

DONALDSON CO INC  
Form 10-Q  
June 03, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

- ☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED APRIL 30, 2008 OR  
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_.

Commission File Number 1-7891

DONALDSON COMPANY, INC.

(Exact name of registrant as specified in its charter)

<b>Delaware</b>	<b>41-0222640</b>
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

**1400 West 94th Street**  
**Minneapolis, Minnesota 55431**

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(952) 887-3131**

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$5 Par Value 77,845,522 shares as of April 30, 2008.

## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

#### DONALDSON COMPANY, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Thousands of dollars, except share and per share amounts)

(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2008	2007	2008	2007
Net sales	\$ 587,760	\$ 483,988	\$ 1,625,099	\$ 1,394,147
Cost of sales	399,494	334,166	1,100,784	959,243
Gross margin	188,266	149,822	524,315	434,904
Operating expenses	124,744	99,649	346,379	288,163
Operating income	63,522	50,173	177,936	146,741
Other income, net	(2,567)	(1,889)	(4,589)	(5,796)
Interest expense	4,239	4,181	12,555	10,298
Earnings before income taxes	61,850	47,881	169,970	142,239
Income taxes	15,863	7,734	46,590	34,812
Net earnings	\$ 45,987	\$ 40,147	\$ 123,380	\$ 107,427
Weighted average shares outstanding	78,633,945	79,922,357	79,406,931	80,672,942
Diluted shares outstanding	80,525,835	81,826,193	81,398,771	82,671,646
Basic earnings per share	\$ .58	\$ .50	\$ 1.55	\$ 1.33
Diluted earnings per share	\$ .57	\$ .49	\$ 1.52	\$ 1.30
Dividends paid per share	\$ .11	\$ .09	\$ .31	\$ .27

See Notes to Condensed Consolidated Financial Statements.

## DONALDSON COMPANY, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Thousands of dollars, except share amounts)

(Unaudited)

	April 30, 2008	July 31, 2007
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 53,277	\$ 55,237
Accounts receivable, less allowance of \$7,992 and \$6,768	419,849	357,341
Inventories	260,462	201,221
Prepays and other current assets	74,544	59,845
Total current assets	808,132	673,644
Property, plant and equipment, at cost	886,093	796,364
Less accumulated depreciation	(480,329)	(431,931)
Property, plant and equipment, net	405,764	364,433
Goodwill	133,270	124,607
Intangible assets	47,291	46,301
Other assets	119,088	110,032
Total Assets	\$ 1,513,545	\$ 1,319,017
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Short-term borrowings	\$ 108,737	\$ 123,114
Current maturities of long-term debt	32,899	33,667
Trade accounts payable	196,874	173,862
Other current liabilities	159,386	128,301
Total current liabilities	497,896	458,944
Long-term debt	177,362	129,004
Deferred income taxes	35,179	37,624
Other long-term liabilities	73,416	68,747
Total Liabilities	783,853	694,319
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock, \$1 par value, 1,000,000 shares authorized, no shares issued		
Common stock, \$5 par value, 120,000,000 shares authorized, 88,643,194 issued	443,216	443,216
Retained earnings	493,723	387,257
Stock compensation plans	23,385	20,821
Accumulated other comprehensive income	119,489	70,008
	(350,121)	(296,604)

	<b>April 30, 2008</b>	<b>July 31, 2007</b>
Treasury stock, at cost 10,704,214 and 9,500,372 shares at April 30, 2008 and July 31, 2007, respectively		
<b>Total Shareholders' Equity</b>	<b>729,692</b>	<b>624,698</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 1,513,545</b>	<b>\$ 1,319,017</b>

See Notes to Condensed Consolidated Financial Statements.

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## DONALDSON COMPANY, INC. AND SUBSIDIARIES

### CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of dollars)  
(Unaudited)

	<b>Nine Months Ended April 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>OPERATING ACTIVITIES</b>		
Net earnings	\$ 123,380	\$ 107,427
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	41,850	35,498
Changes in operating assets and liabilities	(53,541)	(66,518)
Tax benefit of equity plans	(6,588)	(5,041)
Stock option expense	3,762	3,127
Other, net	(5,050)	(27,665)
Net cash provided by operating activities	103,813	46,828
<b>INVESTING ACTIVITIES</b>		
Net expenditures on property and equipment	(52,109)	(52,933)
Acquisitions, investments and divestitures, net	(2,475)	(40,299)
Net cash used in investing activities	(54,584)	(93,232)
<b>FINANCING ACTIVITIES</b>		
Purchase of treasury stock	(69,284)	(61,890)
Proceeds from long-term debt	50,140	1,036
Repayments of long-term debt	(5,785)	(5,652)
Change in short-term borrowings	(17,807)	125,641

	<b>Nine Months Ended April 30,</b>	
Dividends paid	(24,428)	(21,659)
Tax benefit of equity plans	6,588	5,041
Exercise of stock options	5,672	5,045
Net cash provided by (used in) financing activities	(54,904)	47,562
Effect of exchange rate changes on cash	3,715	1,584
Increase (decrease) in cash and cash equivalents	(1,960)	2,742
Cash and cash equivalents - beginning of year	55,237	45,467
Cash and cash equivalents - end of period	\$ 53,277	\$ 48,209

See Notes to Condensed Consolidated Financial Statements.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### Note A Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Donaldson Company, Inc. and subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Certain amounts in prior periods have been reclassified to conform to the current presentation. The reclassifications had no impact on the Company's net earnings or shareholders' equity as previously reported. Operating results for the three and nine month periods ended April 30, 2008 are not necessarily indicative of the results that may be expected for future periods. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended July 31, 2007.

### Note B Inventories

The components of inventory as of April 30, 2008 and July 31, 2007 are as follows (thousands of dollars):

	<b>April 30, 2008</b>	<b>July 31, 2007</b>
Materials	\$ 106,239	\$ 87,490
Work in process	29,046	19,793
Finished products	125,177	93,938

	<b>April 30, 2008</b>	<b>July 31, 2007</b>
Total inventories	\$ 260,462	\$ 201,221

**Note C** Accounting for Stock-Based Compensation

Under Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payment Revised 2004*, stock-based employee compensation cost is recognized using the fair-value based method for all new awards granted after August 1, 2005. Compensation costs for unvested stock options and awards that were outstanding at August 1, 2005, are recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under the pro-forma disclosures under SFAS 123. The Company determined the fair value of its option awards using the Black-Scholes option pricing model. The following assumptions were used to value the options granted during the nine months ended April 30, 2008 (there were no options granted during the three months ended April 30, 2008): range of 3 months to 8 year expected life; expected volatility range of 15.2 percent to 21.7 percent; risk-free interest rate range of 2.9 percent to 4.2 percent and annual dividend yield of 1.0 percent. The expected life selected for options granted during the period represents the period of time that the options are expected to be outstanding based on historical data of option holder exercise and termination behavior. Expected volatilities are based upon historical volatility of the Company's stock over a period at least equal to the expected life of each option grant. Option grants are priced at the fair market value of the Company's stock on the date of grant. The weighted average fair value for options granted during the nine months ended April 30, 2008 and 2007 was \$10.75 per share and \$7.87 per share, respectively. For the three months and nine months ended April 30, 2008, the Company recorded pretax compensation expense associated with stock options of \$0.4 million and \$3.8 million, respectively, and recorded \$0.2 million and \$1.4 million of related tax benefit, respectively. For the three months and nine months ended April 30, 2007, the Company recorded pretax compensation expense associated with stock options of \$0.3 million and \$3.1 million, respectively, and recorded \$0.1 million and \$1.2 million of related tax benefit, respectively.

The following table summarizes stock option activity during the nine months ended April 30, 2008:

	<b>Options Outstanding</b>	<b>Weighted Average Exercise Price</b>
Outstanding at July 31, 2007	5,744,275	\$ 23.09
Granted	447,703	\$ 42.88
Exercised	(721,672)	\$ 20.73
Canceled	(10,781)	\$ 26.03
Outstanding at April 30, 2008	5,459,525	\$ 25.02

The total intrinsic value of options exercised during the nine months ended April 30, 2008 and 2007 was \$16.1 million and \$17.4 million, respectively.

The following table summarizes information concerning outstanding and exercisable options as of April 30, 2008:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$5 to \$15	1,099,192	1.85	\$ 11.69	1,099,192	\$ 11.69
\$15 to \$25	1,366,773	4.05	\$ 18.02	1,366,773	\$ 18.02
\$25 to \$35	2,359,038	5.94	\$ 31.13	2,183,225	\$ 30.91
\$35 and above	634,522	9.28	\$ 40.48	368,738	\$ 41.12
	5,459,525	5.03	\$ 25.02	5,017,928	\$ 23.94

At April 30, 2008, the aggregate intrinsic value of shares outstanding and exercisable was \$101.6 million and \$98.8 million, respectively.

As of April 30, 2008, there was \$3.2 million of total unrecognized compensation cost related to non-vested stock options granted under the 2001 Master Stock Incentive Plan. This unvested cost is expected to be recognized during the remainder of fiscal 2008, fiscal 2009, fiscal 2010 and fiscal 2011.

#### Note D Net Earnings Per Share

The Company's basic net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares. The Company's diluted net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares and dilutive shares relating to stock options, restricted stock and stock incentive plans. Certain outstanding options were excluded from the diluted net earnings per share calculations because their exercise prices were greater than the average market price of the Company's common stock during those periods. For both the three and nine months ended April 30, 2008 there were 228,548 options excluded from the diluted net earnings per share calculation. For both the three months and nine months ended April 30, 2007 there were 10,000 options excluded from the diluted net earnings per share calculation.

The following table presents information necessary to calculate basic and diluted net earnings per common share (thousands, except per share amounts):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2008	2007	2008	2007
Weighted average shares outstanding basic	78,634	79,922	79,407	80,673
Diluted share equivalents	1,892	1,904	1,992	1,999
Weighted average shares outstanding diluted	80,526	81,826	81,399	82,672

		<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 30,</b>	
Net earnings for basic and diluted earnings per share computation		\$ 45,987	\$ 40,147	\$ 123,380	\$ 107,427
Net earnings per share	basic	\$ .58	\$ .50	\$ 1.55	\$ 1.33
Net earnings per share	diluted	\$ .57	\$ .49	\$ 1.52	\$ 1.30
<u>Note E</u> Shareholders Equity					

The Company reports accumulated other comprehensive income as a separate item in the shareholders equity section of the balance sheet.

Total comprehensive income and its components are as follows (thousands of dollars):

	<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net earnings	\$ 45,987	\$ 40,147	\$ 123,380	\$ 107,427
Foreign currency translation gain	22,675	17,254	49,167	23,463
Net gain (loss) on hedging derivatives, net of deferred taxes	291	(297)	69	192
Reduction in pension liability, net of deferred taxes	56		245	
Total comprehensive income	\$ 69,009	\$ 57,104	\$ 172,861	\$ 131,082

Total accumulated other comprehensive income and its components at April 30, 2008 and July 31, 2007 are as follows (thousands of dollars):

	<b>April 30, 2008</b>	<b>July 31, 2007</b>
Foreign currency translation adjustment	\$ 130,556	\$ 81,389
Net loss on hedging derivatives, net of deferred taxes	(138)	(207)
Pension liability, net of deferred taxes	(10,929)	(11,174)
Total accumulated other comprehensive income	\$ 119,489	\$ 70,008

During the third quarter of fiscal 2008, the Company repurchased 0.5 million shares for \$20.7 million at an average price of \$41.35 per share. The Company repurchased 1.7 million shares for \$69.3 million at an average price of \$40.67 per share during the first nine months of fiscal 2008. As of April 30, 2008 the Company had remaining authorization to repurchase up to 2.3 million shares pursuant to the current authorization.



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The Company has two reportable segments, Engine Products and Industrial Products, that have been identified based on the internal organization structure, management of operations and performance evaluation. Corporate and Unallocated includes corporate expenses determined to be non-allocable to the segments, interest income and expense and non-operating income and expenses. Segment detail is summarized as follows (thousands of dollars):

	<b>Engine Products</b>	<b>Industrial Products</b>	<b>Corporate and Unallocated</b>	<b>Total Company</b>
<b>Three Months Ended April 30, 2008:</b>				
Net sales	\$ 324,992	\$ 262,768		\$ 587,760
Earnings before income taxes	43,456	25,997	(7,603)	61,850
<b>Three Months Ended April 30, 2007:</b>				
Net sales	\$ 276,660	\$ 207,328		\$ 483,988
Earnings before income taxes	35,581	17,801	(5,501)	47,881
<b>Nine Months Ended April 30, 2008:</b>				
Net sales	\$ 902,488	\$ 722,611		\$ 1,625,099
Earnings before income taxes	115,279	70,429	(15,738)	169,970
Assets	614,229	581,193	318,123	1,513,545
<b>Nine Months Ended April 30, 2007:</b>				
Net sales	\$ 793,924	\$ 600,223		\$ 1,394,147
Earnings before income taxes	102,125	51,135	(11,021)	142,239
Assets	532,532	504,377	264,035	1,300,944

There were no Customers over 10 percent of net sales for the three and nine months ended April 30, 2008. There were no Customers that made up 10 percent or more of net sales for the three months ended April 30, 2007. Sales to one Customer accounted for 11 percent of net sales for the nine months ended April 30, 2007. There were no Customers over 10 percent of gross accounts receivable as of April 30, 2008 and 2007.

**Note G** Goodwill and Other Intangible Assets

The Company's most recent annual impairment assessment for goodwill was completed during the third quarter of fiscal 2008. The results of this assessment showed that the fair values of the reporting units to which goodwill is assigned continue to be higher than the book values of the respective reporting units, resulting in no goodwill impairment. The Company has allocated goodwill to its Industrial Products and Engine Products segments. The current year addition to the Industrial Products segment is a result of the acquisition of LMC West, Inc. on February 2, 2008. Pro forma financial results are not presented as the acquisition is not material to the Company's financial results. Following is a reconciliation of goodwill for the nine months ending April 30, 2008 (thousands of dollars):

	<b>Engine Products</b>	<b>Industrial Products</b>	<b>Total Goodwill</b>
Balance as of August 1, 2007	\$ 17,912	\$ 106,695	\$ 124,607
Acquisition activity		723	723
Foreign exchange translation	1,137	6,803	7,940
Balance as of April 30, 2008	\$ 19,049	\$ 114,221	\$ 133,270

As of April 30, 2008 other intangible assets were \$47.3 million, a \$1.0 million increase from the balance of \$46.3 million at July 31, 2007. The increase in other intangible assets is due to acquisition activity and foreign exchange translation partially offset by amortization.

Note H Guarantees

The Company and its partner, Caterpillar, Inc., in an unconsolidated joint venture, Advanced Filtration Systems Inc., guarantee certain debt of the joint venture. As of April 30, 2008, the joint venture had \$18.0 million of outstanding debt of which the Company guarantees half.

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The Company estimates warranty costs using standard quantitative measures based on historical warranty claim experience and evaluation of specific Customer warranty issues. Following is a reconciliation of warranty reserves for the nine months ended April 30, 2008 and 2007 (thousands of dollars):

	<b>April 30, 2008</b>	<b>April 30, 2007</b>
Beginning balance	\$ 8,545	\$ 8,789
Accruals for warranties (including changes in estimates)	5,983	5,811
Less settlements made during the period	(2,151)	(5,432)
Ending balance	\$ 12,377	\$ 9,168

At April 30, 2008, the Company had a contingent liability for standby letters of credit totaling \$18.5 million that have been issued and are outstanding. The letters of credit guarantee payment to third parties in the event the Company is in breach of specified bond financing agreement and insurance contract terms as detailed in each letter of credit. At April 30, 2008, there were no amounts drawn upon these letters of credit.

Note I Employee Benefit Plans

The Company and certain of its subsidiaries have defined benefit pension plans for many of their hourly and salaried employees. The domestic plans include plans that provide defined benefits as well as a plan for salaried workers that provides defined benefits pursuant to a cash balance feature whereby a participant accumulates a benefit comprised of a percentage of current salary that varies with years of service, interest credits and transition credits. The international plans generally provide pension benefits based on years of service and compensation level.

Net periodic pension costs for the Company's pension plans include the following components (thousands of dollars):

	<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Service cost	\$ 3,703	\$ 3,670	\$ 11,027	\$ 11,343
Interest cost	3,656	3,499	10,910	10,625
Expected return on assets	(5,935)	(5,098)	(17,748)	(15,370)
Transition amount amortization	43	32	120	490
Prior service cost amortization	107	88	320	264

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
Actuarial (gain)/loss amortization	(22)	287	(70)	858
Settlement and curtailment gain				(1,949)
Total periodic benefit cost	\$ 1,552	\$ 2,478	\$ 4,559	\$ 6,261

The Company's general funding policy for its pension plans is to make at least the minimum contributions as required by applicable regulations. Additionally, the Company may elect to make additional contributions up to the maximum tax deductible contribution. For the nine months ended April 30, 2008, the Company made \$9.4 million in contributions to its non-U.S. pension plans. The Company has not made and does not anticipate making any contributions to its U.S. pension plans in the current year and estimates that it will contribute up to an additional \$0.6 million to its non-U.S. pension plans during the remainder of fiscal 2008.

#### Note J Commitments and Contingencies

The Company is not currently subject to pending litigation other than litigation which arises out of and is incidental to the conduct of the Company's business. All such matters are subject to many uncertainties and outcomes that are not predictable with assurance. The Company does not consider any of such proceedings which are currently pending to be likely to result in a material adverse effect on the Company's consolidated financial position or results of operation.

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#### Note K Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, on August 1, 2007. The new standard defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authorities based solely on the technical merits of the position. If the recognition threshold is met, the tax benefit is measured and recognized as the largest amount of tax benefit that in the Company's judgment is greater than 50 percent likely to be realized. As a result of the implementation of FIN 48, the Company recognized a \$0.3 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the August 1, 2007 balance of retained earnings.

As of the FIN 48 adoption date of August 1, 2007, the total unrecognized tax benefits were \$28.2 million, and accrued interest and penalties on these unrecognized tax benefits totaled \$4.8 million. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense.

The Company's uncertain tax positions are affected by the tax years that are under audit or remain subject to examination by the relevant taxing authorities. The following tax years, in addition to the current year, remain subject to examination, at least for certain issues, by the major tax jurisdictions indicated:

<b>Major Jurisdictions</b>	<b>Open Tax Years</b>
Belgium	2005 through 2007
China	1998 through 2007

<b>Major Jurisdictions</b>	<b>Open Tax Years</b>
France	2003 through 2007
Germany	2004 through 2007
Italy	2003 through 2007
Japan	2006 through 2007
Mexico	2002 through 2007
United Kingdom	2000 through 2007
United States	2004 through 2007

At April 30, 2008 the total unrecognized tax benefits were \$28.5 million, and accrued interest and penalties on these unrecognized tax benefits were \$5.0 million. If the Company were to prevail on all unrecognized tax benefits recorded, substantially all of the unrecognized tax benefits would benefit the effective tax rate. With an average statute of limitations of about 5 years, up to \$4.5 million of the unrecognized tax benefits could potentially expire in the next 12 month period, unless extended by audit.

The effective tax rate for the three months and nine months ended April 30, 2008 was 25.6 percent and 27.4 percent, respectively. The effective tax rate for the three months and nine months ended April 30, 2007 was 16.2 percent and 24.5 percent, respectively. The nine months ended April 30, 2008 contains \$9.3 million of tax benefits, which predominantly occurred in the first and third quarters, primarily related to the expiration of the statute of limitations on previously unrecognized tax benefits and an increase in deferred tax benefits related to enacted foreign tax rate changes. The nine months ended April 30, 2007 contained \$10.0 million of tax benefits related to the expiration of the statute of limitations on previously unrecognized tax benefits, the favorable resolution of certain foreign and state tax positions, dividends from foreign subsidiaries and the reinstatement of the Research and Experimentation Credit, most of which occurred in the third quarter.

The average underlying tax rate for the year-to-date period has increased from the prior year by 1.3 percent. The mix of earnings between entities, changes to foreign tax rates and incentives, the expiration of the Research and Experimentation Credit, and a reduced dividend received deduction all contributed to the increase.

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#### Note L New Accounting Standards

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). The portion of the statement that requires recognition of the overfunded or underfunded status of defined benefit postretirement plans as an asset or liability in the statement of financial position was adopted in fiscal 2007 with minimal impact. SFAS 158 also requires measurement of the funded status of a plan as of the date of the statement of financial position. That provision will require the Company to change its measurement date from April 30 to July 31 beginning with fiscal year 2009.

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company is a worldwide manufacturer of filtration systems and replacement parts. The Company's product mix includes air and liquid filters and exhaust and emission control products for mobile equipment; in-plant air cleaning

systems; compressed air purification systems; air intake systems for industrial gas turbines; and specialized filters for such diverse applications as computer disk drives and semiconductor processing. Products are manufactured at more than 35 plants around the world and through three joint ventures.

The Company has two reporting segments engaged in the design, manufacture and sale of systems to filter air and liquid and other complementary products. The two segments are Engine Products and Industrial Products. Products in the Engine Products segment consist of air intake systems, exhaust and emissions systems, liquid filtration systems and replacement parts. The Engine Products segment sells to original equipment manufacturers (OEMs) in the construction, mining, agriculture, defense, aerospace and transportation markets and to independent distributors, OEM dealer networks, private label accounts and large equipment fleets. Products in the Industrial Products segment consist of dust, fume and mist collectors, compressed air purification systems, liquid filters and parts, static and pulse-clean air filter systems for gas turbines, and specialized air filtration systems for diverse applications including computer disk drives. The Industrial Products segment sells to various industrial end-users, OEMs of gas-fired turbines and OEMs and end users requiring highly purified air and liquids.

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto and other financial information included elsewhere in this report.

### Overview

The Company reported record diluted net earnings per share of \$0.57 for the third quarter of fiscal 2008, up from \$0.49 in the third quarter of the prior year. Net income for the quarter was \$46.0 million, up 14.5 percent from \$40.1 million in the third quarter of the prior year. The impact of foreign currency translation increased reported net earnings by 7.1 percent in the quarter. The Company reported record sales in the third quarter of fiscal 2008 of \$587.8 million, an increase of 21.4 percent from \$484.0 million in the third quarter of the prior year. The impact of foreign currency translation increased reported sales by 7.6 percent in the quarter.

Overall, the Company's globally-diversified portfolio of filtration businesses provided the foundation to deliver another quarter of growth. All of the Company's product groups within the Industrial Products and Engine Products segments, with the exception of Transportation Products, posted double-digit sales growth this quarter, both as reported and in local currency. Geographically, sales increased by more than 15 percent in the United States and Asia, and by more than 25 percent in Europe. The strong sales growth helped lift the Company's operating income as a percentage of sales 40 basis points in the quarter, driving a 27 percent increase in operating income. Net income for the quarter was also impacted by a \$4.0 million net tax benefit due primarily to the expiration of the statute of limitations on matters previously reserved.

For the nine month period, the Company reported net sales of \$1.625 billion, an increase of 16.6 percent from \$1.394 billion in the prior year. The impact of foreign currency translation increased reported sales by 6.1 percent. Net income for the nine month period was \$123.4 million, up 14.9 percent from \$107.4 million in the prior year. The impact of foreign currency translation increased net earnings

by 9.0 percent. The Company reported diluted net earnings per share of \$1.52 for the nine month period, up 16.9 percent from \$1.30 in the prior year.

Results of Operations

Sales in the United States increased \$33.0 million or 15.8 percent for the third quarter of fiscal 2008 compared to the third quarter of the prior year. Total international sales in U.S. dollars increased \$70.8 million or 25.7 percent in the third quarter compared to the prior year. In U.S. dollars, Europe sales increased \$44.6 million or 28.3 percent, Asia sales increased \$19.1 million or 19.3 percent and other international sales increased \$7.1 million or 37.3 percent for the third quarter of fiscal 2008 as compared to the prior year period. Translated at constant exchange rates, total international sales increased 12.3 percent over the prior year quarter. For the nine month period ended April 30, 2008, sales in the United States increased \$47.2 million or 7.7 percent from the prior year, and total international sales in U.S. dollars increased \$183.8 million or 23.5 percent from the prior year.

The impact of foreign currency translation during the third quarter of fiscal 2008 increased sales by \$37.0 million, or 7.6 percent. This was primarily due to the weakening of the U.S. dollar against most other world currencies. The impact of foreign currency translation on the year-to-date results as of the third quarter of fiscal 2008 increased sales by \$84.6 million, or 6.1 percent. Worldwide sales for the third quarter of fiscal 2008, excluding the impact of foreign currency translation, increased 13.8 percent from the third quarter of the prior year. The impact of foreign currency translation increased net income by \$2.9 million and \$9.6 million for the three and nine month periods of fiscal 2008, respectively.

Although net sales excluding foreign currency translation and net earnings excluding foreign currency translation are not measures of financial performance under GAAP, the Company believes they are useful in understanding its financial results. Both measures enable the Company to obtain a clearer understanding of the operating results of its foreign entities without the varying effects that changes in foreign currency exchange rates may have on those results. A shortcoming of these financial measures is that they do not reflect the Company's actual results under GAAP. Management does not intend these items to be considered in isolation or as a substitute for the related GAAP measures.

Following is a reconciliation to the most comparable GAAP financial measure of this non-GAAP financial measure (thousands of dollars):

	<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net sales, excluding foreign currency translation	\$ 550,798	\$ 468,417	\$ 1,540,451	\$ 1,360,392
Foreign currency translation	36,962	15,571	84,648	33,755
Net sales	\$ 587,760	\$ 483,988	\$ 1,625,099	\$ 1,394,147
Net earnings, excluding foreign currency translation	\$ 43,136	\$ 38,772	\$ 113,761	\$ 103,532
Foreign currency translation	2,851	1,375	9,619	3,895
Net earnings	\$ 45,987	\$ 40,147	\$ 123,380	\$ 107,427

Gross margin for the third quarter of fiscal 2008 was 32.0 percent compared to 31.0 percent for the third quarter in the prior year. As mentioned in the second quarter, the Company began utilizing a new warehouse management system at its main U.S. distribution center. The Company encountered start-up challenges during the transition to the new system. Although the Company has caught up on delayed shipments, there will continue to be incremental expenses related to refining the system which resulted in approximately \$3.6 million and \$5.7 million in incremental charges for

the three and nine months ended April 30, 2008, respectively. Gross margin for the third quarter of fiscal 2007 was negatively impacted by an unfavorable product mix in Gas Turbine Systems Products and Industrial Filtration Solutions Products. Offsetting the impact of this on gross margin, plant rationalization and start-up costs were \$0.1 million in the third quarter compared to prior year quarter costs of \$2.5 million. Year-to-date plant rationalization and start-up costs in fiscal 2008 totaled \$0.4 million compared to prior year costs of \$4.7 million. Operating expenses during the third quarter of fiscal 2008 were \$124.7 million, or 21.2

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percent of sales, compared to \$99.6 million, or 20.6 percent of sales, in the prior year period as we continue to invest in essential product and market development initiatives in our global Customer support capabilities. Year-to-date operating expenses were 21.3 percent of sales, up from 20.7 percent in the prior year.

Other income for the third quarter of fiscal 2008 totaled \$2.6 million, compared to \$1.9 million of other income in the third quarter of the prior year. Other income for the third quarter of fiscal 2008 consisted of income from unconsolidated affiliates of \$0.4 million, royalty income of \$2.7 million, interest income of \$0.2 million, foreign exchange losses of \$0.5 million, and other expenses of \$0.2 million. For the third quarter of fiscal 2008, interest expense was \$4.2 million, a slight increase as compared to the third quarter of the prior year, due to higher debt levels. Year-to-date, other income totaled \$4.6 million compared to \$5.8 million reported in the prior year. Year-to-date interest expense was \$12.6 million, up from \$10.3 million in the prior year.

The effective tax rate for the three months and nine months ended April 30, 2008 was 25.6 percent and 27.4 percent, respectively. The effective tax rate for the three months and nine months ended April 30, 2007 was 16.2 percent and 24.5 percent, respectively. The nine months ended April 30, 2008 contains \$9.3 million of tax benefits, which predominantly occurred in the first and third quarters, primarily related to the expiration of the statute of limitations on previously unrecognized tax benefits and an increase in deferred tax benefits related to enacted foreign tax rate changes. The nine months ended April 30, 2007 contained \$10.0 million of tax benefits related to the expiration of the statute of limitations on previously unrecognized tax benefits, the favorable resolution of certain foreign and state tax positions, dividends from foreign subsidiaries and the reinstatement of the Research and Experimentation Credit, most of which occurred in the third quarter. The average underlying tax rate for the year-to-date period has increased from the prior year by 1.3 percent. The mix of earnings between entities, changes to foreign tax rates and incentives, the expiration of the Research and Experimentation Credit, and a reduced dividend received deduction all contributed to the increase.

#### Operations by Segment

Following is financial information for the Company's Engine Products and Industrial Products segments. Corporate and Unallocated includes corporate expenses determined to be non-allocable to the segments, interest income and expense and non-operating income and expenses. Segment detail is summarized as follows (thousands of dollars):

	Engine Products	Industrial Products	Corporate and Unallocated	Total Company
Three Months Ended April 30, 2008:				
Net sales	\$ 324,992	\$ 262,768		\$ 587,760

	Engine Products	Industrial Products	Corporate and Unallocated	Total Company
Earnings before income taxes	43,456	25,997	(7,603)	61,850
Three Months Ended April 30, 2007:				
Net sales	\$ 276,660	\$ 207,328		\$ 483,988
Earnings before income taxes	35,581	17,801	(5,501)	47,881
Nine Months Ended April 30, 2008:				
Net sales	\$ 902,488	\$ 722,611		\$ 1,625,099
Earnings before income taxes	115,279	70,429	(15,738)	169,970
Assets	614,229	581,193	318,123	1,513,545
Nine Months Ended April 30, 2007:				
Net sales	\$ 793,924	\$ 600,223		\$ 1,394,147
Earnings before income taxes	102,125	51,135	(11,021)	142,239
Assets	532,532	504,377	264,035	1,300,944

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Following are net sales by product category within the Engine Products and Industrial Products segments (thousands of dollars):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2008	2007	2008	2007
Engine Products segment:				
Off-road Products	\$ 120,932	\$ 92,750	\$ 332,398	\$ 253,113
Transportation Products	33,188	38,395	91,943	132,316
Aftermarket Products	170,872	145,515	478,147	408,495
Total Engine Products segment	\$ 324,992	\$ 276,660	\$ 902,488	\$ 793,924
Industrial Products segment:				
Industrial Filtration Solutions Products	\$ 155,208	\$ 125,756	\$ 430,304	\$ 371,328
Gas Turbine Products	58,858	41,201	149,046	110,713
Special Applications Products	48,702	40,371	143,261	118,182
Total Industrial Products segment	\$ 262,768	\$ 207,328	\$ 722,611	\$ 600,223
Total Company	\$ 587,760	\$ 483,988	\$ 1,625,099	\$ 1,394,147

**Engine Products Segment** For the third quarter of fiscal 2008, worldwide Engine Products sales were a record \$325.0 million, an increase of 17.5 percent from \$276.7 million in the third quarter of the prior year. Total third quarter Engine Products sales in the United States increased by 7.5 percent compared to the same period in the prior year and international sales increased by 28.7 percent as discussed below. Year-to-date, worldwide net sales were \$902.5 million, an increase of 13.7 percent from \$793.9 million in the prior year. International Engine Products sales



increased 26.9 percent and sales in the United States increased 2.7 percent from the prior year on a year-to-date basis.

Worldwide sales of Off-road Products in the third quarter of fiscal 2008 were \$120.9 million, an increase of 30.4 percent from \$92.8 million in the third quarter of the prior year. Domestic sales in Off-road Products increased 26.0 percent as strong defense, agriculture and non-residential construction markets more than offset a decrease in the residential construction markets. The percentage increase was also impacted by last year's acquisition of Aerospace Filtration Systems, Inc. which increased sales by \$4.7 million in the quarter compared to the prior year period. International sales were up 35.0 percent from the third quarter of the prior year with increases in Europe and Asia of 32.1 percent and 43.2 percent, respectively. In addition to the benefit of foreign exchange on sales in Europe and Asia, the Company's Off-road Products business continued to be strong globally as production of heavy construction, mining and agricultural equipment by our OEM Customers remained high. Year-to-date, worldwide Off-road Products sales totaled \$332.4 million, an increase of 31.3 percent from \$253.1 million in the prior year. Year-to-date sales of Off-road Products internationally and in the United States increased 28.1 percent and 34.6 percent, respectively, from the prior year.

Worldwide sales in Transportation Products in the third quarter of fiscal 2008 were \$33.2 million, a decrease of 13.6 percent from \$38.4 million in the third quarter of the prior year. International Transportation Products sales increased by 18.1 percent driven by increased sales in Europe of 33.2 percent. Sales decreased in the United States by 29.1 percent as a result of the Environmental Protection Agency (EPA) emissions standards which has resulted in lower new truck build rates at our Customers. Year-to-date, worldwide Transportation Products sales totaled \$91.9 million, a decrease of 30.5 percent from \$132.3 million in the prior year. International Transportation Products sales increased 10.9 percent from the prior year on a year-to-date basis. As expected, Transportation Products sales in the United States decreased 46.4 percent from the prior year on a year-to-date basis as a result of EPA diesel emissions standards changes.

Worldwide sales of Aftermarket Products in the third quarter were \$170.9 million, an increase of 17.4 percent from \$145.5 million in the third quarter of the prior year. Domestic Aftermarket Products sales grew 8.4 percent. International sales were up 26.6 percent from the prior year quarter, driven by sales increases in Europe, Asia and other international of 22.4 percent, 22.6 percent and 49.4 percent respectively. Sales volumes were high in these regions as equipment utilization rates remained strong. In

addition, sales continue to benefit from the increasing amount of equipment in the field with the Company's PowerCore filtration systems. Sales of PowerCore replacement filters increased 44.6 percent in the quarter. Year-to-date, worldwide Aftermarket Products sales totaled \$478.1 million, an increase of 17.1 percent from \$408.5 million in the prior year. Year-to-date Aftermarket Products sales internationally and in the United States increased 29.2 percent and 5.7 percent, respectively.

**Industrial Products Segment** For the third quarter of fiscal 2008, worldwide sales in the Industrial Products segment were \$262.8 million, an increase of 26.7 percent from \$207.3 million in the third quarter of the prior year. Total third quarter international Industrial Products sales were up 23.0 percent compared to the same period in the prior year, while sales in the United States increased by 35.7 percent. Year-to-date, worldwide net sales were \$722.6 million, an increase of 20.4 percent from \$600.2 million in the prior year. International Industrial Products sales increased 20.5 percent and sales in the United States increased 20.0 percent from the prior year on a year-to-date basis.

Worldwide sales of Industrial Filtration Solutions Products in the quarter were \$155.2 million, an increase of 23.4 percent from \$125.8 million in the prior year. International sales grew 24.1 percent over the prior year with sales in Europe and Asia showing increases of 28.4 percent and 11.9 percent, respectively. International sales growth was driven by continued strong global manufacturing investment and production utilization conditions. Europe, in particular, experienced an increase in the sale of industrial dust collection systems. Domestic sales increased 22.1 percent over the prior year quarter including the impact of the recent acquisition of LMC West, Inc., which contributed to approximately five percent of the increase. Year-to-date, worldwide sales of Industrial Filtration Solutions products were \$430.3 million, up 15.9 percent from \$371.3 million in the prior year. International Industrial Filtration Solutions product sales increased 19.5 percent from the prior year on a year-to-date basis. Sales in the United States increased 9.3 percent from the prior year on a year-to-date basis.

Worldwide sales of Gas Turbine Products in the third quarter were \$58.9 million, an increase of 42.9 percent from sales of \$41.2 million in the third quarter of the prior year. The Gas Turbine Products sales are typically large systems and as a result the shipments and revenues fluctuate from quarter to quarter. Year-to-date, worldwide Gas Turbine Products sales were \$149.0 million, up 34.6 percent from \$110.7 million in the prior year.

Worldwide sales of Special Application Products in the quarter were \$48.7 million, an increase of 20.6 percent from \$40.4 million in the prior year. Domestic Special Application Products sales increased 25.5 percent. International sales in Special Application Products increased 19.8 percent over the prior year, with increases in Europe and Asia of 20.5 percent and 19.8 percent, respectively, as sales of disk drive filters and PTFE membranes remained strong. Year-to-date, worldwide Special Application Products sales were \$143.3 million, an increase of 21.2 percent from \$118.2 million in the prior year. International Special Application Products sales increased 23.3 percent over the prior year and sales in the United States increased 8.3 percent over the prior year on a year-to-date basis.

#### Liquidity and Capital Resources

The Company generated \$103.8 million of cash and cash equivalents from operations during the first nine months of fiscal 2008. Operating cash flows increased by \$57.0 million from the same period in the prior year primarily as a result of an increase in net earnings of \$16.0 million and a decrease in pension contributions of \$13.3 million as compared to the prior year. Operating cash flows and cash on hand were used to support \$52.1 million in capital additions, the repurchase of 1.7 million outstanding shares of the Company's common stock for \$69.3 million and the payment of \$24.4 million in dividends. For additional information regarding share repurchases see Part II Item 2, Unregistered Sales of Equity Securities and Use of Proceeds.

At the end of the third quarter, the Company held \$53.3 million in cash and cash equivalents, down from \$55.2 million at July 31, 2007. Short-term debt totaled \$108.7 million, down from \$123.1 million at July 31, 2007, primarily due to repayment of short-term debt using proceeds from long-term debt, operating cash flows and cash on hand. The amount of unused lines of credit as of April 30, 2008 was approximately \$558.9 million. Long-term debt of \$177.4 million at April 30, 2008 increased from \$129.0 million at July 31, 2007, due to the additional note issuances discussed below, and represented 19.6

percent of total long-term capital, defined as long-term debt plus total shareholders' equity, compared to 17.1 percent at July 31, 2007. The Company has not made and does not anticipate making any contributions to its U.S. pension plans and estimates that it will contribute up to an additional \$0.6 million to its non-U.S. pension plans during the

remainder of fiscal 2008.

The following table summarizes the Company's contractual obligations as of April 30, 2008 (in thousands):

**Contractual Obligations****Payments Due by Period**

	<b>Total</b>	<b>Less than 1 year</b>	<b>1 - 3 years</b>	<b>3 - 5 Years</b>	<b>More than 5 years</b>
Long-term debt obligations	\$ 209,022	\$ 32,173	\$ 10,478	\$ 41,979	\$ 124,392
Capital lease obligations	1,240	726	182	136	196
Interest on long-term obligations	69,144	10,090	16,316	13,758	28,980
Operating lease obligations	24,764	9,972	10,717	3,782	293
Purchase obligations <sup>(1)</sup>	184,327	177,091	7,236		
Pension and deferred compensation <sup>(2)</sup>	25,752	2,213	3,741	3,058	16,740
<b>Total<sup>(3)</sup></b>	<b>\$ 514,249</b>	<b>\$ 232,265</b>	<b>\$ 48,670</b>	<b>\$ 62,713</b>	<b>\$ 170,601</b>

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- (1) Purchase obligations consist primarily of inventory, tooling, contract employment services and capital expenditures. The Company's purchase orders for inventory are based on expected Customer demand, and quantities and dollar volumes are subject to change.
  - (2) Pension and deferred compensation consists of long-term pension liabilities and salary and bonus deferrals elected by certain executives under the Company's deferred compensation plan. Deferred compensation balances earn interest based on a treasury bond rate as defined by the plan and are payable at the election of the participants.
  - (3) In addition to the above contractual obligations, the Company may be obligated for additional cash outflows of \$28.5 million of unrecognized tax benefits. The payment and timing of any such payments is affected by the ultimate resolution of the tax years that are under audit or remain subject to examination by the relevant taxing authorities.

At April 30, 2008, the Company had a contingent liability for standby letters of credit totaling \$18.5 million that have been issued and are outstanding. The letters of credit guarantee payment to beneficial third parties in the event the Company is in breach of specified financing agreement and insurance contract terms as detailed in each letter of credit. At April 30, 2008, there were no amounts drawn upon these letters of credit.

The Company has a five-year, multi-currency revolving facility with a group of banks under which the Company may borrow up to \$250 million. As of April 30, 2008, there was \$50.0 million of borrowings under these facilities. During the quarter, the Company extended the expiration date of the facility by one year to April 2, 2013. No other changes were made to the facility.

Certain note agreements contain debt covenants related to working capital levels and limitations on indebtedness. As of April 30, 2008, the Company was in compliance with all debt covenants.

On June 1, 2007, the Company issued \$100 million of senior unsecured notes. The first \$50 million was funded on June 1, 2007, and the remaining two \$25 million tranches were funded on September 28, 2007 and November 30, 2007. The three tranches are due on June 1, 2017, September 28, 2017, and November 30, 2017, respectively. The debt was issued at face value and bears interest payable semi-annually at a rate of 5.48 percent. The proceeds from the notes were used to refinance existing debt and for general corporate purposes.

The Company believes that the combination of present capital resources, internally generated funds and unused financing sources are adequate to meet cash requirements for the next twelve-month period.

The Company does not have any off-balance sheet arrangements, with the exception of the guarantee of 50 percent of certain debt of its joint venture, Advanced Filtration Systems, Inc., as further discussed in Note H of the Company's Notes to Condensed Consolidated Financial Statements.

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### Critical Accounting Policies

There have been no material changes to the Company's critical accounting policies as disclosed in the Company's Annual Report on Form 10-K for the year ended July 31, 2007.

### Outlook

**Engine Products Segment** Overall, the Company expects 11 to 13 percent full year sales growth for the Engine Products segment in fiscal 2008. The Company expects its NAFTA Transportation Products sales to begin growing again in the fourth quarter. NAFTA residential construction markets are expected to remain weak. However, high commodity prices and global infrastructure projects are expected to keep global demand strong for new mining, heavy construction and agriculture equipment. The Company's Aftermarket Products sales are expected to continue growing due to ongoing expansion into new markets and strong equipment utilization internationally. The Company expects to continue benefiting from the increasing amount of equipment in the field with PowerCore technology as well as other new proprietary filtration systems.

**Industrial Products Segment** The Company expects 17 to 19 percent full year sales growth for its Industrial Products segment. Full year Industrial Filtration Solutions Products sales are projected to grow 15 to 20 percent due to continued strong global manufacturing investment and production utilization conditions. Gas Turbine Products sales are expected to increase 25 to 30 percent for the full year. Continued strength is expected from both the international power generation and the oil and gas markets. Special Applications Products sales are expected to grow 15 to 20 percent for the full year.

**Other** The Company expects a minimum full year operating income as a percentage of sales of 11 percent, including the impact from the new warehouse management system implementation and commodity cost increases. Operating income is projected to be up 17 to 19 percent over the prior year. The full year tax rate is expected to be between 28 and 31 percent.

### Forward-Looking Statements and Risk Factors

The Company, through its management, may make forward-looking statements reflecting the Company's current views with respect to future events and financial performance. These forward-looking statements, which may be in reports filed under the Securities Exchange Act of 1934, as amended (the Exchange Act), in press releases and in other documents and materials as well as in written or oral statements made by or on behalf of the Company, are subject to certain risks and uncertainties, including those discussed in Item 1A of the Company's Annual Report on Form 10-K for the year ended July 31, 2007, which could cause actual results to differ materially from historical results or those anticipated. These uncertainties and other risk factors include, but are not limited to risks associated with currency

fluctuations, commodity prices, world economic factors, political factors, the company's international operations, highly competitive markets, governmental laws and regulations, the implementation of our new warehouse management system in our U.S. distribution center, and other factors listed in our Annual Report on Form 10-K and our reports on Form 10-Q.

In particular the Company desires to take advantage of the protections of the Private Securities Litigation Reform Act of 1995 in connection with the forward-looking statements made in this Quarterly Report on Form 10-Q. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in the reported market risk of the Company since July 31, 2007. See further discussion of these market risks in the Company's Annual Report on Form 10-K for the year ended July 31, 2007.

### Item 4. Controls and Procedures

- (a) Evaluation of Disclosure Controls and Procedures: As of the end of the period covered by this report (the Evaluation Date), the Company carried out an evaluation, under the supervision

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and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in applicable rules and forms, and (ii) accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

- (b) Changes in Internal Control over Financial Reporting: No change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) identified in connection with such evaluation during the fiscal quarter ended April 30, 2008, has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is not currently subject to pending litigation other than litigation which arises out of and is incidental to the conduct of the Company's business. All such matters are subject to many uncertainties and outcomes that are not predictable with assurance. The Company does not consider any of such proceedings that are currently pending to be likely to result in a material adverse effect on the Company's consolidated financial position or results of operation.

### Item 1A. Risk Factors

There are inherent risks and uncertainties associated with our global operations that involve manufacturing and sale of products for highly demanding Customer applications throughout the world. These risks and uncertainties could adversely affect our operating performances or financial condition. The Risk Factors section in the Company's Annual Report on Form 10-K for the year ended July 31, 2007 includes a discussion of these risks and uncertainties. There have been no material changes from the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended July 31, 2007.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

### Repurchases of Equity Securities

The following table sets forth information in connection with purchases made by, or on behalf of, the Company or any affiliated purchaser of the Company, of shares of the Company's common stock during the quarterly period ended April 30, 2008.

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
February 1 – February 29, 2008	378,482	\$ 41.82	377,700	2,396,600 shares
March 1 – March 31, 2008	51,588	\$ 40.01	49,879	2,346,721 shares
April 1 – April 30, 2008	72,439	\$ 39.87	72,439	2,274,282 shares
Total	502,509	\$ 41.36	500,018	2,274,282 shares

- (1) On March 31, 2006, the Company announced that the Board of Directors authorized the repurchase of up to 8.0 million common shares. This repurchase authorization, which is effective until terminated by the Board of Directors, replaced the existing authority that was authorized on January 17, 2003. There were no repurchases of common stock made outside of the Company's current repurchase authorization during the quarter ended April 30, 2008. However, the Total Number of Shares Purchased column of the table above includes 2,491

previously owned shares tendered by option holders in payment of the exercise price of options during the quarter. While not considered repurchases of shares, the Company does at times withhold shares that would otherwise be issued under equity-based awards to cover the withholding taxes due as a result of exercising stock options or payment of equity-based awards.

## Item 6. Exhibits

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\*3-A Restated Certificate of Incorporation of Registrant as currently in effect (Filed as Exhibit 3-A to Form 10-Q Report for the First Quarter ended October 31, 2004)

\*3-B Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Registrant, dated as of March 3, 2006 (Filed as Exhibit 3-B to Form 10-Q Report for the First Quarter ended October 31, 2006)

\*3-C Amended and Restated Bylaws of Registrant (as of January 25, 2008) (Filed as Exhibit 3.1 to Form 8-K Report filed January 31, 2008)

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\*4-A Preferred Stock Amended and Restated Rights Agreement between Registrant and Wells Fargo Bank, N.A., as Rights Agent, dated as of January 27, 2006 (Filed as Exhibit 4.1 to Form 8-K Report filed February 1, 2006)

10-A Form of Management Severance Agreement for Executive Officers

31-A Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31-B Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Exhibit has previously been filed with the Securities and Exchange Commission and is incorporated herein by reference as an exhibit.

\*\* Pursuant to the provisions of Regulation S-K Item 601(b)(4)(iii)(A) copies of instruments defining the rights of holders of certain long-term debts of the Company and its subsidiaries are not filed and in lieu thereof the Company agrees to furnish a copy thereof to the Securities and Exchange Commission upon request.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DONALDSON COMPANY, INC.  
(Registrant)

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Date: June 3, 2008

By: /s/ William M. Cook  
William M. Cook  
Chairman, President and  
Chief Executive Officer  
(duly authorized officer)

Date: June 3, 2008

By: /s/ Thomas R. VerHage  
Thomas R. VerHage  
Vice President,  
Chief Financial Officer  
(principal financial officer)

Date: June 3, 2008

By: /s/ James F. Shaw  
James F. Shaw  
Controller  
(principal accounting officer)