

DONALDSON CO INC
Form 10-Q
June 03, 2011

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, 2011 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. Yes No

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

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that the registrant was required to submit and post such files). 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 76,332,352 shares as of April 30, 2011.

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,	
	2011	2010	2011	2010
Net sales	\$ 594,565	\$ 497,619	\$ 1,668,579	\$ 1,361,821
Cost of sales	385,407	320,248	1,081,788	890,103
Gross margin	209,158	177,371	586,791	471,718
Operating expenses	125,826	105,288	361,515	308,140
Operating income, net	83,332	72,083	225,276	163,578
Interest expense	2,897	2,956	9,486	8,701
Other income, net	(1,381)	(942)	(5,990)	(2,743)
Earnings before income taxes	81,816	70,069	221,780	157,620
Income taxes	20,005	20,611	62,256	42,627
Net earnings	\$ 61,811	\$ 49,458	\$ 159,524	\$ 114,993
Weighted average shares - basic	77,325,611	77,872,665	77,358,459	78,002,070
Weighted average shares - diluted	78,704,047	79,222,705	78,762,314	79,333,246
Net earnings per share - basic	\$ 0.80	\$ 0.64	\$ 2.06	\$ 1.47
Net earnings per share - diluted	\$ 0.79	\$ 0.62	\$ 2.03	\$ 1.45
Dividends paid per share	\$ 0.130	\$ 0.120	\$ 0.385	\$ 0.350

See Notes to Condensed Consolidated Financial Statements.

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DONALDSON COMPANY, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Thousands of dollars, except share amounts)
(Unaudited)

	April 30, 2011	July 31, 2010
Assets		
Current assets		
Cash and cash equivalents	\$ 263,493	\$ 232,000
Short-term investments	71,828	
Accounts receivable, less allowance of \$6,886 and \$6,315	421,751	358,917
Inventories	257,886	203,631
Prepays and other current assets	67,338	65,667
Total current assets	\$ 1,082,296	\$ 860,215
Property, plant and equipment, at cost	957,931	876,758
Less accumulated depreciation	(567,559)	(510,866)
Property, plant and equipment, net	390,372	365,892
Goodwill	172,841	165,315
Intangible assets, net	55,357	58,292
Other assets	40,941	49,792
Total assets	\$ 1,741,807	\$ 1,499,506
Liabilities and shareholders equity		
Current liabilities		
Short-term borrowings	\$ 56,698	\$ 50,000
Current maturities of long-term debt	46,845	5,536
Trade accounts payable	201,316	165,907
Other current liabilities	189,289	167,813
Total current liabilities	494,148	389,256
Long-term debt	204,689	256,192
Deferred income taxes	7,707	7,076
Other long-term liabilities	80,046	100,349
Total liabilities	786,590	752,873
Shareholders equity		
Preferred stock, \$1.00 par value, 1,000,000 shares authorized, none issued		
Common stock, \$5.00 par value, 120,000,000 shares authorized, 88,643,194 shares issued	443,216	443,216
Retained earnings	882,969	744,247
Stock compensation plans	24,074	22,326
Accumulated other comprehensive income (loss)	42,774	(40,486)
Treasury stock at cost, 12,218,134 and 12,222,381 shares at April 30, 2011 and July 31, 2010, respectively	(437,816)	(422,670)
Total shareholders equity	955,217	746,633
Total liabilities and shareholders equity	\$ 1,741,807	\$ 1,499,506

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,	
	2011	2010
Operating Activities		
Net earnings	\$ 159,524	\$ 114,993
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	45,276	45,158
Changes in operating assets and liabilities	(23,958)	(6,848)
Tax benefit of equity plans	(8,272)	(3,815)
Stock compensation plan expense	7,560	7,110
Deferred taxes	6,188	1,944
Other, net	(17,775)	(9,775)
Net cash provided by operating activities	168,543	148,767
Investing Activities		
Net expenditures on property and equipment	(42,400)	(27,230)
Purchase of short-term investments	(67,985)	
Acquisitions and divestitures	3,493	(250)
Net cash used in investing activities	(106,892)	(27,480)
Financing Activities		
Purchase of treasury stock	(43,101)	(23,783)
Proceeds from settlement of interest rate swap	4,710	
Repayments of long-term debt	(13,202)	(5,386)
Change in short-term borrowings	6,976	(10,024)
Dividends paid	(29,547)	(27,040)
Tax benefit of equity plans	8,272	3,815
Exercise of stock options	13,535	7,332
Net cash used in financing activities	(52,357)	(55,086)
Effect of exchange rate changes on cash	22,199	(1,527)
Increase in cash and cash equivalents	31,493	64,674
Cash and cash equivalents, beginning of year	232,000	143,687
Cash and cash equivalents, end of period	\$ 263,493	\$ 208,361

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. 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, 2011 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/A for the year ended July 31, 2010.

Note B Short-Term Investments

Classification of the Company's investments as current or non-current is dependent upon management's intended holding period, the investment's maturity date and liquidity considerations based on market conditions. If management intends to hold the investments for longer than one year as of the balance sheet date, they are classified as non-current.

All short-term investments have original maturities in excess of three months but not more than six months. There were no short-term investments as of July 31, 2010. The following is a summary of amounts recorded on the Consolidated Balance Sheet for the Company's short-term investments as of April 30, 2011 (thousands of dollars):

	April 30, 2011
Certificates of deposit	\$ 44,430
Commercial paper	27,398
Total short-term investments	\$ 71,828

Note C Inventories

The components of inventory as of April 30, 2011 and July 31, 2010 are as follows (thousands of dollars):

	April 30, 2011	July 31, 2010
Materials	\$ 106,273	\$ 79,371
Work in process	30,278	23,163
Finished products	121,335	101,097
Total inventories	\$ 257,886	\$ 203,631

Note D Accounting for Stock-Based Compensation

Stock-based employee compensation cost is recognized using the fair-value based method for all awards. 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, 2011: range of 8 days to 8 years expected life; expected volatility range of 25.5 percent to 34.7 percent; risk-free interest rate range of 0.12 percent to 3.1 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 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 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, 2011 and 2010 was \$17.26 per share and \$13.24 per share, respectively. For the three and nine months ended April 30, 2011, the Company recorded pretax compensation expense associated with stock options of \$0.8 million and \$5.6 million, respectively, and recorded \$0.3 million and \$2.1 million of related tax benefit, respectively. For the three and nine months ended April 30, 2010, the Company recorded pretax compensation expense associated with stock options of \$1.0 million and \$6.3 million, respectively, and recorded \$0.3 million and \$2.3 million of related tax benefit.

The following table summarizes stock option activity during the nine months ended April 30, 2011:

	Options Outstanding	Weighted Average Exercise Price
Outstanding at July 31, 2010	4,771,812	\$ 30.04
Granted	551,601	57.22
Exercised	(944,412)	22.65
Canceled	(7,665)	47.20
Outstanding at April 30, 2011	4,371,336	35.04

The total intrinsic value of options exercised during the nine months ended April 30, 2011 and 2010 was \$27.9 million and \$15.6 million, respectively.

The following table summarizes information concerning outstanding and exercisable options as of April 30, 2011:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$12 to \$22	747,366	1.37	\$ 17.92	747,366	\$ 17.92
\$22 to \$32	1,115,025	3.19	30.12	1,099,113	30.10
\$32 to \$42	1,195,623	5.66	34.84	1,175,101	34.85
\$42 and above	1,313,322	8.48	49.15	655,215	44.32
	4,371,336	5.14	35.04	3,676,795	31.67

At April 30, 2011, the aggregate intrinsic value of options outstanding and exercisable was \$114.5 million and \$108.7 million, respectively.

As of April 30, 2011, there was \$7.0 million of total unrecognized compensation cost related to non-vested stock options granted under the 2001 and 2010 Master Stock Incentive Plans. This unvested cost is expected to be recognized during the remainder of Fiscal Years 2011, 2012, 2013 and 2014.

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 equivalent shares 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, 2011, there were 79,243 options and 495,938 options excluded from the diluted net earnings per share calculation, respectively. For the three and nine months ended April 30, 2010, there were 293,816 options and 844,366 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,	
	2011	2010	2011	2010
Weighted average shares - basic	77,326	77,873	77,358	78,002
Common share equivalents	1,378	1,350	1,404	1,331
Weighted average shares - diluted	78,704	79,223	78,762	79,333
Net earnings for basic and diluted earnings per share computation	\$ 61,811	\$ 49,458	\$ 159,524	\$ 114,993
Net earnings per share - basic	\$ 0.80	\$ 0.64	\$ 2.06	\$ 1.47
Net earnings per share - diluted	\$ 0.79	\$ 0.62	\$ 2.03	\$ 1.45

Note F Shareholders Equity

The Company reports accumulated other comprehensive income (loss) 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):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2011	2010	2011	2010
Net earnings	\$ 61,811	\$ 49,458	\$ 159,524	\$ 114,993
Foreign currency translation adjustment	48,929	(7,697)	81,031	(10,722)
Currency realization upon sale of business			(101)	
Gain on hedging derivatives, net of deferred taxes	229	179	363	493
Pension and postretirement liability adjustment, net of deferred taxes	664	550		