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PRESENTATION

Operator

Good morning. My name is Tayshaun, and I will be your conference operator today. At this time, I would like to welcome everyone to Donaldson's Third Quarter Fiscal Year 2017 Conference Call. (Operator Instructions) Thank you. I would now like to turn the call over to Brad Pogalz, Director of Investor Relations. The floor is yours.

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

Thanks, Tayshaun. Good morning, everyone, and thank you for joining Donaldson's Fiscal 2017 Third Quarter Earnings Conference Call. With me today are Tod Carpenter, President and Chief Executive Officer; and Scott Robinson, Chief Financial Officer. This morning, Tod and Scott will recap our third quarter performance, the drivers of our increased guidance for fiscal 2017 and provide an update on some of our strategic initiatives.

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. Also for reference, this morning we posted a schedule on our Investor Relations website showing the year-over-year sales change with and without the impact from currency translation. 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. - CEO, President and Director*

Thanks, Brad. Good morning, everyone. I want to begin by welcoming the Hy-Pro employees and their valued customers to Donaldson Company. With their focus on stationary applications, Hy-Pro is a strong complement to Donaldson's mobile hydraulic business. Our two companies leverage product innovation and world-class customer support to solve complex filtration problems. We're looking forward to combining our global footprint and technology with their application expertise to accelerate growth in the strategically important liquid business. I also want to thank our Donaldson employees worldwide for their contribution to our strong results. They're doing an excellent job addressing demand and meeting our customers' needs. At the same time, they are pressing forward on our strategic initiatives, further strengthening our foundation for continued success. I sincerely appreciate their hard work and commitment.

Turning now to a recap of our performance. We had another strong quarter on the top and bottom lines, driven primarily by the Engine segment. We anticipate recent trends to continue, so we increased our full year forecast for sales, operating margin and earnings. In total, we see fiscal '17 sales up approximately 6% and adjusted EPS up more than 10%. Scott will cover our guidance in a few minutes but first, I'll share some third quarter sales highlights.

Total sales increased 6.5%, with Engine up 13.5% and industrial down 5%. Compared with recent trends, our Engine first-fit businesses performed very well last quarter. In Off-Road, sales grew 27.5% to $69 million, representing the highest volume in 10 quarters. A portion of this increase is due to an easy comparison from last year, but there are a couple of other noteworthy drivers. One factor is the mix benefit from the type of equipment being produced. The largest mine haul trucks, for example, have somewhere around 20x the dollar content of an over-the-road truck. Given that dynamic, even a modest increase in production can accelerate our sales. In addition to this mix impact, we are also seeing benefits from our past program wins. We have a strong win rate in both air and liquid, and the first-fit fuel wins are almost all incremental to our business. While the volume in first-fit fuel is still relatively small, our Select Fuel offering, which leverages our innovative Synteq XP media, grew more than 20% last quarter. We saw a slight increase in On-Road last quarter, driven entirely by growth in the U.S.

While it appears this market is stabilizing, it's worth pointing out that third quarter last year was the lowest volume quarter that we had in almost 6 years. The stability we're seeing in our Engine first-fit business is complemented by continued strength in sales of replacement parts. Total Aftermarket sales were up 11% in the quarter, and that's on top of 5% growth in the same quarter last year. Once again, the strength in Aftermarket was broad-based. We had year-over-year growth in all major regions and both channels. Additionally, Partmo added about $4 million to the top line and contributed to the 50% increase we saw in our Latin America aftermarket sales. Sales in our aftermarket OE channel were up in the high single digits last quarter. We had growth in both On- and Off-Road products and sales of PowerCore were up in the low teens.

Based on what we are hearing from our customers and seeing in our data, the demand appears to be more about pull through than restocking. However, it's tough to tell, and we're closely monitoring week-to-week ordering patterns. In our independent Aftermarket channel, sales were up in the low teens. Our lube and fuel business was up in the low 20% range, driven largely by the short cycle program wins we have had in recent years. We are also benefiting from increased activity in the mining and oil and gas industries. Sales to customers with exposure to the energy sector are up meaningfully, driven by the higher amount of content required for setting up and operating these sites. Rounding out the Engine segment, Aerospace and Defense sales were up 22% last quarter, reflecting growth in both Commercial Aerospace and Defense. While our Engine businesses seem to be on firmer footing, we still have some variability within our Industrial segment. Total sales in this segment were down 5%, driven entirely by GTS.

The gas turbine market continues to be challenged by customer delays, low demand for new projects and aggressive competition. Consequently, sales into large turbine systems are below our forecast and last year. We are confident that this market has value over the long term, so we will continue to be selective in how we bid large turbine projects while pursuing growth in sales of replacement parts.

Our Industrial Filtration Solutions business is also facing soft first-fit demand. The modest increase last quarter in IFS reflected a high single-digit increase in sales of replacement parts that was offset by a commensurate decline in project sales. On the positive side, quoting activity in IFS continues to pick up in most geographies, but orders are still slow to develop. Some of this pressure is being mitigated with our innovative product offerings, such as LifeTec filters for the food and beverage industry, pleated bags that replace traditional baghouse filters and DownFlo Evolution. DownFlo Evolution brings the "razor-to-sell-razor blades" model into dust collection and it is being very well received by customers. Sales of this equipment were up more than 20% last quarter, and we continue to gain traction outside the U.S. In Asia Pacific, where we launched about 1.5 years ago, sales were up 40%.

In Special Applications, all the businesses contributed to the 12% increase, but sales of disk drive filters were the biggest driver. The growth in disk drives appears to be more of a temporary shift as hard disk drive storage is getting a short-term benefit from challenges related to the availability of, solid-state storage. That said, for years we have been working on increasing share with major customers and getting extra content per drive. The benefits from these efforts were magnified last quarter when the market headwinds moderated, but we expect that pressure will resume in the near future.

I'll now turn the call over to Scott for a discussion of our third quarter results and outlook.

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

Thanks, Tod. Good morning, everyone. As Tod said, we had another strong quarter. I'll briefly touch on the highlights, and then I'll cover the details of our increased sales and profit outlook.

Third quarter total sales were up 6.5% or 7.7% in local currency. Total operating margin increased to 14.5% from 13.1% last year. Net earnings were up 10%, and GAAP EPS grew to $0.45 from $0.41 in 2016. As a reminder, our prior year results included pretax restructuring charges of $4.1 million. Excluding the impact from restructuring in the prior year results, third quarter 2017 EPS was up $0.02, and operating margin was up 70 basis points, reflecting higher gross margin and expense leverage. There were several moving pieces in our gross margin, which was up 20 basis points on an adjusted basis. We captured some benefits from cost reduction initiatives, but higher-than-expected demand is creating a variety of incremental costs, like premium freight and overtime in our plants. The expense leverage last quarter was primarily driven by sales volume, but the benefit was partially offset by higher incentive compensation. Our other income went down by $2 million, with the difference attributable to a swing from a gain on foreign exchange last year to a loss this year. Our third quarter tax rate increased to 28.7% from 24% last year. Discrete benefits in the prior year accounted for nearly all the increase.

In terms of cash management, we feel good about our working capital in light of the higher demand. The increase in receivables and inventory levels contributed to the cash conversion rate that was below 100%, but not out of line with where we'd expect to be. Meeting our customers' needs is always a priority and the increases were in line with the momentum in the business. Finally, we returned $81.7 million to our shareholders last quarter through dividends and share repurchase, which included buying back another 1% of our outstanding shares. Once again, we are pleased with the solid third quarter results, and we anticipate a strong finish to the fiscal year.

We raised our '17 -- fiscal '17 sales forecast to plus 6%, reflecting year-over-year growth of 10% to 11% in Engine, combined with a decline of 2% to 3% in Industrial. Compared with the midpoint of prior guidance, our total sales forecast went up about 3%, or $65 million. All of that increase is attributable to Engine, which includes an incremental benefit of $6 million from the acquisition of Hy-Pro. The negative impact from currency translation also moderated over the third quarter, resulting in a full year impact that is less than a half a percentage point on total sales. In Engine, the forecast came up for all businesses. The strongest year-over-year growth is coming from Off-Road and Aftermarket which are both expected to be up in the low teens. While the growth in Off-Road is encouraging, our full year forecast puts us at about 2/3 of the peak volume, and it is still below where we were just 2 years ago.

The Aftermarket forecast is a different and very positive story. Based on growth of innovative products, our geographic diversification and roughly $19 million of inorganic contribution from recent acquisitions, we are forecasting Aftermarket sales to be at a record-setting level this year. Sales of On-Road products are expected to be down in the low double-digit range, which is better than our prior forecast because of increased stability in North America. Lastly, in Engine, we expect full year A&D sales to be up in the mid-single digits, a modest increase from prior guidance as we fine-tune the forecast. Our Industrial sales guidance came down slightly, driven by GTS. Based on a strategic shift we made last year, market conditions and competitive dynamics, we now see GTS sales declining in the 20% range. We expect sales of Special Applications will be down low single digits, whereas we're forecasting IFS sales up in the low single digits.

We also raised the midpoint of our operating margin forecast by 20 basis points. We now expect to deliver a margin of 14% to 14.4%. The sales leverage on our fixed expenses is giving us some tailwind, but pressures from a handful of items, including the costs associated with meeting higher-than-expected demand and incentive compensation moderate the incremental gains. Based on the midpoint of our guidance, the implied incremental margin for FY '17 is in the low 30% range, reflecting an incremental rate of 50% in the first half and about 20% in the back half. As a reminder, the first half rate was driven up by a couple of factors, but -- with the most notable being a very easy comparison from the prior year. Additionally, the faster than expected sales pick up in the second quarter gave us extra leverage as our associated expenses lagged demand. We feel that the back half rate is more typical of what we'd expect over the long term. Of course, the incremental rate will vary from quarter-to-quarter and by fiscal year, and it's largely dependent on what's happening with the sales and our level of investment back into the company. Tod will provide an update on some of our strategic investments in a few minutes to let me hit on a few of the other metrics in our fiscal '17 guidance.

We expect a tax rate of 27.7% to 28.7% and our other income is now forecast between $10 million and $15 million. We still see CapEx between $60 million and $70 million, but we revised our cash conversion guidance down to 100% to 110% to account for the increased working capital needs.

We are still planning to repurchase between 2% and 3% of our outstanding shares this year. Altogether, we now expect adjusted EPS between $1.67 and $1.71. The midpoint of this range is 11% above last year's adjusted EPS and 3% of the midpoint of our prior guidance range. As a reminder, GAAP EPS includes a benefit of $0.05 from an escrow settlement in the first quarter, so full year GAAP results will be above adjusted EPS by that amount. In addition to tightening up our FY '17 forecast, we are in the early stages of planning fiscal '18. Given the recent momentum, we thought it will be helpful to share some of the items we are contemplating in the process. I'll forewarn you that I'm going to keep my discussion and any answers to your questions at a high level. We'll provide a detailed outlook when we release our fourth quarter earnings in a few months.

Starting with sales. Our analysis of the Engine end market, which is influenced by trends in our business, third-party data and external customer forecasts, suggests the recent stabilization should continue through at least this calendar year. Should that hold true, it's likely that both production and equipment utilization will be up in our FY '18. The degree of the increase will vary based on several factors, including the type of equipment, the geography where it's being used or produced and the impact from used equipment already in the field. Above all, economic conditions will drive the performance. The outlook in our industrial markets is cloudier, but forecast for durable goods manufacturing is positive, and PMI has been trending over 50 for nearly a year. What we have yet to see is a meaningful shift in global CapEx spending that stimulates project growth, so we will be closely watching trends over the coming months. We still have a lot of work to do on profit projections, but I wanted to share a few of the items we're contemplating in our plan.

There are a handful of tailwinds for FY '18 operating margin, including a lower incentive comp as we reset the annual bonus plans and some relief from the incremental costs associated with higher-than-expected demand. We expect a portion of these benefits will be offset by sales, driving and technology-related investment. It's too soon to comment on the net effect these puts and takes will have on next year's operating margin, but we will be disciplined in our investments and our long-term commitment is to generate incremental profit on increasing sales. We will also maintain a keen focus on our balance sheet next year. I am pleased with the progress we made, and I am confident in our employees' ability to keep driving improvement as we continue to leverage our global ERP and centralized key functions. Our cautious approach to planning this year left us in an excellent position to capture margin while minimizing the risk of reactionary cost cutting. We will take a similar approach next year to ensure we're investing for growth and generating the best returns on our invested capital.

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

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Thanks, Scott. We are encouraged by the stability in the Engine end markets, but the variability between our segments remind us that we are still in a mixed operating environment.

As we look forward, we expect the recovery to be choppy, especially in our Industrial segment, so we will plan cautiously. At the same time, we're making strategic investments in sales driving initiatives, expanding our technology portfolio and strengthening our infrastructure. The most obvious investment to drive near-term growth is adding sales staff to the businesses where we can grow first-fit and/or replacement part sales. Additionally, we are seeking to accelerate growth in some of our newer product offerings, such as Venting Solutions and the LifeTec filters for the food and beverage industry.

We also began building an e-commerce platform this year. We are complete with the design phase and are into the application build phase. We expect to launch next fiscal year in select businesses. This platform will make it even easier to engage with Donaldson for new and existing customers.

In terms of our technology, we will scale up our R&D investment. We have historically spent between 2% and 3% of sales, and we expect to increase that to somewhere between 3% and 4% over the coming years. We want to further widen our technology gap by developing best-in-class media, innovative form factors and new filtration processes.

Another technology focus is connectivity. End users are looking for more ways to efficiently manage their equipment, and we believe Donaldson can play an important role in their quest. We are very early in this process, but one tactic to drive this strategy is leveraging our acquisition last year of EPC and their Filter Minder brand. This company brought a well-known brand, and it had a strong focus on sensors and indicators, so we made it a center of excellence for our Engine business. We will look for ways to integrate this technology into the filtration solution as we believe our customers would value that option.

Finally, we are planning to strengthen our infrastructure for future growth by making people-related and capacity investments. In terms of our people, we will begin work on a global HR system. Much like the business case for our global ERP project, we are confident that a single tool and consistent approach will advance us towards our goal of being a world-class employer. Additionally, we are looking to expand our production infrastructure by adding capacity to certain product lines, with a particular focus on our innovative offerings, like PowerCore and liquid.

Every one of these broad priorities and the tactics associated with them supports our strategic objectives. We will leverage our technology to drive first-fit revenue that drives sales of Aftermarket Products. We will continue to focus on diversification, both in terms of end markets and geographies. And we will actively manage our M&A pipeline to identify, engage and acquire companies that help us accelerate the progress on our strategic objectives.

We've been executing on all of these tactics during the downturn and the recent stabilization gives us an opportunity to accelerate plans in certain areas. We will maintain the disciplined approach we have applied for years, so I want to clearly state that we are not expecting to take a step backwards in terms of operating margin. As Scott said, we expect to deliver incremental profit on growing sales. Our goal is to self-fund these investments by prioritizing our expenses and redirecting a portion of that incremental profit we expect to generate. I'm confident that these actions are necessary and appropriate as we further strengthen our foundation for the long term success of our company.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of George Godfrey with CL King.

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

Really nice revenue growth and total revenue coming in over $600 million. I would've thought the gross margin would've been just a tad higher on such a strong performance on the top line. Could you talk about the first-fit products or specific platforms perhaps that are pressuring the gross margin on such a strong revenue number?

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

Yes, George. This is Scott. I can take that. So in terms of gross margin, I wouldn't say it was related to any one particular product category. As we said, there was some gross margin pressures with the accelerated demand. We had a little bump in overtime costs as well as freight. And we also had a tough comp from last year. So those couple of factors, I would say, is what drove the -- probably the point that you're thinking about.

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

Got it. And then just a follow-up. This morning, Deere announced they're buying Wirtgen Group for $5 billion and focusing more on construction. Do you have a relationship with that company? And if so, is it meaningful or does the Deere open up that door?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

This is Tod. We do have a relationship with them. They are a customer of ours, and we enjoy a nice position. The Deere relationship really just further strengthens between the two companies, what we already enjoy with both of them.

Operator

And your next question comes from the line of Charley Brady with SunTrust Robinson Humphrey.

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

Just on the ERP system, that is essentially done, from what I understand. Can you just talk a little bit about kind of leveraging that as you go through -- you spent the past few years -- 3, 4 years engaged in that in a pretty heavy way and now it's kind of essentially behind you with some small blocking and tackling. But how do you leverage that going forward? I think in the past, you've talked some opportunities, but maybe just a little more granular on where you can take that and what that can mean to margins over, say, a 2- or 3-year period?

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

Sure. This is Scott. So yes, we talked about our ERP implementation quite a bit. We spent 4 years and approximately $90 million on that implementation to convert the company to Oracle R12. Our last conversion was completed on the first day of this fiscal year, so that brings the company onto a single platform. And we feel that we have a long runway of opportunity to have better information, to manage global processes, to standardize processes and to be able to leverage that into a stronger performance of the company. So we're on a long journey of creating centers of excellence and standardizing our processes to both be faster and have better information. We've used the leverage of that system already in our cost-cutting initiatives and we think we have a long runway to continue that. We're not going to make changes overnight. It's going to be slow and steady. We'll win that race, and I think we have a long runway to leverage that and make the company operate more efficiently. Tod mentioned, we want to increase our R&D spend, but we don't want to take profitability backwards to do that. We would envision reducing our transaction processing costs, and leveraging some of those dollars into investments to further the company. Also, that system allowed us to begin the e-commerce project this year, which comes right on the heels of finishing the ERP because we needed a global ERP to link the new e-commerce system into. It also facilitates the HR project that Tod mentioned, because we want to link either an Oracle or another HR system all to R12.

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

And just as a quick follow-up. In the commentary about adding additional capacity to product lines, like PowerCore and liquids, are you talking about building out capacity in an existing footprint that you have? Or is this additional brick and mortar footprint that gets put down?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

This is Tod. Typically, there's both options available to us. Right now, we're looking at adding capacity in our current footprint for both of those as we continue to support growth. Longer-term, we have a region-for-region based operations strategy. And so we look for -- for example, EMEA to support all the EMEA-based customers, APAC to support all the APAC customers. And so longer term, over a 5-year period, we'll look likely to add bricks and mortar over time. But in the near term, it's more expanding to meet the current demand within the current footprints that we have.

Operator

And your next question comes from the line of Jim Giannakouros with Oppenheimer.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Tacking onto that, I think Charles just was asking just about EMEA, but I wanted to focus specifically on China. Curious as to what you're seeing specifically there. And if there are any changes to your approach there, recalling you were pulling back investments there maybe a year or two ago-was when I think you announced that.

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Jim, this is Tod. We have seen a bit of a pickup in China, mid-single-digit increases, for example, in the queue. But nothing that would suggest that we're going to pick up CapEx spending within that particular region or that the customer demand is driving the need to do so. So still remaining on the current strategy, which is a bit more cautious. But longer term, China remains strategically very important for the company.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

And independent Aftermarket, I think you said up low teens. And I believe that's more reflective of end-market demand versus restocking, if I [piece your] comments of this quarter and last quarter appropriately. Are you seeing that more in Off-Road or in On-Road? And can you talk about sequential trends versus, say, year-over-year comps influencing that double-digit increases that you now posted?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

This is Tod again. It's really broad-based. It's across all regions. It's low double-digits at a minimum, across all regions, across Off-Road, certainly driving the higher of the two. But in On-Road, for example, in the Americas, we saw a nice uptick as well. So it's pretty broad-based regionally, and now we're starting to see On-Road even enter the picture. But I would say, it's more heavily weighted Off-Road right now.

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

Jim, this is Brad. I'll add to that, that -- your question about sequential, both On- and Off-Road in that channel were up sequentially as well, high-single, low-double range.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Anything above and beyond what you would expect from a seasonal perspective there, Brad, Tod?

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

I think it was the normal seasonality. What was unique was the baseline and that Q2 was very inflated from the restocking. I think that's the thing we were all watching, and you guys included is, what's going to happen after that big bulge of restocking in second quarter and to see the momentum continue was good for us.

James Giannakouros - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Last one, if I may. Hard disk drives. Appreciating that you probably expect continued pressures there as we do there beyond the near-term benefits, you're citing and the industry is citing. How would you frame your desire or willingness to stay in what is apparently a secularly declining market? Is it a margin or a cash flow contributor, such that staying there makes sense? Or given where you are in your cycle, let's say, in Engine, does it make more sense to make some portfolio moves into higher growth and/or margin areas, where you can leverage your current channel, et cetera?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Yes. So we enjoy a strong position in the market within our disk drive business. We understand that, that is an industry under secular pressure. It will continue to decline for years to come, but it will not go away. That business will not eviscerate. So we look at it as a cash cow. We run it to make sure that it's very efficient. But also, to stay in the #1 position, and it has continued to spin-off new technologies and new technology concepts for us as the demands from the customer base continued to remain high. So we like that business for a lot of reasons, but we do run that as a cash cow type of a business.

Operator

And your next question comes from the line of Brian Drab with William Blair.

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

I just wanted to start with just pointing out that, obviously, the tone on this call is much different from the 2Q call, where I think on the 2Q call, the message was one data point isn't a trend and we're cautious on the outlook -- cautiously optimistic. Today, clearly, I think it's -- we've got 2 really good quarters logged and -- but it sounds like you're able to look out farther, and Scott made the comments on fiscal 2018. Is that just the results we're seeing from CAT and Deere? And can you add a little more color as to what is giving you the -- what I'm interpreting as optimism on the medium-term outlook now?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

This is Tod. So if you look at our customer base and -- the Deere, the CAT, even Cummins, when they talk about engines produced, all 3 of those raised their recent guidance for the balance of this calendar year. So we'd point to them as really good data points that suggest people are feeling a bit more positivity for the balance of this calendar year. For us, short term, we've got three more months to go. We've got another quarter here, we'll end our fiscal year. But we'll take all those data points at that time, and we'll come out in a -- in about three months or so and bake that in and give you full year guidance past, obviously, the calendar year. But right now, there's certainly a bit more optimism across our customer base, and you're seeing that through some of the end market increase, and therefore, our numbers.

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

And then, we don't get a great look into what's happening at Clarcor anymore. But they had recently introduced channel flow product that they made -- that they claim is going to be a perfect replacement for PowerCore in some SKUs. I'm wondering if you could tell us anything about whether you're seeing them in the market. And secondarily, is that product being on the shelves at distributors giving you the opportunity to put PowerCore product into the broader independent distribution channel and maybe resulting in any measurable uptick in your aftermarket business as you stock that product?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

So as we look at PowerCore for year-to-date in the replacement parts area, where Clarcor's entry would compete, we're up in the high teens year-over-year. So we're really proud and comfortable with our position there. They have really released that to a small subset of parts. And so therefore, in really keeping with our strategy and teaming with our OEs, we will continue to honor our strategy of razors to sell razor blades and support them to help them acquire there aftermarket wherever possible. The fact that they had -- that Clarcor have put just a couple of part numbers out there does not throw the channel wide open at this time.

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

Okay, that's helpful. And then this is going to be a reach, but I'm just going to ask it. Is there a chance in fiscal 2018 or a level of revenue growth, where if achieved, that you could generate above 15% operating margin?

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

Yes. I would say that's a bit of a reach at this point. We're still working through our plan. We're committed to delivering incremental profit on revenue growth. We have some unique factors that I talked about earlier in my script. And I promise, we'll roll that all together and we'll give you the best information we can come the fourth quarter earnings release.

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

Okay. And just to be -- I want to make sure this is clear. We're saying -- I was saying it's a reach in asking that question trying to get you to say something and then you acknowledged it -- you're not saying that the margin level's a reach, you're saying my question is a reach?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Yes. We would agree with you, your question is a reach.

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

Right. I just wanted to make that clear in the transcript.

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

It's a fair clarification, and a good one.

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Thanks Brian.

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

Thank you.

Operator

And your next question comes from the line of Laurence Alexander with Jefferies.

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

This is Dan Rizzo on for Laurence. If we back out gas turbines and Specialty Applications, it seems like your sales grew 10% in Q3, 11% in Q2 compared to 2% in Q1. Is there any reason why you can't sustain mid-single-digit growth once you lap the step up in Q2?

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

You lost me in the math, Dan. Sorry about that. This is Brad.

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

Sorry. So if we back out gas turbine and Specialty Applications, I think sales were up 10% in Q3, 11% in Q2, up from 2% in Q1. Is there any reason why we can't sustain mid-single-digit growth once we lap the step up in Q2?

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

In aggregate?

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

Yes.

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

Yes. Well, our full year guide -- I mean, I'm looking at a total number, but the implied Q4 guide is up in the high singles, if you just pick apart the math. I haven't done the subtractions that you're talking about, but I mean, clearly, gas turbine is a lot of noise in the system. The implied guide on that is in the down 20% range. So...

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Maybe -- this is Tod. I would add also that if you're going to take a look at full year and go from Q2 to Q3, we do have some acute events on the Engine side, on the restocking that we would have to normalize looking forward, so that would tamp that down just a little bit. We can't just roll it all in. I mean, Brad could do some activities [in order] to try to figure that out going forward. We've not done that suggestive math that you're pointing to.

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

No, that's actually very helpful. And then, a longer term question. Can you please update us on how do you think electric vehicles could affect your business, both near term and over the next decade or so?

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

Yes. This is Tod. So we look at the electrification question, obviously, very closely in light of Europe and some of the legislation that's going on there for the inner city electric buses as well as small vehicles, for example, small construction equipment and some cities in Europe would likely have to move away from diesel, it's an important question for us. However, when we look toward electrification, while electric will win and displace some diesel engines, it'll likely enter into the smaller diesel engine sector. And at best, going to more of the return to home type of a vehicle. So for example, it may win some share in a garbage truck, for example, or something like that, that returns in municipalities to a home base. But overall, there has to be a much greater technology advance for electrification to win in the heavy-duty diesel engines. So electrification has a place in the future, but it is going to take decades to really displace much of the overall diesel engine shares that we see out there today. But it will have a small entry point. All forecasting that you see today, even taking into account worst-case situations, worst case being electrification has a breakthrough, et cetera, would suggest diesel engines are still going to grow across the world for decades to come.

Operator

And this concludes today's Q&A session. I'll now turn the call back over to Tod Carpenter for closing remarks.

Tod E. Carpenter - *Donaldson Company, Inc. - CEO, President and Director*

That concludes today's call. I want to thank everybody for their time and interest in our company. I also want to thank our employees again. I am very appreciative of their efforts, and I look forward to a strong finish to our fiscal '17. Goodbye.

Operator

And this concludes today's conference call. You may now disconnect.