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Q3 2019 Donaldson Company Inc Earnings Call

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PRESENTATION

Operator

Good morning. My name is Adam, and I will be your conference operator today. At this time, I'd like to welcome everyone to the Donaldson's Q3 Fiscal 2019 Earnings Conference Call. (Operator Instructions) Thank you.

Brad Pogalz, Director of Investor Relations and Corporate Communications, you may begin your conference.

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

Thanks, Adam. Good morning. Thank you for joining Donaldson's Third Quarter 2019 Earnings Conference Call. With me today are Tod Carpenter, Chairman, CEO and President of Donaldson; and Scott Robinson, our Chief Financial Officer. This morning, Tod and Scott will provide a summary of our third quarter performance and an update on 2019. During today's call, we will reference non-GAAP metrics, such as adjusted earnings. You can find a reconciliation of GAAP to non-GAAP metrics within the schedules attached to this morning's press release.

I want to remind everyone that any forward-looking statements made during this call are subject to risks and uncertainties, which are also described in our press release and SEC filings.

With that, I'll now turn the call over to Tod Carpenter. Tod?

Tod E. Carpenter *Donaldson Company, Inc. - Chairman, CEO & President*

Thanks, Brad. Good morning, everyone. Last quarter, we had strong growth in our Advance and Accelerate portfolio. We saw improvement in our gross margin trend and we made progress on our operational efficiency efforts. These accomplishments are largely within our control. On the other hand, macro factors, including political and economic uncertainty, drove a notable shift in our customers' behaviors toward the end of the quarter.

In April, for some of our large OEs and within our dust collection business, backlog and orders abruptly fell to a 2-year low. Within our prior outlook, we attempted to account for market volatility with a wider-than-usual guidance range, which Scott discussed at our Investor Day. However, the acuteness of April suggests it was not wide enough. While the revised forecast is disappointing, there are several bright spots in our business, so let me get into the quarter.

Third quarter sales grew 1.8%, or 5.9% without currency. Benefits from pricing added 1.5% and BOFA was another 1.4%. Engine sales were up 3.6% in third quarter or 7.7% without FX. We also realized 1.7% from pricing, which is our strongest quarterly contribution this year.

Our Off-Road business continues to face mixed conditions. Excluding currency, third quarter sales of Off-Road were slightly down, reflecting destocking at large U.S. customers, combined with the impact of political uncertainty in Latin America. These pressures were partially offset by pre-buys for an upcoming regulatory change in Europe and share gains in China with local manufacturers of Off-Road equipment.

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We were encouraged by Off-Road sales of razor to sell razor blade products, which grew 10 points faster than legacy products last quarter. Fuel filter sales led the portfolio with third quarter growth in the high teens. Program wins with fuel are nearly all incremental to us, demonstrating our success in penetrating the first-fit market with our proprietary Synteq XP media.

In On-Road, sales were up 11% last quarter, including above-market growth of 30% in the U.S. as Class 8 truck production remains elevated.

Third quarter sales of On-Road in China were down nearly 20% in local currency. Significant order volatility from Chinese customers, combined with a strong comparison last year, drove the decline. The order volatility is not new or unexpected, so we remain focused on deepening our relationships to drive profitable growth in China's massive market.

Turning to Aftermarket. Local currency sales were up 8% last quarter. Third quarter was the 13th in a row where both the OE and independent channels were up from the prior year. Within the independent channel, mining and energy markets are providing some support, but economic pressures across Latin America and other developing regions are headwinds.

In the OE channel, a sudden drop mid-April at a small number of large customers indicates to us that there was some destocking. It's unclear if demand pull-through has changed, so we're watching orders closely.

Third quarter sales of innovative products in the OE channel tell us our strategy to gain share is working. These products grew 12 points faster than legacy products last quarter due in part to PowerCore. Third quarter PowerCore sales in Aftermarket grew in the mid-teens to a record level. That's an important point. PowerCore has been around nearly for 20 years, and this industry-changing product is still driving strong growth.

By expanding our portfolio of razor to sell razor blade products, we have won share in the first-fit market, and then created a stable and profitable stream of recurring revenue. Innovative products have significantly contributed to success in recent years, and they'll play a critical role in our future.

Rounding out Engine, Aerospace and Defense sales were up 20% last quarter. Order timing and a soft comparison last year were the primary drivers.

Turning to the Industrial segment. Third quarter sales declined 1.9%. The impact from currency was offset by benefits from BOFA and pricing. Third quarter sales of Industrial Filtration Solutions, or IFS, grew 2%. Excluding currency and BOFA, sales were roughly flat with last year, but there was some variability within the business.

Starting with dust collection, local currency sales of new equipment declined in the high single digits last quarter. We are still quoting new projects, but customers are increasingly reluctant to make the investment.

A notable exception is Latin America, where our small base of new equipment sales nearly doubled in local currency. We're gaining share with a large global manufacturer as we evolve our customer engagement model. By leveraging our depth of knowledge and breadth of offering, we can help these customers improve outcomes at their facilities around the world, creating new value for them and us.

We also have momentum in dust collection replacement parts. We are investing in people and tools, and we are seeing evidence of progress. For example, China sales were up more than 50% in local currency. With growing share and benefits from China's Blue Sky initiative, we expect to take this small business and grow it rapidly over time.

Additionally, replacement parts for dust collectors in the U.S., which is our most mature market, grew in the mid-single digits last quarter. Also in the U.S., we booked our first guest orders through e-commerce last quarter. We recently enabled this feature. And while the dollar amount is still small, we believe it will drive profitable growth as we make it easier for potential customers to engage with us.

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In process filtration, local currency sales were up nearly 20%, and that's on top of 20% growth last year. To drive process filtration, we have significantly increased the sales team, and we are adding new production capacity. These products sell into the food and beverage industry at higher margins than our corporate average, helping to bolster our profitability.

As expected, sales of Gas Turbine Products, or GTS, were down 12% in local currency last quarter. The decline was due to lower sales to new projects, which we partially offset by significant growth in replacement parts. We are confident in our GTS positioning. Our disciplined management of the large turbine business, combined with our focus on growing the replacement part sales, is driving year-over-year improvement in profit on a dollar and rate basis.

Results in Special Applications also matched our forecast. Excluding FX, sales declined about 3%, driven by lower sales of disk drive filters that were partially offset by growth across the rest of the portfolio.

Before turning the call over to Scott, I want to summarize some of the successes we saw last quarter. First, our strategic investments to drive the Advance and Accelerate portfolio are getting results. Local currency sales of this portfolio were up in the high single digits last quarter compared with a low single-digit increase for the balance of the company.

Second, our razor to sell razor blade model works. Innovative products in Engine were up in the low double digits, and the Downflo Evolution offering in dust collection was up in the mid-single digits.

Third, our focus on replacement parts drives growth and adds stability. Replacement parts sales had a local currency increase of more than 10% last quarter versus the modest decline in sales of first-fit and new equipment. These products make up more than 60% of total revenue, and they help to mitigate the impact of cyclicality in some of our businesses.

With that, I'll now turn the call over to Scott. Scott?

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

Thanks, Tod. Good morning, everyone. Sales grew 2% last quarter, including a 4% headwind from currency. As expected, the impact from FX was higher than what we've seen so far this year, and we do think the pressure will lessen in fourth quarter. That dynamic was one reason we modeled the sequential step-up in Q3 to be more muted than Q4, which is consistent with what I said at Investor Day.

Of course, the sharp drop in backlog late in the third quarter changes expectations. I'll discuss that later. We generated EPS of $0.58 in the third quarter, which is up 9% from last year, due primarily to taxes. Benefits from a lower corporate rate in the U.S., combined with stock option activity and other discrete items, resulted in a tax rate nearly 5 points below last year. Based on Q3, our full year tax rate is now forecast between 24.4% and 25.4%.

In terms of business performance, third quarter operating margin declined 20 basis points to 14%. I want to remind everyone that we adopted a revenue recognition accounting standard in fiscal '19, which effectively diluted third quarter operating margin by 10 basis points.

Gross margin was also impacted by revenue recognition. Third quarter gross margin declined 40 basis points to 33.8%, with half the decline coming from the accounting change. We are still experiencing higher raw material and supply chain costs, which we mostly offset with 150 basis points of benefits from pricing. Broadly speaking, the year-over-year and sequential trends in gross margin were favorable, and our third quarter performance was in line with forecast. Our operating expense rate was 30 basis points favorable to last year due to lower incentive compensation.

In our segments, Engine's profit rate grew 40 basis points to 14.6%. That's 50 basis points without the revenue recognition impact. Third quarter was our strongest performance for Engine profit this year, and an incremental margin in the mid-20% range was the best in 2 years. Pricing added 1.7% to Engine in the third quarter, helping to get gross margin modestly up from 2018. While pricing is a never-ending activity, we feel good about the practices we're developing and the results we're getting. We also had some expense favorability in Engine, including savings from lower incentive compensation.

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The profit rate in our Industrial segment was down 50 basis points from last year or 40 basis points without revenue recognition. The decline was driven by a higher expense rate, reflecting investments in businesses like process filtration and connected solutions.

We offset a small amount of the expense rate pressure with higher gross margin reflecting strong GTS performance and a little pricing and better mix. While gross margin in both segments was up modestly, the consolidated rate was down a bit due to unallocated corporate costs and mix between segments.

Third quarter capital expenditures increased to $45 million from $27 million last year due to capacity expansion projects. New production for PowerCore, fuel and process filtration are big drivers, and we are expanding our footprint in every major region. Based on our progress, we now plan to invest about $150 million in CapEx this year.

We did a small amount of share repurchase last quarter. Year-to-date, we have repurchased 1.6% of outstanding shares, and we're on track to hit 2% in fiscal '19. We paid dividends of $24 million last quarter. And last Friday, we announced a 10.5% increase to our quarterly dividend. The larger-than-typical dividend increase comes after 2 years of record profits with adjusted earnings up 18% last year and 13% so far this year. So we felt the move supported our long-term view. We have paid a dividend for more than 60 years. And in 2016, we were proud to have been added to the high-yield Dividend Aristocrats index for 20 consecutive years of dividend increases. I think that's an impressive trend, and last week's announcement demonstrates our commitment to the dividend and our confidence in the future of Donaldson.

We also announced a new share repurchase program, which replaces the prior authorization. Like the last program, we have capacity to repurchase up to 10% of our outstanding shares, signaling our continued commitment to share repurchases as another means of returning value to shareholders.

I want to switch gears now and cover the key changes to our forecast. Full year sales are now expected to grow between 3.5% and 4.5%, reflecting updated sales projections for Off-Road, Aftermarket and IFS. Sales of Off-Road are now expected to decline in the mid-single digits. This guide implies fourth quarter sales will be down in the mid-teens, reflecting a sharp drop in backlog from a few of our largest customers. Aftermarket sales are expected to grow in the mid-single digits for fiscal '19.

We expect a modest increase in fourth quarter, which includes a 2% headwind from FX. Once again, large OEs drove most of the change. We still expect On-Road will grow in the mid-teens and Aerospace and Defense will be up in the mid-single digits. Altogether, we project Engine sales will grow between 3.5% and 4.5% this year or 6.5% to 7.5% without currency.

The other notable change to our sales forecast was IFS. We now expect sales to grow in the high single digits, reflecting lower sales for new dust collection equipment. Excluding BOFA, fourth quarter sales of IFS are still projected to grow. There were no changes to the GTS or Special Applications forecasts, which were year-over-year declines in the high single and low single digits, respectively. Our new forecast for the Industrial sales growth is 4% to 5% or 7% to 8% without currency.

Fiscal '19 operating margin is projected between 13.8% and 14.2%. Excluding the impact from revenue recognition, we expect an increase of 10 to 50 basis points from last year. The change from our prior forecast was driven by a reduced operating expense leverage on a lower base of sales.

Our full year gross margin forecast did not change. We still expect a year-over-year decline of about 50 basis points, or 30 basis points without revenue recognition. Please note that our forecast does not include any tariffs on imports from Mexico. Although the U.S. is a net exporter for us, we do import a small percent of our cost of goods from Mexico. Like all of you, we are evaluating the details as they emerge.

Turning back to the FY '19 forecast. Our full year EPS is now projected between $2.20 and $2.24. At the midpoint, that's $0.12 below the prior forecast.

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Breaking that down, $0.02 came from Q3. Business performance was $0.04 short, and the tax rate gave $0.02 back. The remaining $0.10 came out of the fourth quarter, driven by lower sales. Although we don't typically provide this level of detail, there are some unique dynamics between the quarters, which I touched on at Investor Day. In the 60 days since that presentation, changes to our customers' behavior have clearly impacted our perspective.

What hasn't changed is our urgency related to gross margin improvement, and that work is in-flight. New capacity gives us a chance to reset our supply chain, and we are seeing success from managing the price/cost relationship. Longer term, we can mix the company up by growing sales of higher-margin products, like replacement parts, process filtration, high-tech membranes and venting solutions. Between operational cost takeout and business performance, we plan to grow our gross margin and deliver all-time high operating margin by the end of fiscal '21. That's consistent with what we laid out at Investor Day.

And I also want to remind you of the story I shared that day. Recall that Tod and I went on a world tour last year to review budgets. Well, we're doing that again this year. We are very early in the overall process, but I wanted to share one item for 2020 that we've already identified. As we reset the annual plan, which we do every year, we estimate a headwind from incentive compensation of about $10 million in 2020. We'll be working to offset that amount during our detailed budget reviews.

At a high level, our goal for the 2020 plan is that we have reasonable growth projections that balance expense discipline with continued investments in our Advance and Accelerate businesses. As I frequently say, we are committed to delivering higher levels of profit on increasing sales, and our entire team is aligned around that commitment. I'm excited to begin a deep dive into our 2020 plan, and I look forward to sharing the details in a few months.

I'll now turn the call back to Tod. Tod?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Thanks, Scott. For the record, I'm excited about the world tour, too. Our plan process is more robust than ever. Our leaders are engaged, and we are aligned around a clear set of strategic growth plans. We will continue to fund growth priorities and attack profit enhancement opportunities. The top priority right now for our operations team is reducing cost and reoptimizing the supply chain. We are at an operational inflection point, and the new capacity Scott referenced is a tool for increasing our gross margins.

We had seen some pockets of success already with our lower levels of premium freight and better costing where line transfers are happening, but there is still more work to do. We're also focused on our strategic growth priorities, which include expanding our technologies and solutions, extending our market access and executing strategic acquisitions.

I want to provide a couple of recent examples of how we are executing against these priorities. Expanding technologies and solutions starts with innovation, and we are world-class. As our Chief Technology Officer, Michael Wynblatt, says, the secret to leading in the filtration market is having great filter media, and that's enabled by having great scientific fundamentals.

That's where Donaldson is very different from our competitors. We design our media and can leverage R&D across multiple markets. We diversify with technology. The result is that we create premium products and drive higher returns on our R&D investments. This capability is part of our DNA, and we are investing to make ourselves even stronger.

We broke ground on our material research center a few weeks ago. We're building a new R&D facility to further strengthen our material science capabilities. Importantly, we are focused on breakthrough innovation. We will start with the fundamentals, and then design technologies and products to further penetrate new and adjacent markets.

Another example of innovation is connected solutions. We have pilots happening with customers in both segments, and we recently introduced a commercial solution for monitoring truck engine air filters. Our solution uses existing telematics and helps the fleet managers optimize their maintenance schedule. We are selling the product for air filters today, and we plan to add fuel and hydraulic monitoring in the future.

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In addition to the fleet managers, we have pilots going with major OE customers. Early indications are positive, and we are excited about the partnership we are building with this new capability. These are just a couple of recent examples of how we are executing our strategic priorities, but there are many more. By focusing on portfolio management and having global alignment, we are operating as one Donaldson team, and I'm confident that we can create long-term value for all our stakeholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Brian Drab of William Blair.

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

I just wanted to ask -- and Scott, I think you may have touched on this, which is with respect to the longer-term target. You have the targets that you gave for the -- out through fiscal 2021 at the Investor Day. With the revenue guidance -- first, focusing on revenue. With the revenue guidance coming down for this year, do we have to take up the expectation for the -- for fiscal 2020 and 2021? I came out of that Analyst Day thinking you grow 7% this year, and then 4% organically beyond, and now it feels like we have to take that 4% up to maybe 5% or a little higher.

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

Yes. So the targets that are listed in our Investor Day presentation, I mean, those are still in existence. We still stand by those. We obviously brought down the fourth quarter a little bit. So just inherently, to reach those same exact numbers, you need to adjust upward a little bit to get there. But we still have a range and we still are committed to that range of outcome for the FY '18 to FY '21 framework that we listed out at the Investor Day.

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

Okay. And then Scott, you mentioned the world tour and the budget and the incentive. Incremental incentive comp for next year, that $10 million, was that contemplated? It sounds like it -- that was not really contemplated when you talked about your incremental margin guidance. And if I'm doing the math correctly, I mean, that could be over a 100 basis points headwind to adjusted operating margin.

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

Yes. I mean I would say that was partly contemplated.

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

Brian, this Brad. I'll add that as we came -- if you think about FY '18 and '21, as we came into '19, now we have somewhere in the neighborhood of $10 million of favorability this year that we expect from incentive comp. We've talked about that the last few quarters, that that's a driver of our expense favorability, and then that just gets offset in '20. So if you think about '18 to '21, it's a wash in the middle of that.

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

Okay. That's helpful. And then just one last quick one, the On-Road market seems to still be holding up very well. Do you feel like you're gaining significant share there? And where do you think that's going over the next year? It looks like that market is forecast to soften somewhat, and I'm just wondering what your perspective is on that at this point.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Brian, this is Tod. On-Road for Donaldson is largely a U.S.-based story at this point. Clearly, we would suggest to you that the On-Road market is likely late cycle in the U.S. but all the customer base and their public comments, et cetera, suggest that, that will continue through the balance of the calendar year. We'll continue to keep an eye on that and make sure that, that does hold.

I do want to point out an interesting point on On-Road, and that's specific to our China-based efforts. So we called out in our script that China this quarter was down 20% in local currency. However, it's a bit of an anomaly because we also said that it was a tough comp. The

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last year in Q3, China On-Road was up 400%. And so going down 20% this quarter was not a surprise to us. And in fact, sequentially, from Q2 this year to Q3 this year, we're actually up 20%. So it's really -- we still continue to make good gains in China, and we just had a tough comp to come into. So overall, you wrap that all up, and we're still in a very favorable outlook on On-Road.

Operator

And your next question comes from George Godfrey of CL King.

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

I wanted to ask about the CapEx moving to the upper end of the range, $150 million, and what you think that, that implies as a percentage of revenue, not only for this year but for next year. And my bigger question is, it's just getting more and more expensive and requiring more and more investment to develop the products that your customers are asking and it seems like that's a pretty big ramp from where we were just 2 or 3 years ago.

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

Yes. Okay. So I'll start with that. So we said we expect CapEx to be elevated this year and next year as we bring on additional capacity to account for the rebalancing of the supply chain and the additional volumes that we're experiencing. The $150 million is just a forecast of the progress we're making with regard to bringing the additional capacity online. So in my mind, that's a positive thing that we're increasing that. Next year, we'll continue to be elevated, and we'll be smart about the investments we're going to make, but we're going to continue to invest in capacity. And many of those projects that we'll complete next year are in-flight right now and so we continue with our progress.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

And George, this is Tod. I'll just comment relative to the potential cost increases to develop new products. As you know, we're on a multiple-year journey to increase our R&D spend from what has typically been 2% to 3% to 3% to 4% of sales. And the reason we're doing that is really to help support our overall strategic direction to further diversify the company, which really we're strengthening our material science space, which, longer term, allows us to go after adjacencies, which frankly are higher-margin base products than our current portfolio. So we look to mix the product -- the overall company up over time. So it's really not a reflection relative to developing additional air products, et cetera. It's really a reflection of the Donaldson Company continuing our world-class excellence in technology and furthering our advantage against our competition.

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

So just to follow up then, the increased capacity production, like when I hear all of those things, volume capacity, I think, operating leverage, so that's what you're expecting as these new programs and capacity is filled? I'll leave it there.

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

Yes. I mean we laid out our incremental margin expectations at the Investor Day, but we're projecting incremental margin at 20% to 25% range through FY '21, with the highest incremental towards the end of that cycle. So we're investing for improved margins and we're projecting the incremental margins to go along with that.

Operator

And your next question comes from Nathan Jones of Stifel.

Adam Michael Farley ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

This is Adam Farley on for Nathan. Just turning to Aerospace and Defense. Pretty strong constant currency comp there. I know you called out an easy comp year-over-year. But what is driving that performance? Is it broad-based? Is it discrete projects besides the comp? Any color there would be great.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

It's just a lumpy business. We just happened to have had a good quarter relative to that. We have not changed our outlook full year. It's still expected to be up mid-single digits, roughly. In fact, likely, if you do the math on all that, it would suggest a little tougher fourth quarter outlook to it. But it's just the lumpiness of the business.

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

Adam, this is Brad. I'll chime in on this point Tod just mentioned. If you look at our fourth quarter results last year, that was the largest quarter we've had in that business in years. So there is an aspect of this lumpiness that just pops all based on timing of orders.

Adam Michael Farley ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Okay. That's helpful. And then just turning to IFS. So the industrial economy is starting to slow down a little bit. It seems like some capital progress might be moving to the right. What -- do you guys have any confidence that some of this capital will free up later in the year? Or is there just too much uncertainty out there?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

So there's 2 things to break down that business. One would be the first fit or capital-based equipment and the other would be the Aftermarket. Taking the Aftermarket first, we're still growing in Aftermarket. We have good worldwide initiative, good momentum there, mid-single digits in the quarter, look to continue to execute well going into the fourth quarter, and that signals industrial production and utilization. So that's all a positive.

Where we saw a bit of a change in there is the quote to order time cycle elongated. So we're still quoting the projects as we expected them and so we have a nice order opportunity, if you will. It's just that people are not converting them as fast as they were previously in the year, and so that elongation has kind of kicked things out now. That speaks to some uncertainty also in the outlook, and we'll just have to keep a close eye on it. We're going to be smarter in about 90 days, and we'll bake what our new information is into full year at the next call.

Operator

And your next question comes from Laurence Alexander of Jefferies.

Nicholas Cecero ***Jefferies LLC, Research Division - Equity Associate***

This is Nick Cecero on for Laurence. So you called out rising raw materials again. And I guess as you look across your raw material basket, whether it be steel, filter media or petrochemical-based products, I guess, where are you seeing the most pressure?

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

This is Brad. I'll take that. Overall, prices paid were up in the low single digits. Steel and media continue to be the biggest ones. And actually, media is the largest within that. So as we came into the year, we expected both would be up. Steel has moderated and stabilized since then, while media continues to be a bigger increase.

Nicholas Cecero ***Jefferies LLC, Research Division - Equity Associate***

Got it. And when you look across Q3 and you look across your entire portfolio, you look at Advance and Accelerate mature in critical core. For your Advance and Accelerate part of the portfolio, are you seeing any signs of sales deceleration and margin compression? Or has it been pretty resilient thus far?

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

It's been pretty resilient so far. Particularly inside there is our dust collection Aftermarket business. That's up mid-single digits, continuing in a positive momentum. Our international market business was up mid- to high single digits. Venting, process filtration, as we talked about, was up roughly about 20%. So we're feeling across-the-board still very positive with the results that we're seeing.

Operator

And your final question comes from Charley Brady.

Charley Brady

Just wondering on the commentary about the large OEMs kind of pulling back a little bit. Can you talk to maybe inventory levels at the independent side? And I know we're only a month into the Q4, but any signs coming out of Q3 that, that has reversed? Or has that trend kind of continued into Q4? And then I have a follow-up question on that.

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Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Charley, this is Tod. So when you look at the Off-Road sector, which is where we really saw that specifically, you really have to take into account, we saw a little bit of that in the construction-based markets. Mining, we didn't necessarily see that. But remember, that's still likely early cycle, still way off peak, so mining would be more business as usual. Construction likely moved from mid-cycle to later cycle, so you saw some destocking in that area.

And then with ag, we also saw some within ag. But really, ag is a different story. We had it at about mid-cycle, but it could be mid- to early or mid- to late. It's just that there's so much uncertainty surrounding the agricultural markets that how that will float is going to be different. If tariffs start to remove themselves, for example, the ag market could be obviously early cycle. And so that one really drives uncertainty, but we did see some destocking. And the destocking that we saw was through the OE and the OES channels, not the independent channel.

Charley Brady

Great. I appreciate that. And just one more from me. So on the raw material cost, the hindsight, you're still experiencing higher raw mats costs. Can you give us a sense of where you are today in terms of price versus cost on price realization? And is there opportunity do you think to put through additional price increases to further offset that?

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

Yes. Yes. So I mean we were pleased with our pricing performance in the quarter. We added 1.7% to Engine and 1.1% to Industrial. So we've been making good progress on our pricing discipline, in our processes by which we determine what prices we're going to go out with. Pricing is really never done, but we feel we have good hygiene in place, and we feel pretty good about where we have arrived with all the work we've put on it. And we want to continue to win our first-fit programs and we want to continue to drive the Aftermarket business. Those are market-based pricing concepts that have to be dealt with, but we're pleased with our process, and we'll continue to work on it every day into the future.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

Yes. And this Tod. I'll just add a little bit of color. I would suggest that to you that we have likely returned to more normalcy across the corporation in our business processes on how we approach pricing worldwide.

Operator

And we have no further questions at this time. So we'll turn the call back over to Mr. Tod Carpenter for closing remarks.

Tod E. Carpenter ***Donaldson Company, Inc. - Chairman, CEO & President***

That concludes today's call. I want to thank everyone for listening, for your time and interest in Donaldson Company. Have a great week. Goodbye.

Operator

Thank you for your participation today. You may now disconnect.

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