

DONALDSON CO INC
Form 10-Q
June 03, 2013

**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, 2013 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)

Delaware
(State or other jurisdiction of
incorporation or organization)

41-0222640
(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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o 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

Smaller reporting company

(Do not check if a 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 146,949,730 shares as of April 30, 2013.

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,	
	2013	2012	2013	2012
Net sales	\$ 619,371	\$ 647,237	\$ 1,804,354	\$ 1,836,415
Cost of sales	397,870	419,008	1,185,583	1,192,435
Gross margin	221,501	228,229	618,771	643,980
Operating expenses	122,914	129,792	375,455	380,448
Operating income	98,587	98,437	243,316	263,532
Other income	(3,608)	(4,340)	(11,962)	(13,750)
Interest expense	2,719	2,787	8,275	8,856
Earnings before income taxes	99,476	99,990	247,003	268,426
Income taxes	29,634	29,044	72,235	75,106
Net earnings	\$ 69,842	\$ 70,946	\$ 174,768	\$ 193,320
Weighted average shares - basic	148,136,620	150,536,631	148,404,503	150,385,389
Weighted average shares - diluted	150,234,445	153,207,471	150,591,003	153,067,148
Net earnings per share - basic	\$ 0.47	\$ 0.47	\$ 1.18	\$ 1.29
Net earnings per share - diluted	\$ 0.46	\$ 0.46	\$ 1.16	\$ 1.26
Dividends paid per share	\$ 0.100	\$ 0.080	\$ 0.280	\$ 0.230

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, 2013	July 31, 2012
Assets		
Current assets		
Cash and cash equivalents	\$ 263,988	\$ 225,789
Short-term investments	65,700	92,362
Accounts receivable, less allowance of \$7,128 and \$6,418	437,414	438,796
Inventories	240,476	256,116
Prepays and other current assets	65,752	72,599
Total current assets	1,073,330	1,085,662
Property, plant, and equipment, at cost	1,020,391	949,619
Less accumulated depreciation	(607,570)	(564,710)
Property, plant, and equipment, net	412,822	384,909
Goodwill	165,511	162,949
Intangible assets, net	42,596	46,200
Other assets	63,349	50,362
Total assets	\$ 1,757,608	\$ 1,730,082
Liabilities and shareholders equity		
Current liabilities		
Short-term borrowings	\$ 30,000	\$ 95,147
Current maturities of long-term debt	82,002	2,346
Trade accounts payable	178,028	199,182
Other current liabilities	167,802	201,848
Total current liabilities	457,832	498,523
Long-term debt	119,079	203,483
Deferred income taxes	5,326	4,611
Other long-term liabilities	93,838	113,451
Total liabilities	676,075	820,068
Shareholders equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized, none issued		
Common stock, \$5.00 par value, 240,000,000 shares authorized, 151,643,194 shares issued	758,216	758,216
Retained earnings	499,808	366,788
Stock compensation plans	21,401	24,948
Accumulated other comprehensive loss	(40,926)	(101,888)
Treasury stock at cost, 4,585,928 and 3,980,832 shares at April 30, 2013 and July 31, 2012, respectively	(156,967)	(138,050)
Total shareholders equity	1,081,533	910,014
Total liabilities and shareholders equity	\$ 1,757,608	\$ 1,730,082

See Notes to Condensed Consolidated Financial Statements.

DONALDSON COMPANY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Thousands of dollars)
(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2013	2012	2013	2012
Net earnings	\$ 69,842	\$ 70,946	\$ 174,768	\$ 193,320
Foreign currency translation gain (loss)	(13,563)	5,689	29,401	(57,392)
Gain (loss) on hedging derivatives, net of deferred taxes of (\$72), \$145, (\$269), and (\$169), respectively	13	(448)	144	(21)
Pension and postretirement liability adjustment, net of deferred taxes of (\$7,682), (\$4,978), (\$14,963), and (\$9,219), respectively	16,214	8,810	31,417	3,449
Total comprehensive income	\$ 72,506	\$ 84,997	\$ 235,730	\$ 139,356

See Notes to Condensed Consolidated Financial Statements.

DONALDSON COMPANY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of dollars)
(Unaudited)

	Nine Months Ended April 30,	
	2013	2012
Operating Activities		
Net earnings	\$ 174,768	\$ 193,320
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	48,527	46,214
Changes in operating assets and liabilities	(8,346)	(43,836)
Tax benefit of equity plans	(9,483)	(9,698)
Stock compensation plan expense	7,363	8,624
Deferred taxes	(4,037)	4,214
Other, net	8,597	(16,437)
Net cash provided by operating activities	217,389	182,401
Investing Activities		
Net expenditures on property, plant, and equipment	(69,425)	(57,987)
Change in short-term investments	30,781	(119,930)
Net cash used in investing activities	(38,644)	(177,917)
Financing Activities		
Purchase of treasury stock	(60,975)	(82,573)
Repayments of long-term debt	(1,093)	(46,084)
Change in short-term borrowings	(66,530)	70,519
Dividends paid	(41,184)	(34,277)
Tax benefit of equity plans	9,483	9,698
Exercise of stock options	12,131	12,345
Net cash used in financing activities	(148,168)	(70,372)
Effect of exchange rate changes on cash	7,622	(18,586)
Increase (Decrease) in cash and cash equivalents	38,199	(84,474)
Cash and cash equivalents, beginning of year	225,789	273,494
Cash and cash equivalents, end of period	\$ 263,988	\$ 189,020

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 its subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S.) (U.S. GAAP) 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. Operating results for the three and nine month periods ended April 30, 2013, 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 U.S. GAAP. 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, 2012.

Note B Short-Term Investments

All short-term investments are time deposits and have original maturities in excess of three months but not more than twelve months. The Company had \$65.7 million and \$92.4 million in short-term investments as of April 30, 2013 and July 31, 2012, respectively.

Note C Inventories

The components of inventory as of April 30, 2013 and July 31, 2012 are as follows (thousands of dollars):

	April 30, 2013	July 31, 2012
Materials	\$ 101,528	\$ 111,808
Work in process	32,847	30,767
Finished products	106,101	113,541
Total inventories	\$ 240,476	\$ 256,116

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Note D Accounting for Stock-Based Compensation

Stock-based compensation expense is recognized using the fair-value method for all awards. In addition to granting stock options, the Company also granted reload options related to options previously granted which were exercised during the nine months ended April 30, 2013. A reload stock option is granted for the number of shares tendered as payment for the exercise price and tax withholding obligation upon the exercise of a stock option with a reload provision. The exercise price of the reload option is equal to the market price of the stock on the date of grant and the reload option will expire on the same date as the original option which was exercised. 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, including reload options which generally have a shorter contractual life, granted during the nine months ended April 30, 2013: range of less than 1 year to 8 years expected life; expected volatility range of 23.4 percent to 29.7 percent; risk-free interest rate range of 0.02 percent to 1.68 percent; and annual dividend yield of 1.0 percent. The expected life for options granted during the period represents the period of time that the options are expected to be outstanding based on the contractual life and 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 have exercise prices equivalent to 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, 2013 and 2012 was \$8.37 per share and \$9.38 per share, respectively. For the three and nine months ended April 30, 2013, the Company recorded pre-tax stock option expense of \$1.4 million and \$6.9 million, respectively, and recorded \$0.4 million and \$2.2 million, respectively, of related tax benefit. For the three and nine months ended April 30, 2012, the Company recorded pre-tax stock option expense of \$1.3 million and \$6.4 million, respectively, and recorded \$0.4 million and \$2.1 million, respectively, of related tax benefit.

The following table summarizes stock option activity during the nine months ended April 30, 2013:

	Options Outstanding	Weighted Average Exercise Price
Outstanding at July 31, 2012	8,056,327	\$ 20.97
Granted	934,436	33.84
Exercised	(1,314,912)	14.48
Canceled	(78,726)	34.07
Outstanding at April 30, 2013	7,597,125	23.54

The total intrinsic value of options exercised during the nine months ended April 30, 2013 and 2012 was \$27.5 million and \$27.6 million, respectively.

The following table summarizes information concerning outstanding and exercisable options as of April 30, 2013:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.00 to \$15.89	1,402,473	1.37	\$ 15.27	1,402,473	\$ 15.27
\$15.90 to \$20.89	1,955,461	4.04	17.44	1,955,461	17.44
\$20.90 to \$25.89	1,391,656	5.99	21.78	1,391,656	21.78
\$25.90 to \$30.89	918,849	7.61	29.15	608,544	29.16
\$30.90 and above	1,928,686	8.73	34.33	429,773	34.80
	7,597,125	5.53	23.54	5,787,907	20.48

At April 30, 2013, the aggregate intrinsic value of options outstanding and exercisable was \$97.6 million and \$92.0 million, respectively.

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As of April 30, 2013, there was \$8.9 million of total unrecognized compensation expense related to non-vested stock options granted under the 2010 Master Stock Incentive Plan. This unvested expense is expected to be recognized during the remainder of Fiscal Years 2013, 2014, 2015, and 2016.

Note E 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 common share equivalents relating to stock options 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 the three and nine months ended April 30, 2013, there were 29,800 options and 80,486 options excluded from the diluted net earnings per share calculation, respectively. For the three and nine months ended April 30, 2012, there were 11,606 options and 1,061,741 options excluded from the diluted net earnings per share calculation, respectively.

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,	
	2013	2012	2013	2012
Weighted average shares - basic	148,137	150,537	148,405	150,385
Common share equivalents	2,097	2,670	2,186	2,682
Weighted average shares - diluted	150,234	153,207	150,591	153,067
Net earnings for basic and diluted earnings per share computation	\$ 69,842	\$ 70,946	\$ 174,768	\$ 193,320
Net earnings per share - basic	\$ 0.47			