

DONALDSON CO INC
Form 10-Q
March 10, 2016

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 JANUARY 31, 2016 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)

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 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

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 - 132,940,932 shares as of February 29, 2016.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DONALDSON COMPANY, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Millions of dollars, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2016	2015	2016	2015
Net sales	\$517.2	\$588.5	\$1,055.2	\$1,185.0
Cost of sales	346.4	385.4	706.3	772.8
Gross profit	170.8	203.1	348.9	412.2
Operating expenses	117.1	137.3	239.7	269.4
Operating income	53.7	65.8	109.2	142.8
Interest expense	5.5	3.7	10.5	7.2
Other income, net	(1.2	) (3.3	) (4.1	) (7.1
Earnings before income taxes	49.4	65.4	102.8	142.7
Income taxes	11.4	17.4	26.3	38.8
Net earnings	\$38.0	\$48.0	\$76.5	\$103.9
Weighted average shares - basic	133.7	138.0	133.8	138.8
Weighted average shares - diluted	134.4	139.7	134.7	140.6
Net earnings per share - basic	\$0.28	\$0.35	\$0.57	\$0.75
Net earnings per share - diluted	\$0.28	\$0.34	\$0.57	\$0.74
Dividends paid per share	\$0.170	\$0.165	\$0.340	\$0.330

See Notes to Condensed Consolidated Financial Statements.

DONALDSON COMPANY, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Millions of dollars)
 (Unaudited)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2016	2015	2016	2015
Net earnings	\$38.0	\$48.0	\$76.5	\$103.9
Foreign currency translation loss	(18.8	) (53.7	) (29.4	) (96.5
Net gain (loss) on hedging derivatives, net of deferred taxes of (\$0.1), (\$0.1), \$0.2 and (\$0.7), respectively	(0.1	) 0.2	(0.7	) 1.2
Pension and postretirement liability adjustment, net of deferred taxes of \$9.5, (\$4.1), \$10.7 and (\$4.4), respectively	(16.3	) 7.3	(17.3	) 12.2
Total comprehensive income	\$2.8	\$1.8	\$29.1	\$20.8

See Notes to Condensed Consolidated Financial Statements.

DONALDSON COMPANY, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Millions of dollars, except share amounts)
 (Unaudited)

	January 31, 2016	July 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$222.1	\$189.9
Short-term investments	9.8	27.5
Accounts receivable, less allowance of \$6.5 and \$6.7	402.7	460.0
Inventories	274.8	265.0
Prepays and other current assets	97.3	88.3
Total current assets	1,006.7	1,030.7
Property, plant, and equipment, at cost	1,149.4	1,128.1
Less accumulated depreciation	(677.6	) (657.5
Property, plant, and equipment, net	471.8	470.6
Goodwill	228.5	223.7
Intangible assets, net	41.7	37.9
Other assets	40.2	46.6
Total assets	\$1,788.9	\$1,809.5
Liabilities and shareholders' equity		
Current liabilities		
Short-term borrowings	\$261.4	\$187.3
Current maturities of long-term debt	1.2	1.8
Trade accounts payable	150.1	179.2
Other current liabilities	174.8	192.3
Total current liabilities	587.5	560.6
Long-term debt	389.0	389.2
Deferred income taxes	3.3	12.5
Other long-term liabilities	103.3	68.5
Total liabilities	1,083.1	1,030.8
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	758.2	758.2
Retained earnings	843.5	815.2
Non-controlling interest	4.0	3.9
Stock compensation plans	16.7	17.9
Accumulated other comprehensive loss	(209.4	) (162.0
Treasury stock at cost, 18,712,985 and 17,044,950 shares at January 31, 2016 and July 31, 2015, respectively	(707.2	) (654.5
Total shareholders' equity	705.8	778.7
Total liabilities and shareholders' equity	\$1,788.9	\$1,809.5

See Notes to Condensed Consolidated Financial Statements.

DONALDSON COMPANY, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Millions of dollars)
 (Unaudited)

	Six Months Ended	
	January 31,	
	2016	2015
Operating Activities		
Net earnings	\$76.5	\$103.9
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	36.6	37.4
Changes in operating assets and liabilities, excluding effect of acquisition	(16.1)	(69.4)
Tax benefit of equity plans	(1.8)	(5.4)
Stock compensation plan expense	5.3	7.7
Deferred taxes	(1.3)	(2.3)
Other, net	10.1	13.5
Net cash provided by operating activities	109.3	85.4
Investing Activities		
Net expenditures on property, plant, and equipment	(42.8)	(51.0)
Proceeds from sale of short-term investments	18.0	87.5
Acquisitions, net of cash acquired	(12.9)	(96.6)
Net cash used in investing activities	(37.7)	(60.1)
Financing Activities		
Purchase of treasury stock	(68.0)	(174.2)
Repayments of long-term debt	(0.7)	(1.3)
Change in short-term borrowings	73.1	137.2
Dividends paid	(45.2)	(45.7)
Tax benefit of equity plans	1.8	5.4
Exercise of stock options	5.0	8.1
Net cash used in financing activities	(34.0)	(70.5)
Effect of exchange rate changes on cash	(5.4)	(22.2)
Increase (decrease) in cash and cash equivalents	32.2	(67.4)
Cash and cash equivalents, beginning of year	189.9	296.4
Cash and cash equivalents, end of period	\$222.1	\$229.0

See Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note A – Summary of Significant Accounting Policies

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 (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 six month periods ended January 31, 2016, are not necessarily indicative of the results that may be expected for future periods. The year-end condensed balance sheet data was derived from the Company's audited financial statements but does not include all disclosures required by U.S. GAAP. For further information, refer to the Audited Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the year ended July 31, 2015.

Revision of Previously Reported Interim Financial Statements During the second and third quarters of Fiscal 2015, revenue for certain transactions was accelerated and therefore inappropriately recognized in our European Gas Turbine Systems business through the alteration of documents by certain individuals with the intention to recognize revenue in periods earlier than would be allowable under U.S. GAAP. The Company assessed the impact of this inappropriately accelerated recognition and has chosen to correct these misstatements by revising previously issued Fiscal 2015 second and third quarter financial statements. The impact of these misstatements is included in the Fiscal 2015 amounts in the accompanying condensed consolidated financial statements, including applicable footnotes, and is summarized as follows (millions of dollars except per share amounts):

	Three Months Ended			Six Months Ended		
	January 31, 2015			January 31, 2015		
	As Previously Reported	Effect of Revision	As Revised	As Previously Reported	Effect of Revision	As Revised
Net sales	\$596.9	\$(8.4)	) \$588.5	\$1,193.4	\$(8.4)	) \$1,185.0
Cost of sales	391.4	(6.0)	) 385.4	778.8	(6.0)	) 772.8
Gross profit	205.5	(2.4)	) 203.1	414.6	(2.4)	) 412.2
Operating income	68.2	(2.4)	) 65.8	145.2	(2.4)	) 142.8
Earnings before income taxes	67.8	(2.4)	) 65.4	145.1	(2.4)	) 142.7
Income taxes	18.2	(0.8)	) 17.4	39.6	(0.8)	) 38.8
Net earnings	\$49.6	\$(1.6)	) \$48.0	\$105.5	\$(1.6)	) \$103.9
Basic earnings per share	0.36	(0.01)	) 0.35	0.76	(0.01)	) 0.75
Diluted earnings per share	0.35	(0.01)	) 0.34	0.75	(0.01)	) 0.74
Comprehensive income	3.4	(1.6)	) 1.8	22.4	(1.6)	) 20.8

New Accounting Standards Not Yet Adopted In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amended revenue recognition guidance to clarify the principles for recognizing revenue from contracts with Customers. The guidance requires an entity to recognize revenue to depict the transfer of goods or services to Customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with Customers. Additionally, qualitative and quantitative disclosures are required about Customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2019 using one of two prescribed retrospective methods. Early adoption is permitted. The Company is evaluating the impact that ASU 2014-09 will have on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could be Achieved after the

Requisite Service Period (ASU 2014-12), which amended guidance related to share-based payments where terms of the award provide that a performance target could be achieved after the requisite service period. This guidance is effective for the Company beginning in the first quarter of Fiscal 2018. The Company is evaluating the impact that ASU 2014-12 will have on the Company's consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs (ASU 2015-03), which amended guidance requiring the issuance of debt costs related to a

recognized debt liability be presented on the balance sheet as a direct deduction from the amount of the debt liability, consistent with debt discounts and premiums. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2017. Early adoption is permitted. The Company is evaluating the impact that ASU 2015-03 will have on the Company's consolidated financial statements.

In May 2015, FASB issued ASU 2015-07, Fair Value Measurement (Topic 850): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (ASU 2015-07), which amended guidance requiring a company to categorize investments for which fair values are measured using the net asset value (NAV) per share practical expedient. ASU 2015-07 also limits the disclosures to investments for which the entity has elected to measure the fair value using the practical expedient. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2017. Early adoption is permitted. The Company does not expect the application of ASU 2015-07 to have a significant impact on its results of operations or financial position. The Company expects ASU 2015-07 only to affect the Company's disclosures.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory (ASU 2015-11), which amended the guidance requiring companies not using the last-in, first-out (LIFO) method to measure inventory at the lower of cost and net realizable value rather than the lower of cost or market. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2017. Early adoption is permitted. The Company does not expect the application of ASU 2015-11 to have a significant impact on its results of operations or financial position.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes (ASU 2015-17), which amended the guidance requiring companies to separate deferred income tax liabilities and assets into current and non-current amounts in a classified statement of financial position. This accounting guidance simplifies the presentation of deferred income taxes, such that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2018. The Company is evaluating the impact that ASU 2015-17 will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (ASU 2016-02), which amended the guidance requiring companies to recognize assets and liabilities for leases with lease terms of more than twelve months. The new guidance will require companies to record both capital and operating leases on the balance sheet. This accounting guidance is effective for the Company beginning in the first quarter of Fiscal 2019. The Company is evaluating the impact that ASU 2016-02 will have on the Company's consolidated financial statements.

Note B – Inventories

The components of inventory as of January 31, 2016 and July 31, 2015, are as follows (millions of dollars):

	January 31, 2016	July 31, 2015
Raw materials	\$104.4	\$113.4
Work in process	26.7	22.6
Finished products	143.7	129.0
Total inventories	\$274.8	\$265.0

Note C – Accounting for Stock-Based Compensation

Stock-based compensation expense is recognized using the fair-value method for all awards. The Company determines the fair value of its option awards using the Black-Scholes option pricing model. Options granted are priced at the fair market value of the Company's stock on the date of grant. There were 941,350 of stock options awarded during the six