closed was there a separate charge that you did a breakout that was a part of seven and a half-million, or was it better than that seven and a half-million that wasn't clear to me in the release?

Jim Shaw: It's part of that number.

Charles Brady: It is. Okay. And have one more, and then I'll get back in the line here. On European truck, can you remind us what kind of exposure you have to the European truck which was obviously faring -- like it would fare a little bit better than next year than the US truck market?

Jim Shaw: Brad's going to look that up Charlie and we'll get back to you here and maybe we can move to the next caller.

Charles Brady: Yep. Great. Thanks.

Tim: And we'll go next to Lawrence Alexander with Jefferies.

Dan: Hi guys this is Dan Furtado for Lawrence, how are you?

Jim Shaw: Hi. Good. How are you?

Dan: So just on just on clarification. So last quarter you announced final savings of 35 million from a restructuring. And of that announcement you - are you thinking you're going to do $30 million in - this year and then there was a second restructuring in October which will add $15 million this year. Do I have that right? Or I'm sorry, yes, $15 million this year. Is that correct?

Jim Shaw: Yes. So the first part, you've got that right, roughly $30 million of benefits this fiscal year. And then the restructuring actions that we just took here at the end of October will give another $15 to $20 million of incremental.

Dan Furtado: Okay, all right. Thank you for the clarification.

And just given and I we've talked about this in the past, but just given the current state of the macro environment, I mean we've seen more opportunities for bolt-on's and for tuck-in acquisitions.

Tod Carpenter: Dan, this is Tod. When we looked at our acquisition strategy we just looked to continue to execute our strategy. We continue to work on our pipeline which we would consider to be strategic. But we have a selective approach.

Dan Furtado: Right. And but I'm just thinking. Is there more opportunities popping up now, I mean given the way everything is?

Tod Carpenter: No. I would not say that there's more opportunities. We just continue to be diligent and thoughtful about executing on our acquisition strategy.

Dan Furtado: Okay, all right. Thank you, guys.

Brad: Hi everyone. This is Brad. Before we turn the call back to the next question, I want to answer Charlie's question. For context, our on-road business in Europe is just about 14% of our total on-road business.

So go ahead. And we can transfer to the next call.

Operator: I'll go next to Gary Farber with C.L. King.

Gary Farber: Yes. Can you just discuss, because you highlighted all the new product initiatives, give some sense of the growth that you're seeing in your own R&D budget? Is it growing that much?

And then also even if customers aren't ordering as much can you discuss also what you hear from your customers in response to their own needs for new product development?

Tod Carpenter: Sure. Gary, this is Tod. Relative to our R&D budget, our R&D budget has not changed. It remains at 2% to 3% of sales. That's been a benchmark that we hold ourselves to pretty consistently. In the little bit more headwinds on our challenged revenue moment that we're in, it's probably closer to the 3% than the midpoint.

But we continue to invest into product development. It's a significant portion of our company being a technology-led filtration company.

As far as customers in new projects, the outlook especially on liquid and air that I gave a bit earlier, in liquid, for example, we say we're talking about a backlog of $1.3 billion worth of opportunity. We've had a number of wins, over 100 wins in the last nine months for example within liquid. However that backlog, even when we subtract out the wins, continues to remain over $1 billion as new programs continue to come in across our customer base.

So our customers still are demanding new technology in both air and liquid and we continue to service them.

Gary Farber: Right, okay. And then just one more, on the cost savings that you previously announced and you're announcing today, is that a growth number and that will sort of be offset a little bit by incentive comp and things like that?

Jim: Yes. This is Jim. So the numbers that I was referring to in terms of the 30, and then the 15 to 20 are gross numbers. In my remarks I did clarify that last year we said we'd have an offset of about $20 million from incentive comp. That offset now is somewhere in the neighborhood of $11 million so yes, that its gross but then there are other offsets to that.

Gary Farber: Okay, thank you.

Operator: And we'll go next to Josh Berman with William Blair.

Josh Berman: Hi, good morning. The first thing, I guess beyond what you've announced and then what you did last year, do you see further opportunities for restructuring looking forward?

Tod: We have no further actions planned at this time. But given the outlook we continue with a watchful eye if you will to the end market uncertainties. And we'll gauge and adjust as necessary.

Within our company this is standard work as we look to control what we can control. And as I opened my remarks, operating efficiency comes to the forefront during these difficult times.

Josh Berman: Okay. And then turning to operating expenses, so like, you know, on an adjusted basis OPEX came in around like $112, $113 million in the first quarter. Is that, you know, an appropriate run rate moving forward or would you expect that to either step up or down in coming quarters?

Jim: So this is Jim. There is some variability by quarter because a certain percentage of that is variable in terms of related with sales and towards the latter half of the year we do project higher sales.

The other item is within our second quarter that is the period where we grant our options. And given the way the accounting works for those we generally take about half of the expense from that annual grant in that period so it's about $8 million or so. So the second quarter generally has a little bit higher OPEX as a percent of sales.

Josh Berman: All right, all right, thank you.

Operator: And we'll go next to Matthew Page with Gabelli & Company.

Matthew Page: Morning guys. Thanks for taking my call.

Tod: Good morning.

Jim: Good morning.

Matthew Page: If we're thinking longer term, what do you need to see before you have confidence that the off-road end markets can turn?

Tod: We're looking to see some backlog increases and more confidence out of our OE base looking for things like better vehicle production rates being forecast by our customers. Looking to see more of a commodities, a broad-based commodities increase, and that would be both in the end markets and the mining market.

So anything from iron ore to corn, we would like to see really a return to a more positive commodities outlook. That in turn would then bolster the overall production rates as well as really get the mines moving again for example.

Those are just a couple of things. On the industrial side we'd really like to see a better CAPEX spend across the industrial sectors and just essentially manufacturing utilization rates.

Now one thing I would say that we look at, when we do start to see those items we believe that the OEs will be a little bit careful to just start adding production rates.

And so consequently they'll need more than one month of that favorability before they start to act. So it could lag just a little bit on that first-fit side before we see the bounce.

Matthew Page: Right. And then I guess my second question is you purchased just over 2 million shares or about 1.5% of your outstanding in the quarter. Could you just speak to how you're thinking about repos throughout the year relative to your goal of 2% to 4%?

Jim: Yes. This is Jim. In terms of how we look at share purchases it's really a key part of our long term ability to return cash to shareholders. So in any given year we're going to give or repurchase at least 1% of our outstanding shares to offset any dilution.

And then from there it's really taking into account where we're at from a capital structure, other opportunities, other options, so we were fairly aggressive during the first quarter just given where heading into the quarter we were from a leverage ratio and other opportunities.

But, you know, we're not looking to do dramatically different than what our long term strategy is. I won't be able to comment, like we're going to do this much this quarter, but we are targeting to stay between that 2% and 4% this year versus, you know, the last couple years where we've been higher in that range or above that range actually just given where our debt structure was.

So we're going to be a little bit more conservative throughout the course of the year which is more in line with our long term averages.

Matthew Page: Great. I appreciate the time gentlemen. Enjoy Thanksgiving.

Tod: Thanks.

Operator: And we'll go next to Richard Eastman with Robert W. Baird.

Richard Eastman: Yes, good morning.

Tod: Good morning Rick.

Jim: Good morning.

Richard Eastman: Tod on the engine side of the business, the aftermarket business for Donaldson, I mean would you - could you just hang a couple percentages on the aftermarket business? You know how much of that is off-road? You know we've tended to think, you know, maybe 75% of your aftermarket engine business is off-road. Is that, you know, in the ballpark or...?

Tod Carpenter: Brad's going to break that down for you while he looks it up Rick; maybe we can talk .

Richard Eastman: Yes.

Brad: Rick yes. That's about right. About a quarter of our business is on-road in aftermarket.

Richard Eastman: Yes. Yes.

Brad: And the balance is off-road.

Richard Eastman: You know I think what steps out at you from your matrix, your engine matrix when you look at the aftermarket business is you still had pretty nice growth in both Europe and Asia on the aftermarket side, but a substantial stepdown in the U.S. and the Americas.

Is that - and with the single maybe reason for that, would it be the oil and gas and the engine filters that end up in that support market?

Tod Carpenter: Rick I'd say in the U.S. we saw a little bit more destocking across both the OE and the independent channel. So we've seen further degradation. I do believe that oil and gas clearly has some effect on that - on the reduction and we would say that it looks now to be a little bit more than we had originally expected the way that it's affecting us from vehicle utilization. Yes.

Richard Eastman: I see. Okay. Okay. And then just another question on European industrial sales, again, up 4%, and looked pretty good across the board. Is that attributed more to backlog than it is to order flow?

I mean to Jim's maybe point early in the conference call, did we, you know, kind of flush some backlog out of there? Were the orders up 4% or mid-single digits on industrial sales in Europe?

Tod Carpenter: Right. Our order intake Rick on the industrial sales in Europe has been a bright side actually. We continue to do quite well in our dust collection business in Europe. And so it was not a reducing of a backlog. That was more of a US-based phenomenon.

So we actually see some strength in Europe on the order intake in both of our aftermarket as well as the project-based work.

Richard Eastman: Very good. Okay. And then just two other things, when - Jim there was a comment in the press release about referencing the exclusion of any additional costs for the independent investigation, is that suggesting that there would be more costs? I guess this kind of trailed into November.

But would those be kind of a one-time charge off or is there some operating expense needed now to - that we need to build into the business?

Jim: The costs that are booked through or what's in the release, the $2.6 million, because most of those are professional fees that we book as incurred was through the end of October. So because the investigation did go on through part of November we do expect some additional costs.

We haven't quantified those as yet. But somewhere in the neighborhood of $1 million just given where the timing of the investigation was. But again, I don't have an exact number as of yet.

Richard Eastman: Yes. And that would be considered or at least accounted for maybe as more of a one-timer to finish that out and close that out.

Jim: Correct.

Richard Eastman: Yes. Okay. And then just maybe just one last thought Tod, given the seasonal progression of Donaldson's revenue, you know, that historically has occurred from Q1 to Q2, you know, I think some of the comments that you made in both the press release and here on the call, and again we've got some backlog reduction at least in the U.S. businesses. Obviously yearend build rates are going to come into effect on the off-road side which if there is a build rate it might be zero.

But I would presume that the seasonal revenue decline from Q1 to Q2 this year would be much larger than normal.

Is there any reason to think otherwise here?

Tod Carpenter: No. We don't believe that it's actually going to be more than normal seasonally into...

Richard Eastman: Okay.

Tod Carpenter: Q2 Rick. And the reason for that is because we had a tough couple of months last year. So from a comp standpoint of view we were a bit soft in the quarter. What does actually drive maybe the top line and I'm speaking the local currency with that comment Rick.

But when you put in FX over the top of course that may - you might interpret it as rolled up as a bit more - a bit tougher.

Richard Eastman: Yes.

Brad: Rick this is Brad. One thing I'd add is so when Jim was talking about guidance, we said the first half would be down about 10%. And we were basically down 10% in the first quarter. So Q2 is a comparable decline.

Richard Eastman: Yes, okay. That's a good thought. Okay, thank you. Thank you again and happy Thanksgiving to your families.

Tod: And thanks.

Jim: Happy Thanksgiving to you too, Rick.

Operator: We'll go next to Charles Brady with SunTrust Robinson Humphrey.

Charles Brady: And just - thanks guys. Just a quick follow-up, on your commentary on the IFS replacement, I think it was a replacement mark where you thought it was I guess transitorily or temper. I forget the word you used.

But it sounded like that that was maybe timing issues with the word you used. What gives you - what's your reasoning behind that thinking that makes you say it's a timing issue and that, you know, things really are not, you know, a little bit weaker than might be - you might be thinking?

Tod Carpenter: This is Tod. The reason that we make that comment is because we only saw that slowdown in the U.S. And specifically it was not across the balance of the comprehensive model geographically.

So we don't see it in Europe. And as we continue to execute here in the U.S. we're pretty pleased right now with the pace that we're seeing that business continue.

Charles Brady: Thank you.

Operator: And we'll go next to Stanley Elliott with Stifel.

Stanley Elliott: Hey guys. Good morning. Thank you for taking my question.

I may have missed it. Do you guys split or breakout how the restructuring should split between the businesses? Is it going to be kind of the - similar to the two-third, one-third? Is it the weakness that we've seen so far within the engine and industrial split?

Jim: Stanley this is Jim. Actually it's - I'll just give you the split here because the gas turbine portions of the charges right now are in our corporate and allocated and have not been allocated to the businesses.

So that's not within the business. But then of the remaining 7.5 about $5 million is engine and about $2.5 million is industrial.

Stanley Elliott: Okay. And then, you know, sort of the liquids opportunity I think it's been pretty interesting, you know, from a growth perspective.

I guess I've talked about the backlog. Is there any sort of kind of timeframe that you all could share when, you know, more of these projects start to roll through or is that going to be more determined on kind of what's happening at the OEM level?

Tod: As far as the first-fit wins, is that what you mean Stanley?

Stanley Elliott: Yes. You know just on the first-fit wins but then also I guess as a core layer to that, given that you're starting at a relatively smaller base with just the liquid business compared to the air business, right. Expectations, my guess would be for that to outgrow the overall portfolio. Is that a reasonable way to think about it?

Tod: It is. Our liquid growth has outpaced our air growth. Our liquid growth coming into this fiscal year for example, we were roughly ahead by one year in our strategic plan based upon the liquid wins that we've had across the company.

When we win something Stanley especially on the first-fit proprietary typically what happens is it'll be two to three years before that product on that new customer platform starts to hit that end market.

And then of course we're building that presence and therefore the aftermarket opportunity and it grows over time. The - it's the reason why that, one of the reasons why we continue to talk about PowerCore because it shows the power of the model of what we're representing by having those first-fit proprietary wins.

So that PowerCore model is essentially what the balance of our proprietary first-fit wins follows.

Stanley Elliott: And then lastly on the construction commentary and some of the softness there, you know, the construction put in place numbers have been pretty good.

Should we read through that that, what you're talking about is more relegated to construction and around energy markets and that some of the more typical and nonresidential recovery that, you know, we've seen is doing a little bit better?

Tod: The softening that we see in construction is really we're talking about from a global perspective.

So we saw additional softening in some geographies like China. We clearly see it hard in Brazil right now.

So when we roll it up comprehensively it's not necessarily driven for us by an end market in our comments to you on why we've reduced that outlook. It's more a geographic rolling up to a consolidated number at the company level.

Jim: And maybe the one thing I'll add to that is our business is heavily weighted towards the non-res versus res just given the type of equipment we're on.

Stanley Elliott: Okay, and I appreciate it. And have a great Thanksgiving.

Tod: You too.

Jim: You, too.

Operator: We'll go next to Larry Pfeffer with Avondale Partners.

Larry Pfeffer: Good morning gentlemen. I appreciate you taking my question.

Tod: Morning Larry.

Larry Pfeffer: Just some clarification on the on-road outlook. Do you have kind of an outlook for the 2016 U.S. on-road truck builds?

Tod Carpenter: What we baked into our guidance is we have in the U.S. more of a positive tone in the first half of our year and then as we get into the Calendar Year of 2016, or the second half of our fiscal year we have a more muted outlook.

So we know that in the U.S. first rate truck builds, there is a decline in the future. And we've just tried to take a more cautious approach in the second half of our fiscal year and bake that in for the U.S. markets.

Brad: And this is Brad, Larry. To some extent we're reading a lot of the same stuff you guys are as well. I mean that's obviously factoring in what our large customers are saying and what we see with ACT data.

Larry Pfeffer: Okay. And I was going to ask a question, if you're looking at ACT or something like that for a build rate so I appreciate that clarification.

You know then looking towards the - and you talked about the win rate above 75% and that could be $.5 billion of future revenues. How do you look at that in terms of how that would filter out over the next few years, and then kind of versus what an annualized obsolescence or end of product life number would be?

Tod Carpenter: So the obsolescence portion, I'll take that first. On a particular end market is of course very different from Ag to construction to mining on how that works, and even different into the on-road of course.

So we look at that as it will - the reason why we put a ten-year benchmark is because we say the product life is about ten years. And we just kind of take that line in the sand across all those markets.

So we look to continue to populate that external aftermarket across that timeframe. And that's how we measure it.

As far as a growth rate and a ramp up, we don't talk about specifically how that calculates out, just simply because especially in these difficult times production rates really are a bit more difficult to predict.

And so the models that we have—we haven't taken and broken that down and then put that directly into the guidance over the next ten years. We do have comfort though that we have enough backlog and enough products, new wins in the hopper as well as what we're working on to support our expectations for growth in the company.

Larry Pfeffer: Understood. And then, Jim, just a question, I know you mentioned in your prepared remarks on potential for lessening the currency translation impact through the facility in Poland.

Are you prepared to give kind of a - what you would expect to revise EPS sensitivity would be to the euro or any kind of just general color you could give on that?

Jim: Yes. With regards to that plant in particular we've factored that into the roughly $12 million that I mentioned so that savings is already assumed in there.

In terms of euro exposure overall about 20% of our business is euro denominated. So it's not just the euro. A lot of the basket of currencies really has an impact overall.

But the euro being the biggest one is why we call that out. But with regards to the Poland facility in particular that's already factored into the remarks I made.

Larry Pfeffer: Okay, got it. Well thank you very much guys and Happy Thanksgiving.

Tod: Thank you.

Tod: Happy Thanksgiving to you too Larry.

Operator: And at this time there are no other questions in the queue. I'll turn it back to Tod Carpenter for any closing remarks.

Tod Carpenter: That concludes today's call. I want to thank everyone for their time and interest in Donaldson. I also want to thank our employees for what they do every day to support our customers. I sincerely appreciate the tremendous amount of work and resilience they have shown during these uncertain times.

Good-bye.

Operator: That does conclude today's conference call. We appreciate your participation.

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