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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Donaldson's First Quarter 2021 Earnings Conference Call. (Operator Instructions)

I would now like to turn the call over to Charley Brady, Director of Investor Relations. Thank you. Please go ahead.

Charley Brady *Donaldson Company, Inc. - Director, Investor Relations*

Good morning. Thanks for joining Donaldson's first Quarter 2021 Earnings Conference Call. With me today are Tod Carpenter, Chairman, CEO and President of Donaldson; Scott Robinson, Chief Financial Officer; and Brad Pogalz, EAME Finance Director, who you all know. This morning, Tod and Scott will provide a summary of our first quarter performance, along with an update on key considerations for fiscal 2021.

During today's call, we will also reference non-GAAP metrics. A reconciliation of GAAP to non-GAAP metrics is provided within the schedules attached to this morning's press release. Finally, please keep in mind that any forward-looking statements made during this call are subject to risks and uncertainties, which are 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*

Good morning, everyone. I want to start by welcoming Charley to the team. He joined Donaldson last week after 2 decades on the sell side, which included 15 years of covering our company. He already knows us well, so our Investor Relations program is in good hands. Welcome, Charley.

Turning to the quarter. We feel good about our results. First quarter sales were up 3% sequentially, which is not typical seasonality, signaling that the worst of the impact from the pandemic on our business may be behind us. Sales of replacement parts outperformed first-fit by a wide margin, providing valuable stability. And we saw continued evidence of share gains in strategically important markets and geographies, helped, in part, by our robust portfolio of innovative products.

First quarter profit performance was another highlight. Gross margin was up 60 basis points from the prior year, resulting in the highest first quarter gross margin in 4 years and the best sequential improvement in at least a decade. We reduced operating expenses by 5% while maintaining investments in our strategic growth priorities, particularly as they relate to the Industrial segment. And altogether, we had a decremental operating margin of only 4%, which we view as very positive given the uneven economic environment.

Finally, our company remains in a strong financial position. We had excellent cash conversion during the quarter, and our balance sheet is solid. We're on track to deliver our strategic and financial objectives in fiscal '21, and we'll talk about those planned later in the call. But first, let me provide some additional color on recent sales trends.

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Total sales were down 5.4% from prior year or 6.4% in local currency. In the Engine segment, more than 1/3 of the decline came from aerospace and defense due largely to the significant impact from the pandemic on commercial aerospace. We have a great team and strong customer relationships, so we expect our aerospace business will recover. In the meantime, we are pursuing optimization initiatives to put our cost structure on a firmer footing during this rough patch.

In our other Engine businesses, trends seem to be improving. On-Road sales were down 21% in the quarter, which is still a steep decline, but notably better than the past few quarters. Although Class 8 truck production in the U.S. remains depressed, order rates are increasing and third-party forecasts for the next calendar year suggest that Class 8 recovery is on the horizon. Should that happen, we believe our strong position with OEM customers would give us nice momentum in the On-Road first-fit market. In Off-Road, trends were mixed by region. In Europe, sales from new Exhaust and Emissions programs were not yet enough to offset the lower rate of production for programs already in place. In the U.S., lower production of construction and mining equipment is still a headwind for Off-Road, but we had a meaningful sequential increase in first quarter and year-over-year trends are also improving. We had a very strong quarter in China with Off-Road sales up more than 50%. Their economic recovery appears to be underway, and we are also benefiting from new relationships with Chinese manufacturers that want our high-tech products, including PowerCore. China produces more heavy-duty equipment than any other country in the world, and our team is doing an excellent job building and strengthening relationships with large local customers. While we expect to have some variability in quarter-to-quarter trends, we are also confident that we have a long runway for growth in China.

First quarter sales in Aftermarket were down only slightly from the prior year and they were up 6% from the prior quarter. All of the year-over-year decline in Aftermarket came from the U.S. The independent channel is still being impacted by the oil and gas slowdown, which we partially offset with pricing actions implemented earlier this calendar year. And large OE customers are still tweaking inventory to match demand.

Outside the U.S., Aftermarket performed very well. In Europe, first quarter sales were up 4% in local currency as conditions improved in Western Europe. In China, first quarter sales of Engine Aftermarket were up more than 30%, reflecting strong growth in both channels. We are gaining share with the new OEM customers and end users are paying greater attention to equipment maintenance. Part of our success in China is due to PowerCore, which is growing rapidly from a small base. Importantly, PowerCore continues to do well outside of China. Global sales of PowerCore replacement parts were up in the low single digits last quarter and we set another record. PowerCore is our most mature example of how our razor to sell razor blade strategy works, and the brand is still going strong after 20 years.

Turning now to the Industrial segment. First quarter sales were down about 6%, including a benefit from currency of about 2%. The decline was driven primarily by Industrial Filtration Solutions, or IFS. The pandemic is creating a headwind in terms of equipment utilization and a lower willingness to invest. Quoting activity for new dust collectors was down in the first quarter and the quote-to-order cycle remains elongated. Generally, customers are focusing on must-do projects while deferring expansion and productivity investments to a future date.

With the market under pressure, we are focused on building our brand and gaining share. We have strengthened our capabilities related to market analysis and virtual selling, and our e-commerce platform gives us incredible reach. We also continue to leverage our technology advantage, and we are encouraged by the opportunity that presents in an underserved market like China.

For quarter -- first quarter sales of dust collectors were up modestly in China and the needs in that region are changing in our favor. Some manufacturers are dealing with compliance upgrades related to the Blue Sky initiative, while others are going beyond the minimum requirements and striving for better air quality. That shift represents an exciting opportunity for us, so we will continue to invest for growth in that region.

Process Filtration for the food and beverage market is another exciting opportunity. We launched our LifeTec brand filter late in 2016, and we have seen tremendous growth since then. Sales of Process Filtration parts were up again last quarter with a low single digit increase, which partially offset the pandemic-related pressure on sales of new equipment. Our strategy for growing Process Filtration is solid. We are focused on winning new contracts with large global manufacturers, which gives us the opportunity to sell their plants.

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Some of these customers have hundreds of plants. So we are, once again, doubling our sales team for Process Filtration. We also made an organizational change to better align our team with the needs of our food and beverage customers. While these types of optimization initiatives are standard work for us, I'm calling it out because during our fourth quarter call, we said Process Filtration sales were about $50 million in fiscal 2020. Following our reorganization, that number is more like $68 million. Our IFS numbers are unchanged, but we wanted you all to have the right baseline as we talk about year-over-year trends in this exciting business.

Trends across the balance of our Industrial segment were mixed. Sales of Gas Turbine Systems were up 11%, driven by strong growth of replacement parts as we continue to gain share. In special applications, we faced pressure from the secular decline in the disk drive market, combined with lower sales of our memory products. We partially offset the decline with strength in our Venting Solutions business, which is also benefiting from share gains as we expand into new markets, including the auto industry.

Overall, we see strong evidence of how our diverse business model is providing some insulation from the pandemic. We are gaining share in strategically important markets and geographies. We are investing to keep the momentum, and we continue to show progress on our initiatives to increase gross margin. I'll talk more about our longer-term plans in a few minutes.

So I'll now turn the call over to Scott. Scott?

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

Good morning, everyone. I also want to welcome Charley. He's got great perspective, and he's a strong addition to our team. We are excited to have him join us, and I hope you all will have a chance to connect or reconnect with him soon.

Now turning to the quarter. Like Tod said, we are pleased with our results. Economic conditions were better than what we had in the fourth quarter, and we made progress on our strategic initiatives. First quarter margin was a highlight for us in terms of year-over-year and quarter-over-quarter performance. Versus the prior year, operating margin was up 50 basis points, driven entirely by gross margin. That translates to a decremental margin of 4%, but that's probably not the level to expect over time. For a better comparison, I'd point you to our sequential trends. First quarter sales were up 3% from the fourth quarter and our operating profit was up almost 6%. That yields an incremental margin of 24.5%, which is in line with our longer-term targets from Investor Day and several points ahead of our historic average. As I've said many times, we are committed to increasing levels of profitability on increasing sales, and we have solid plans to keep driving margins higher.

We saw evidence of those actions last quarter, so let me share some details. First quarter gross margin increased 60 basis points to 35% despite the impact from lost leverage and higher depreciation. On the other hand, gross margin benefited from lower raw material costs. Our procurement team has done an excellent job capturing cost improvements by working with existing suppliers and identifying new ones, which added to the benefits from lower market prices. We also had a favorable mix of sales in the first quarter. Specifically, aggregate sales of our Advance and Accelerate portfolio, which includes a significant portion of our replacement part sales along with many of our higher-tech businesses, outperformed the company. And our Advance and Accelerate portfolio also comes with a higher average gross margin. As we continue to drive investments into these businesses, we are shifting more weight towards higher-margin categories. Over time, mix should be a constant factor in driving up our gross margin.

Our strong gross margin performance in the first quarter was complemented by disciplined expense management. Operating expenses were down 5% from the prior year, which resulted in a slight increase as a rate of sales. We had significant savings in discretionary categories like travel and entertainment, due in large part to pandemic-related restrictions. At the same time, we continue to invest in our strategic priorities. We are building teams and adding resources to areas like R&D, Process Filtration, connected solutions and dust collection. These investments are tilted heavily towards the Industrial segment, which contains most of the Advance and Accelerate businesses. Given that dynamic, we are not surprised that the first quarter Industrial profit margin was down slightly. Importantly, first quarter gross margin was up in both segments, so we feel good about where we ended. As our investments translate to growth, we expect our margin and return on invested capital will go up over time.

Moving down the P&L. First quarter other expense was $1.5 million compared with income in the prior year of $2.6 million. The delta was largely due to a pension charge and the impact of certain charitable options. During the first quarter, we contributed to the Donaldson

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Foundation and there was also a charge for securing face masks that will go to frontline workers in our communities. We generally spread these contributions over a fiscal year, so the impact was more timing related than a change in trajectory for us.

I also want to share some highlights of our capital deployment in the first quarter. As expected, capital expenditures dropped meaningfully from the prior year. With our large projects related to capacity expansion mostly complete, we are turning our attention to optimization and productivity initiatives. We returned more than $40 million of cash to shareholders last quarter, including the repurchase of 0.3% of outstanding shares and dividends of $27 million. We have paid a dividend every quarter for 65 years, and we are on track to hit another milestone next month. January marks the 5-year anniversary of when we were added to the S&P High-Yield Dividend Aristocrat Fund. So this anniversary signals that we have been increased our dividend annually for the past 25 years. We are proud of this record, and we intend to maintain our standing in this elite group.

As we look to the balance of fiscal '21, there are still plenty of reasons to be cautious. The magnitude and ultimate impact from the pandemic are still unknown, and we continue to face uneven economic conditions. Given these dynamics, we feel prudent to hold back on detailed guidance, but we did want to expand our information provided during our last earnings call. In terms of sales, we expect second quarter will end between a 4% decline and a 1% increase from the prior year, and that means sales should be up sequentially from the first quarter. We also expect a year-over-year sales increase in the second half of fiscal '21. And sales are planned to migrate towards a more typical seasonality, meaning the second half will carry slightly more weight than the first. We are modeling a full year increase in operating margin, driven by gross margin. Our productivity initiatives should ramp up over the fiscal year. And we expect benefits from lower raw material costs and mix will still contribute to a higher gross margin, but to a lesser extent than what we have been seeing.

Of course, the caveat to gross margin impact is from a strong recovery. While we would be happy if our first-fit businesses accelerate beyond their expectations, that could create a scenario where mix goes from a tailwind to a headwind. That's obviously a high-grade problem, and we would address the situation if that's the case. As the rate of sales, we intend to keep fiscal '21 operating expenses about flat with the prior year. Specific to the second half of the year, we are still expecting headwinds from higher incentive compensation. And pending a return to a more normal operating environment, we would anticipate year-over-year increase in expense categories that have been significantly depressed by the pandemic. But as always, we are exploring optimization initiatives to offset these headwinds. I am confident that we can maintain an appropriate balance, allowing us to invest in our longer-term growth opportunities by driving efficiency elsewhere in the company.

For our full year tax rate, we are now expecting something between 24% and 26%. The forecast range is more narrow than last quarter, simply due to having a clarity with the first quarter complete. There were no changes to our other planning assumptions, but let me share some context. Capital expenditures are planned meaningfully below last year, reflecting the completion of our multiyear investment cycle. Our long-term target is plus or minus 3% of sales, and we would expect our CapEx to be below that level this year. We plan to repurchase at least 1% of our outstanding shares, which would offset dilution from stock-based compensation. Should we see incremental improvement in the economic environment, it is reasonable to expect that we would repurchase more than 1% this fiscal year. Finally, our cash conversion is still expected to exceed 100%. We had a very strong cash conversion in the first quarter, driven by reduced working capital, lower capital expenditures and lower bonus payoffs. As sales trends improve versus the first quarter, we would expect our cash conversion to drift down a bit over the year, which is typical of a more favorable selling environment.

Stepping back from the numbers, our objectives for the year are consistent with what I shared last quarter. We will: invest for growth and market share gains in our Advance and Accelerate portfolio; execute productivity initiatives that will strengthen gross margin; maintain control of operating expenses, including the implementation of select optimization initiatives; and protect our strong financial position through disciplined capital deployment and working capital management.

As I close my section, I want to take a moment to thank my colleagues around the world for their continued resilience. We had a solid start to the fiscal year despite the pandemic fatigue that I know everyone is feeling. I am proud of what you all accomplished, and I look forward to continued success. I also want to thank Brad for his great contributions and his friendship. I wish you and your family my best as you move to Europe. The good news is we will still work together.

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With the mushy stuff out of the way, I'll turn the call now back to Tod.

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

Thanks, Scott. This year, we have a straightforward plan, we play offense where we can and defense where we must. Our defensive efforts are all about managing costs and one way we are doing that is through optimization. The most significant example relates to productivity improvements in our plants, which are being enabled by the capital investments we made over the last 2 years.

But it's not just about large projects for us. Our employees have a continuous improvement mindset, and our culture has a shared commitment to operating efficiently. Our teams are consistently finding ways to leverage tools and technology, and their work allows us to deploy more resources to support our strategic growth priorities. As we look forward, we're excited about those opportunities. For example, food and beverage is the first step on our journey into life sciences. We expanded production capabilities of our LifeTec filters and our new R&D facility in Minnesota, we believe we are in an excellent position to press forward. At the same time, we're pressing forward in our more mature markets. Driven by our spirit of innovation, we continue to bring new technology to applications that have been using old technology for a long time. A great example is a recently announced product for baghouse dust collection. Baghouses have used the same low-tech solution for decades, and they represent about half of the $3 billion to $4 billion industrial air filtration market. Our game-changing product, the Rugged Pleat collector, delivers improved performance and lower cost of operation for customers' heavy-duty applications like mining, woodworking and grain processing. So we will deploy new technology to gain share in this significant market.

In the Engine segment, we continue to lead with technology, which is critical given the size of the opportunity. We are currently competing for projects with an aggregate 10-year value of more than $3.5 billion, telling us the market for innovation is healthy, and we have a significant opportunity to win new business. Our OE customers are working to improve fuel economy and reduce emissions from the diesel engine, and they are also increasingly interested in growing their parts business. Our products meet both of those needs. We have a multi-decade track record of providing industry-leading performance, and we can also show that our technical and design characteristics help our customers retain their parts business. Based on the opportunities in front of us, we believe the diesel engine will remain a valuable part of our growth story for a long time. But we also know the market is changing. So our focus on growing the Industrial segment while expanding our global share of the engine market, including new technologies related to air filtration for hydrogen fuel cells, puts us in a strong position for long-term growth.

I also want to touch on the role of acquisitions in our growth formula. With capital markets recovering from the pandemic, we've been getting more questions lately about our philosophy. So I thought I'd take a minute to realign everyone. Our focus is very consistent with what we laid out 18 months ago at our Investors Day. At a high level, we remain a disciplined buyer. We're most interested in new capabilities and technologies, especially those that accelerate our entrance into strategically important markets, and we are targeting companies that will be accretive to our EBITDA margin. As always, we will pursue companies that align with our long-term plans versus simply buying share. The filtration market is split between a small number of large companies, us included, and a significant number of smaller companies. The timing for executing an acquisition is always uncertain, so we will continue to work our process. Additionally, we recognize and appreciate that filtration is a high value market. So our goal is finding the best opportunity at a reasonable price. With a robust acquisition strategy and significant organic growth options, we feel confident that we can continue to drive strong returns on invested capital for a long time to come.

Before closing, I want to thank our employees for their continued commitment to our company. The level of global coordination and collaboration continues to impress me, and I believe we have done very well during the pandemic as a business and as a culture. To the Donaldson employees around the world, thank you for your commitment to advancing filtration for a cleaner world.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Bryan Blair with Oppenheimer.

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Bryan Francis Blair ***Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst***

In terms of your second quarter sales expectations, can you offer a little more color on what you're thinking about by segment?

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

Sure. So Bryan, as we look outward, we would suggest that the On-Road story is led by U.S. recovery. And an emerging portion of the On-Road story is China for us. And so we would look for a pickup in those markets. Second, we would look for agriculture -- an agricultural market end market pickup worldwide. So that's really broad-based. Construction still feels a bit more muted, and mining is still bouncing around at low levels.

Bryan Francis Blair ***Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst***

Okay. Helpful detail. And I'm sorry if I missed this detail on the prepared remarks, but how did innovative products perform in Engine Aftermarket for the quarter?

Brad Pogalz ***Donaldson Company, Inc. - EAME Finance Director***

Bryan, this is Brad. The performance overall was really good. Tod touched on PowerCore. We hit another record, and that was up a little bit in the quarter. And then if we look at the total IP products, so that was maybe 25% of Aftermarket, they were up in the mid-single digits in the quarter.

Bryan Francis Blair ***Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst***

Got it. And then any more color you can offer on Process Filtration trends? I know that on the new equipment side, there has been pressure for a while. Are you seeing stabilizing orders early in the second quarter? Or is that still pressured on that side?

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

Yes. So on the new equipment side, we'd say we still see some pressure, some headwinds across that CapEx-based investments, just like we do on our dust collection business, on Process Filtration. But on the replacement part cycle, we'd say we still continue to gain share, evidenced by the fact that it was up in low single digits in the quarter.

Operator

Your next question comes from Rick Eastman with Baird.

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

A couple of things. And by the way, welcome to Charley, and Brad we'll miss you. But just a quick question. Tod, could you maybe throw just a little bit more color? I'm still maybe a little bit surprised that the U.S. Aftermarket business didn't perform better, just -- in Engine, just given the easy comp that we saw. So maybe you could -- and was there any -- did any of the China growth in Aftermarket come out of the U.S., meaning did we previously serve that through exports?

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

Yes. It's a great question, Rick. So the China growth is just true share gain growth. It's not a realignment of exports or anything like that. So China is really share gain. Within the U.S., you're seeing many parts of the end markets pick up clearly within utilization. The headwinds that we still have is oil and gas and the oil and gas comps, where fracking really stepped down and still remains a headwind to us on the comp side. So that's really the story in the U.S. All other parts are that. Now there's one other nuance. So you talked about the potential for China. That didn't happen in China, but it did happen a bit in the U.S. So we did have some movement out of the United States to Latin America where we now service customers in Latin America. And so that's a bit of a headwind as well. So it's oil and gas and that line transfer as well.

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. And is the expectation around the Aftermarket business -- Engine Aftermarket business, is the expectation that, that business is -- finally laps the negative comparison, we can have a positive compare in the second quarter here, the fiscal second, just around Engine Aftermarket?

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

Yes, that's our view.

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. Okay. And then, Tod, you had flagged this in your comments, but when I look at the On-Road business and Off-Road business sales in the fiscal first quarter relative to the fourth, and I just look at it in dollars, what are we kind of to make of this? I mean, how comfortable do you feel here with the On-Road and the Off-Road Engine business ticking up fairly meaningfully in dollars? On-Road was -- you had a $32 million quarter, Off-Road 60 -- almost a $65 million quarter, pretty substantial step-up. So in your mind, when you think about those 2 businesses, OE businesses, are you seeing the order flow support that acceleration? Or is the first quarter maybe more a testament to the third and fourth quarters to be in the bottom?

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

Yes. So Rick, it goes back to kind of how I opened with the first answer, right? So On-Road U.S., it's clearly a U.S.-based story. And all the statistics with ACT and all of what you see out there on the new truck orders filling in is clearly what we're experiencing. And so we would see that we have some tailwinds within that market, still unsettled as to how long that will last or how big that step-up would be. But we are seeing more positive momentum in the On-Road, particularly our U.S. story, but also an emerging part of that story is our share gains across China. And then on the Off-Road side, it's really an ag story. It's a broad-based story, and you hear that out of Deere's report and many of the others. And so we do see some momentum in that area as well.

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. Okay. And just my last question, promise here. Tod, when you mentioned Aftermarket sales versus first-fit or equipment sales. In the quarter, from a total Donaldson perspective, what did those growth rates or declines look like across Engine and across Industrial? Is that a number you have?

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

For the sequential performance?

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

No, just year-over-year. So against your revenue decline of, what, 5%, was Aftermarket in total flat or was it up a little bit versus the equipment or first-fit?

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

So Rick, a little confused with that. On the table that we put within the release, of course, we show that Aftermarket was essentially down 1% over last year Q-to-Q. And Off-Road was down about [5.5%]...

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Yes. I'm just -- yes, not to interrupt you, but just...

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

(inaudible) I'm not getting it.

Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Just total sales for Donaldson. I mean we have -- we obviously have Aftermarket sales or replacement sales on the Industrial side as well in dust collection. I think you kind of referenced those -- parts of those are better. But I'm just curious if you have a number like that.

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

Got it. Got it. Sorry, I misunderstood, Rick. Apologies. Yes, so both segments were -- Aftermarket was down low single digits versus low doubles for first-fit in both segments.

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Richard Charles Eastman ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Down low double digit. Okay.

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

Yes. So pretty consistent with Tod's opening remarks about how Aftermarket significantly outperformed, that was pretty much true in both segments.

Operator

Your next question comes from Nathan Jones with Stifel.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Maybe just talk a little bit about gross margins. Nice to see those get back to 35% here. Just looking back at the Analyst Day presentation a couple of years ago, I think your targets were probably 35.5%, 36%. Clearly, we've had a little demand disruption in the interim here. Do you guys still think you're on target to get kind of -- to those kind of 35.5%, 36% gross margin level if we get volume back to, say, 2019 levels? And then what's the path forward for net?

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

Nathan, this is Scott. So we still feel good about our Investor Day targets. As we've said, the time line certainly got pushed out due to the pandemic and the revenue declines we've experienced, but we still feel good about those targets. We will continue to work to drive up that margin. We were pleased with the performance in the last quarter and in the fourth quarter of last year. So good growth in gross margins. We still see that Investor Day target of op margin between 15% and 15.8% that we gave out in the Investor Day as a reasonable target for us. And as revenues grow, we're going to be working to continue to improve our operating margins. So I think we still have those targets in sight, and we're still driving in that direction.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Okay. Then a question on inventory. I think, Tod, in your comments, you mentioned that the OEMs were still tweaking inventory levels. Do you feel like there's still a little destocking in the OEM channel? I think for the last quarter or 2, you've said the Aftermarket is pretty much flat. And with the prospect here that we're going to see sequential growth in your end market demand, should we also start to see some restocking, both at the distributed and OEMs?

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

Nathan, I actually visited customers in the quarter here on the independent channel, and I would tell you that I feel comfortable that it's at pull-through levels. I'll be with more customers tomorrow. So I would say the independent channel is pretty stable. On the OE side, you get a little bit of fits and starts with that. And so that's why the word tweaking, if you will. The end of the year is here now in December. They typically do some balance sheet management, pull it out. We see the comeback and then the bounce in January, et cetera. so net-net, it's just small movements, but it feels like the pull-through. The one place where we are starting to feel a little bit of pickup and you can see some restocking is China, but that's really driven by our personal share gains.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Do you think that calendar year 2021 should see some meaningful restocking in these channels, just given your demand outlook over the next few quarters here?

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

Tough to say, Nathan. I -- how will this thing unfold relative to the pandemic, will it walk up or will it step up? I'm not really sure. But as economies open up worldwide, clearly, they might add back carefully because cash is still very important to many businesses, especially the independent channels. And so, we're really not sure what the behavior will be like this time out of this recession. It may be different on the restocking behavior than previous.

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Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Okay. And just one more on the dust collector business. You did say that dust collector orders were down in the quarter you just reported. Are we still in the phase where we're going down at a faster rate or going down at a slower rate?

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

Slower rate, still elongated at least double on quote-to-order cycles. But must-do projects are being done, other projects are just being put off as long as they can. So we've clearly worked through much of that, but there's a carefulness cloud that hangs over that type of investment still.

Nathan Hardie Jones ***Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst***

Not surprising in this environment.

Operator

And your next question comes from Brian Drab with William Blair.

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

Charley, looking forward to working with you. And Brad, I've already sent you probably 80 mails wishing you good luck, but good luck again.

Brad Pogalz ***Donaldson Company, Inc. - EAME Finance Director***

Thanks, Brian.

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

Did you say or can you say what percentage of revenue for Engine and what percentage of total revenue is generated in China in the quarter, in the first quarter?

Brad Pogalz ***Donaldson Company, Inc. - EAME Finance Director***

Sure, Brian, this is Brad. I'll take that one. Engine was -- about 6% of Engine sales came from China in the quarter, and Industrial was higher at about 12%. But I'd remind everybody that our Disk Drive business, about half of that comes out of China. So that's inflated a bit. And the nice thing with Engine is with these growth rates, we've seen that share grow pretty meaningfully over the last 5 or so years. So Engine as a percent of China -- the percent of China for Engine coming out of that is much higher than it's been.

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

Okay. I appreciate that. And then, Tod, you talked about the Advance and Accelerate portion of the portfolio and specifically Process Filtration. Just wondering, can you comment on some of these other areas you mentioned at the Investor Day, like venting, semiconductor, hydraulics? I think you might have touched on some of that. But what are the -- how are those businesses growing outside of Process Filtration? And also, is this Advance and Accelerate category still growing? At the time of the Investor Day, it was like 5 to 7 points beyond what the corporate average was.

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

Yes. So first I'll touch with our venting business. We're very pleased with the share gains we've had in venting. It's still coming off of a low base to the company, but we're looking to get that to be a 4% level of the overall corporation. It's still between -- it's gone from less than 1% to between 1% and 2%. So we've had some nice growth, and we also have some significant program wins ahead of us. So very pleased with the team and the progress and the growth on the venting side.

Relative to other portions of the portfolio, hydraulics, we also continue to grow more of a mid-single-digit in this type of an environment situation than venting, which is clearly within the double digits. So we -- we're very pleased with the investments we've made across the Advance and Accelerate portfolio. It's delivering quite nicely. As far as performance outside or above the overall company averages, yes, we would say that mid-single digits above company average is clearly our expectation and the reason why we continue to invest within that particular segment of our portfolio.

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

Okay. And then just last, I'd be interested if you had any update on the market reception of the remote monitoring technology that you introduced recently?

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

As you can imagine, within our IAF with our dust collection-based businesses, where the overall market is still very careful on quote-to-order cycles. They're also very careful on any types of investments. And so we're still in that push type of a mode out to the marketplace. We do have hundreds of installations, but we still continue to push it out to the marketplace. And the market has not switched to a pull yet. We would look for that sometime in the future, and we would have to get more market normalcy certainly before we would expect that to happen.

Operator

Your next question comes from Laurence Alexander from Jefferies.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

This is Dan Rizzo on for Laurence. You mentioned savings in A&D, some optimization -- or you mentioned an optimization program. I was wondering if there's a target for the savings you expect over the next couple of years.

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

We're still working on the plan on that. We clearly will come out with some additional guidance once we firm those type of activities up. But those kind of adjustments really still lie ahead of us.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay.

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

And this is Scott. I just want to say, as we mentioned, we're working hard to explore cost optimization initiatives across the company. And we work hard to manage that OpEx, especially as we move into the next few quarters here.

Daniel Dalton Rizzo ***Jefferies LLC, Research Division - Equity Analyst***

Okay. And then you mentioned being disciplined and sticking to the plan in terms of looking for inorganic growth. I was wondering if the pandemic has altered the landscape of potential targets, whereas there might be more or less or if anything's changed in the last 9 months, whatever it's been?

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

It has changed things a little bit. So for example, if you're in the mask business, it's pretty interesting, you can buy mask making companies these days, which you couldn't in the past. So maybe people are trying to cash in within that filtration piece, but that's really -- believe it or not, it's a low technology space. So that's been one of the changes that's happened. But the balance of the areas where we are interested in, there has not been really any change in behaviors. It's still a very highly valued segment, and we continue to knock on doors and work our lists.

Operator

Our last question comes from Dillon Cumming with Morgan Stanley.

Dillon Gerard Cumming ***Morgan Stanley, Research Division - Research Associate***

Just first, Tod, you mentioned that you're kind of doubling the sales force around Process Filtration and food and beverage. I guess, first, what does that imply about the level of growth that you see for that business, both, I guess, this year and next? And related to that, Scott, I think you mentioned that you front load some costs being associated with those sales force adds in Industrial. Do you feel like you've front loaded enough of those that we can get back to kind of year-over-year EBT margin improvement in Industrial next quarter? Or is that still going to kind of play out in the next quarter or 2?

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

Yes. So maybe I'll start and then I'll let Scott pick up. So relative to the growth rates that we would expect out of that type of an investment, particularly in this type of an environment, we have to be able to be let into the plants to be able to make those sales. So we would expect mid-single digits to high single-digit type of growth rates across our Process Filtration business, and I'll let Scott pick up from there.

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

Yes. And I think you've heard Tod say, we're essentially doubling the sales force, so we're making a big investment there. And certainly, new sales folks when they come on, take time. You could say things are a little bit challenging right now with the pandemic, but we still feel that's a strong investment for our future. We noted Industrial margins were down 10 basis points this quarter. And that's because we're making investments in the Industrial. So I can see the need for your question. And I would submit that as those people come up to speed and hopefully, things get a little bit better here with the pandemic that those investments will begin to return at a higher rate, and that Industrial margin will start to increase.

So we need to leverage those investments. Certainly, there's front-loaded costs which are impacting us now as revenues are a little soft on the Industrial side, but we expect that situation to improve over time. And we're going to continue to invest in high-margin opportunities in our Advance and Accelerate portfolio. But over time, we expect the margins of the company to increase. And our Advance and Accelerate portfolio carries a higher-than-average corporate gross margin, and that will be a positive tailwind for the company.

Dillon Gerard Cumming ***Morgan Stanley, Research Division - Research Associate***

Yes. Okay. Got it. That's helpful. And then maybe kind of switching back to some of your longer cycle businesses in IFS and dust collection. I think you guys have been calling out CapEx [hesitancy] in kind of longer growth cycles for several quarters now. It's certainly understandable, and you were talking about that earlier. But I guess, what do you think these customers are kind of looking for at this point? Because it seems like PMIs are broadly more -- are more stable than a couple of quarters ago, and we're bumping up against about a year of project deferrals at this point. So I guess, how sustainable is it for customers to kind of be maintaining this current level of CapEx spending in that business?

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

Well, a dust collector's lifespan is between 15, 20 years, typically. And so consequently, they can go a little bit longer and continue to run and just have the replacement parts changed out, if you will, and that's on the upgrade side. The other part of it is new equipment or plant expansion. So you haven't seen a whole lot of plant expansions going on. So that cycle is still pretty dormant out there, which would normally give us a good lift. So overall, we do need more confidence across the economic recovery, both in the U.S. and Western Europe, in order to really be able to be comfortable that we're looking at an uptick within that business.

Brad Pogalz ***Donaldson Company, Inc. - EAME Finance Director***

Dillon, this is Brad. I'll add one point. If you think about PMI and just activity, that's good for the Aftermarket side of that business. We would watch capacity utilization as probably more a trigger for new equipment. So keep your eye on that metric, we are, too.

Dillon Gerard Cumming ***Morgan Stanley, Research Division - Research Associate***

Okay. Got it. That's helpful. Maybe just my last question here. The cash balance is starting to creep up a bit. And I know, Tod, you went through and kind of reiterated some of your capital allocation priorities. But you guys have the 1% repurchase framework laid out. Is there kind of a level of cash that you're kind of targeting for the end of the year or as a placeholder number that we can benchmark towards? And I guess, if you want to assume that you can't kind of execute M&A by the end of the year, is there still kind of a placeholder we can kind of reference for buybacks versus that benchmark in terms of kind of a level of cash you'd be comfortable holding at year-end?

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

Yes. So we kind of run the company on a net debt-to-EBITDA target of 1.0. So that's our target. We're slightly below that now. We want to be conservative in light of the situation we have. Our capital deployment strategy is invest either organically or inorganically in the company, pay that dividend, which has been going on for 65 years; and then buy back shares. We knew this is kind of an awkward year,

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which is why we came out with a share buyback target initially at 1%. We bought 0.3% of the outstanding shares for the first quarter. And I made the statement that if things continue to improve, you could very well reasonably expect us to increase that 1% up to -- up a fair amount.

And so that's kind of where we sit right now. As things crystallize here, we'll be a bit firmer with our guidance, but we're committed to 1%. And we said, if things continue to improve, we'll likely increase that because we are generating very strong cash conversion in the first quarter. That will come down a bit as revenue trajectory changes and our CapEx is down. So we feel that our free cash flow is a very strong kind of print right now. So we're happy about that, and we'll manage it as we go forward, and we'll keep you appraised of our estimates.

Operator

I'd now like to turn the call back over to Tod Carpenter, CEO, for closing remarks.

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

Thanks, Denise. That concludes today's call. I want to thank everyone listening for your time and interest in Donaldson Company. And I hope that you, your families and friends are safe, and I wish you all a happy holiday season. Goodbye.

Operator

This concludes today's conference call. You may now disconnect.

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