REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q4 2024 Donaldson Company Inc Earnings Call

EVENT DATE/TIME: AUGUST 28, 2024 / 2:00PM GMT

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

CORPORATE PARTICIPANTS

Sarika Dhadwal *Donaldson Company Inc - Investor Relations*
Tod Carpenter *Donaldson Company Inc - Independent Director*
Scott Robinson *Donaldson Company Inc - Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Bryan Blair *Oppenheimer & Co. Inc. - Analyst*
Tim Thein *Raymond James & Asociates, Inc. - Analyst*
Adam Farley *Stifel Financial Corp. - Analyst*
Brian Drab *William Blair & Company - Analyst*
Rob Mason *Robert W. Baird & Co. Incorporated - Analyst*

PRESENTATION

Operator

Thank you for standing by and welcome to the Donaldson Company fourth quarter and full year 2024 earnings conference call. (Operator Instructions)

I'd now like to turn the call over to Sarika Dhadwal, Senior Director of Investor Relations and ESG. You may begin.

Sarika Dhadwal ***Donaldson Company Inc - Investor Relations***

Good morning. Thank you for joining Donaldson's fourth quarter and full-year fiscal 2024 earnings conference call. With me today are Tod Carpenter, Chairman, CEO and President; and Scott Robinson, Chief Financial Officer.

This morning, Tod and Scott will provide a summary of our fourth-quarter and full-year performance and details on our outlook for fiscal 2025. We will also provide an update on our fiscal 2026 financial targets.

During today's call, we will discuss non-GAAP or adjusted results. For fourth-quarter and full-year fiscal 2024 non-GAAP results exclude pretax restructuring and other charges of $6.4 million related to footprint optimization and cost reduction initiatives. This compares to $4.9 million and $21.8 million of charges in fourth quarter and full year fiscal 2023, respectively, related to the organizational redesign as well as costs associated with exiting a lower-margin customer program.

A reconciliation of GAAP to non-GAAP metrics is provided within the schedules attached to this morning's press release. Additionally, 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. Please go ahead.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Thanks, Sarika. Good morning. Fiscal 2024 was another record year for Donaldson Company, record sales, record margins, and record EPS.

We surpassed $3.5 billion in sales, achieved operating margin of 15.4% and delivered adjusted EPS of $3.42, a 13% increase above prior year. Our cash conversion was over 97%, well above our historical average and we returned $286 million to our shareholders through dividends and share buybacks.

Through mixed end market conditions, the Donaldson team furthered our mission of advancing filtration for a cleaner world through our investments and progress on our strategic initiatives, including our 2030 ESG ambitions.

I'll now discuss our fourth-quarter results, which capped off a tremendous year for our company. Sales increased 6% over prior year, driven by higher volumes across all three operating segments, operating margin improved 200 basis points over 2023, and EPS

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

increased 21%.

Each of our segments demonstrated sales growth and improved profitability. Here are some highlights. In mobile solutions, volume was the primary driver of sales growth as a result of strength in our aftermarket business. Segment profitability continued to be robust as a result of mix, higher volumes, and pricing.

In industrial solutions, aerospace and defense sales rose approximately 40% to a record level and drove industrial profit margin to an all-time high. In life sciences, sales grew above 20% and profitability improved year over year.

Shortly after the end of the quarter, we completed the acquisition of a 49% stake in Medica S.p.A., a leader in hollow fiber membrane technology and retain a call option to purchase the remaining 51% stake in the years to come.We are pleased with this investment and our joint development agreement as we work towards developing and commercializing hollow fiber modules for applications, including bioprocessing and food and beverage.

Throughout the quarter, we maintained our focus on strong and consistent execution for our customers through our best-in-class operations teams and global footprint.

With relatively stable supply chain conditions, we significantly improved on-time delivery rates and our backlogs remain in great shape as we begin fiscal 2025. We executed and also laid the groundwork for the future through R&D and capital expenditures. R&D investment increased approximately 16% over 2023 and included product development initiatives in our legacy and newly acquired businesses.

Capital expenditures were primarily focused on increasing capacity and expanding new products and technology, including in our life sciences segment.

Now some detail on fourth quarter sales. Total company sales were $935 million, up 6% year over year, driven primarily by volume. Price contributed approximately 1%.

In mobile solutions, total sales were $575 million, a 6% increase versus 2023. Aftermarket sales grew 13% to $453 million, driven by solid growth in both the OE and independent channels. OE channel sales were up high teens versus prior year, benefiting from a return to more normalized levels of demand following destocking in the prior year.

In the independent channel, sales increased high-single-digits as a result of improved product availability and market share gains. The strength in aftermarket was partially offset by continued declines in our first-fit businesses. Off-road sales of $90 million decreased 13% as weak agriculture markets persisted in most regions.

On-road sales declined 12% to $33 million due to lower equipment production in China and the United States. I'll provide some additional color on our mobile business in China, where the macro environment remains difficult. Sales decreased 19% year over year driven by declines in our first-fit businesses.

While China now represents a low-single-digit portion of total segment sales, it remains a strategically important area for us over the long term. We are optimistic about our ability to gain share over time through programs already won and through our technology-led products as regulations become tighter and as Chinese manufacturers compete in Western markets.

Now on the industrial solutions segment. Industrial sales increased 4% to $288 million. Aerospace and defense sales rose 40% to $50 million, driven by robust commercial aerospace and rotorcraft markets as well as ongoing demand in defense due to the modernization of equipment and the impact of global conflicts. Industrial Filtration Solutions or IFS sales declined 1.5% from weaker dust collection demand in Europe and power generation project timing.

In the life sciences segment, sales were $72 million, up 21% year over year, largely as a result of Disk Drive sales, which continued to

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

rebound from trough levels a year ago. Food and beverage sales also increased in the quarter.

Looking to fiscal 2025, Donaldson is poised for another record year, delivering value to our shareholders through record sales and record earnings. We are forecasting a sales increase between 2% and 6%, driven by solid growth in all three segments, adjusted operating margin between 15.3% and 15.9% and adjusted earnings per share between $3.56 and $3.72.

Given fiscal 2024 results and our projections for fiscal 2025 and 2026, we are also taking the opportunity to update our fiscal 2026 financial targets previously laid out at our last Investor Day. First, on sales. We now expect consolidated sales to increase at a three-year CAGR between 3% and 7% slightly below our previous 4% to 8% projection. Our updated view is driven by a slower-than-expected sales ramp-up in life sciences where biopharmaceutical markets have slowed.

Our outlook for mobile and industrial solutions is unchanged. With respect to consolidated operating margin, our fiscal 2026 target range is now 15.8% to 16.6% slightly above our previous range of 15.6% to 16.4% with mobile and industrial operating margins far exceeding our previous expectations and with the path to life sciences operating margin strength elongating.

Our mobile and industrial businesses have benefited from sales mix, volume growth, pricing and deflation of select input costs and we expect current profitability levels to continue. With respect to life sciences, we now believe the ramp-up in profitability will take longer than initially expected given macro pressures and constrained customer capital spending particularly for early-stage assets.

Our view of sales and profitability mix in the three-year projection period since Investor Day has somewhat changed. However, our ability to return value to our shareholders through higher levels of profitability on higher sales has not. We remain committed to and confident in our long-term strategy of utilizing our diversified technology-led portfolio of businesses to further penetrate existing markets and enter into new markets.

Now I'll turn it over to Scott, who will provide more details on the financials and our outlook. Scott?

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Thanks, Tod. Good morning, everyone. I would like to start by thanking our teams around the globe for their hard work. We had a terrific quarter, which concluded a terrific year. Our employees delivered for our customers and our shareholders and I am proud of what we accomplished.

Before I cover our outlook, I will provide details on fourth-quarter results. EPS grew 21% year over year to $0.94 on 6% sales growth. Operating profit increased 21% and operating margin was 16.3%, 200 basis points above 2023 driven by gross margin expansion and operating expense leverage.

Gross margin of 36.2% increased 190 basis points above prior year from select input cost deflation and leverage on higher sales. Operating expenses as a percent of sales were 19.9% versus 20.0% a year ago from leverage on higher sales, partially offset by higher people-related costs and acquisition-related expenses.

Now we'll discuss segment profitability. Mobile solutions pretax profit margin was 18.3%, 210 basis points above prior year due to favorable mix from strong aftermarket performance, volume growth, and pricing benefits. Improved manufacturing efficiency in our plants also contributed to strong performance.

Industrial solutions pretax profit margin was a record 20.1%, 90 basis points above a tough comparison, 19.2% in the prior year period. The year-over-year improvement was driven by volume and pricing.

Our margin performance in both mobile and industrial has been outstanding all year, pushing Donaldson's blended margins to record levels. We look forward to continuing this robust performance in the years to come.

Our life science business generated a pretax loss of approximately 1%, including a headwind from acquisitions of 15 percentage points.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

This compares to a pretax loss of 12% in the prior year period. Leverage on higher sales from our legacy businesses drove the improvement.

While profitability in the segment has been negatively impacted by a slower acquisition-related sales ramp combined with investments for growth, we are committed to and confident in the scaling of our acquisitions and to long-term profitable growth in this segment.

Turning to a few balance sheet and cash flow statement highlights. Fourth quarter capital expenditures were approximately $19 million. Cash conversion in the quarter was 93% above historical averages and on par with prior year as our focus on working capital efficiency continue.

In terms of other capital deployment, we returned approximately $82 million to shareholders, inclusive of $32 million in the form of dividends and $49 million in share repurchases.

Before turning to our fiscal '25 outlook, I will touch on the footprint and cost optimization program we put in place this quarter which resulted in pretax charges of $6.4 million or approximately $0.04 of EPS. One of Donaldson's core strengths and competitive advantages is our global footprint.

With investments in every major region, we are able to support the production and distribution of our innovative and high-growth products in region for region. As our business evolves, we continually strive to optimize our footprint and have identified certain projects resulting in improved efficiency.

Now our fiscal '25 outlook. First on sales. We forecast full-year total sales to increase between 2% and 6%. This includes a pricing benefit of approximately 1% and an immaterial impact from currency translation.

For mobile solutions, we are expecting an increase of between 0% and 4% with growth in aftermarket and off-road more than offsetting on-road declines. Aftermarket sales are projected to increase low-single-digits after lapping solid results in the prior year as vehicle utilization rates remain high and as we continue to gain market share.

Off-road sales are forecast to increase low-single-digits for market share gains, partially offset by weaker demand from softer end market conditions, including in agriculture and construction. On-road sales are expected to decrease low-double-digits as we exit certain nonstrategic products and as global heavy-duty truck production remains muted.

Industrial solutions sales are projected to grow between 4% and 8%. IFS sales are expected to increase high-single-digits with strength across most businesses, including duct selection, industrial hydraulics, and industrial gases. Aerospace and defense sales are forecast to be flat year over year at high levels due to lapping of an outstanding 2024 with the backdrop of supportive end market conditions.

For life sciences, we expect an increase of low-double-digits, driven by sales growth across all businesses. Our legacy businesses, including disk drive, food and beverage, and vehicle electrification are all poised for strong performance and we are pleased with the progress we have made on integrating our bioprocessing acquisitions.

As Tod mentioned, challenging market conditions and tightened customer capital spending have dampened our expectation for the segment in the near-term. We expect profitability to be approximately breakeven for the full year.

On a consolidated basis, we are forecasting adjusted operating margin between 15.3% and 15.9% driven by sustained gross margin performance. At the midpoint, this represents an all-time record for the company and compares to an adjusted operating margin of 15.4% in 2024.

Our outlook for interest expense is approximately $21 million on par with the prior year. Other income net is forecasted to be between $16 million and $20 million, up from $13 million a year ago. Our tax rate is forecast between 23% and 25%, an increase from 22.7% in fiscal 2024 due to a reduction in discrete tax benefits.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

For adjusted EPS, we expect between $3.56 and $3.72, a $0.22 or 7% increase at the midpoint from adjusted EPS of $3.42 in the prior year. In total, in fiscal 2025, we are well poised to once again deliver higher levels of profitability on higher sales.

Now on to our balance sheet and cash flow outlook. Cash conversion is anticipated to be in line with historical averages at 85% to 95%. Capital expenditures are projected between $85 million and $105 million and will continue to include growth investments, including capacity and new products and technologies. Our capital deployment strategy has not changed. Reinvestment back into Donaldson organically or inorganically is our top priority.

To that end, our R&D investments are forecasted to continue to increase and our M&A focus areas remain Life Sciences and Industrial Services. We also intend to continue our long history of paying and increasing our dividend. Lastly, we plan to repurchase approximately 2% to 3% of shares outstanding.

Before turning the call back to Tod, I will provide some additional details on our updated fiscal 2026 financial targets. For mobile solutions, our sales outlook is unchanged. From a profitability standpoint, given our recent outperformance and expectations for continued strength, we are increasing our fiscal 2026 targeted operating margin range to between 18.1% and 18.9%, which at the midpoint is up 250 basis points from the initial range of 15.6% to 16.4%.

In industrial solutions, our sales outlook is also unchanged. However, given recent higher-than-expected profitability trends and our forecast for continued leverage from higher sales, we have increased the operating margin range to between 17.8% and 18.6%, which at the midpoint is over 100 basis points of improvement from 16.6% to 17.4% previously.

For life sciences, we are reducing our sales and margin expectations given the aforementioned market dynamics. We now look for sales to increase at a 12% to 16% CAGR over the three-year period versus 18% to 22% previously and forecast profitability between 5% and 11% below our previous range of 22.1% to 22.9%.

Importantly, for the consolidated company, while we have lowered our total sales growth expectation to between 3% and 7% from 4% to 8% previously, we have improved our profitability outlook to between 15.8% and 16.6%, which at the midpoint is 20 basis points above our previous target.

I'll now turn the call back to Tod for some closing remarks.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Thanks, Scott. I'm excited by what lies ahead for Donaldson Company. Through our mission of advancing filtration for a cleaner world, the company has evolved, driven by the strength of our team and our dedication to executing on our long-term strategic initiatives. I am confident in our ability to deliver value to all of our stakeholders in the years to come. We are optimistic about the future in each of our segments.

In mobile solutions, we remain the market leader with our technology-led product portfolio. Our proprietary razor-to-sell razor-blade model has been paying dividends and we expect to continue to gain share.

In industrial solutions, we are excited about our connectivity strategy and the ongoing build-out of our services capabilities. Our one-stop shop approach is working.

In life sciences, we are making progress in commercializing our bioprocessing business. We recently announced the expansion of our relationship through our Univercells Technologies business with the Gene Therapy Program at the University of Pennsylvania.

The Gene Therapy Program or GTP is renowned for its pioneering work, seeking to make gene therapies for rare diseases accessible worldwide. This expanded relationship is aimed at determining the scalability of product manufacturing using our bioreactors.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Overall, the interest in our technologies is robust, and our therapy pipeline is growing. While market conditions across our segments have and will continue to fluctuate, we are committed to investing for the future executing and remaining agile again with the overarching mission of the company as our guiding principle.

In fiscal 2024, we made considerable progress on our 2030 ESG ambitions as well and we look forward to providing an update in the quarters to come and with our upcoming fiscal 2024 sustainability report.

With that I will now turn the call back to the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions)

Bryan Blair, Oppenheimer.

Bryan Blair *Oppenheimer & Co. Inc. - Analyst*

I was hoping to level-set a bit more on life sciences trends and outlook, at least with our growth trends and outlook. And I know that bioprocessing trailing revenue base is quite limited. So the numbers there are impacted by that, but are you willing to speak to fiscal '24 growth rates across food and bev, disk drive, vehicle electrification, and bioprocessing? And then what's contemplated in your fiscal '25 outlook for each?

Tod Carpenter *Donaldson Company Inc - Independent Director*

Bryan, we haven't broke the model out externally to that level. We can tell you that we do expect a low-double-digit growth though in food and beverage. Bioprocessing will certainly be a bit more muted and that's what we put within the model. That's really the longer-term change if you will. And then disk drive will continue to crawl forward from the bottoms we experienced here over the past year. That's just generally kind of how you would put the model together.

Bryan Blair *Oppenheimer & Co. Inc. - Analyst*

Okay. Understood. The step up in fiscal '26 mobile and industrial profit expectations is encouraging certainly supported by the trends of your operations. Maybe speak to what the key drivers have been for much stronger-than-expected margin expansion in the legacy segments particularly in mobile.

And then on the life sciences side, we know that the demand backdrop in for biopharma is still muted. Is that the exclusive driver of the lowered growth and profit outlook or are there also differences in the forward model in terms of investments required, cost structure et cetera?

Tod Carpenter *Donaldson Company Inc - Independent Director*

So let's take mobile first. And within mobile, what you have is really the power of the mix overall, expanding the operating margin. Specifically, we have clear share gain within our aftermarket organizations. We also have the benefit of a little bit of the tailwind due to the OE destocking in the past.

So given the sense of where we are, for example, on that mix. You will have seen on our OE channel within aftermarket, which is about 40% of that business is up, say, high-teens within the quarter. And then when you look at the independent channel, which is 60%, you'll have seen clear share gains and up high-single-digits. That really shows the power of the mix. You also have obvious headwinds within the OE sector of the first-fit production within mobile solutions.

And specifically what really showed up in this quarter, the new piece of data would be a little bit more headwind in mining, which we had not been experiencing in the past. So net-net, we've got a good strong mix opportunity. We're very optimistic about the future and been able to hold that operating margin specifically because of the share gains we have in Aftermarket and we've been working really hard to

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

get a fair relationship with our OEs and get the pricing opportunities appropriate there.

Within the life sciences sector, yes, the bioprocessing upstream and downstream is really where we look to grow. That is clearly a more careful market at this point in time. We also would point out that new cell and gene therapy development is also a place where we look to grow. What's interesting about when you combine those, we see less expansion by the biopharma within the bioprocessing equipment sector.

And so that has become more muted as well as in the cell and gene therapy activities, we told you we had about 140 or so development programs within therapeutics. We're up in the quarter double-digits. You can see the slowness happening, for example, with less programs going into Phase I and Phase II clinical trials. And so things are just evolving more slowly than we would have expected and it's just really the backdrop of the comprehensive sector if you will.

Bryan Blair ***Oppenheimer & Co. Inc. - Analyst***

Understood. Appreciate the color. And one more quick one, if I may. Perhaps offer a little more color around Medica S.p.A., and then fit in the portfolio and your continued build-out of the bioprocessing puzzle that you've laid out.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah. We're really optimistic about what we have within the bioprocessing activities. We look at the some of the parts and we're very positive. Clearly, the market is telling us it's going to take longer than we had originally hoped. In our typical Donaldson and other models, when programs slip, they'll slip a quarter or two quarters. But within bioprocessing, they seem to slip a year or two years.

And so that's really we just thought it was prudent within the longer-term outlook to take that into account and therefore the model change. But overall, when you sum it up, we're excited about what we have. The customers are telling us they're excited about the overall products that we're bringing to them.

They are disruptive. They like the efficiency output that it brings to them. We just need to continue as a company to work our process to commercialize them and push them out. It's just going to take a little bit more time than we had originally thought but on a good track.

Operator

Tim Thein, Raymond James.

Tim Thein ***Raymond James & Asociates, Inc. - Analyst***

Good. Thank you. Good morning. The first question was on, hey, good morning. Yeah, just on the Industrial segment, I was hoping you could maybe give a little bit more color specifically on IFS and you mentioned in the release some of the timing issues that may have impacted sales in the quarter, but the kind of a step-up in growth projected here in '25.

And I guess it's a little hard to generalize for that segment just given the number of end-markets. But one of the themes has kind of been around larger-scale CapEx, just a little slower to move forward and just maybe just some mainly is around larger capital projects. And I know that's not a great generalization for what drives that segment, but maybe just give some color around the pieces within the portfolio that are giving you confidence in that high-single-digit growth projected in '25?

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah, Tim, just generally, as you describe the macro of what we're experiencing, I think you're very spot on to the overall condition that we're experiencing. For example, IAF, so dust collection equipment in Europe certainly is muted. It's the biggest headwind that we have. And it's specific to Europe. It's not other region-based and so that is the biggest headwind that we have.

And then the other one is timing relative to power generation projects. We still feel very good. It's a multi-year positive trend within power generation, certainly going up. Our backlogs are healthy. It's a very lumpy business as we talked about many times before. It's just in a lumpy moment again. Therefore, it was down in the quarter.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

But as we look forward, we do not expect it to be down. Next year, we do expect it to be up year-over-year and we see that within our backlogs. So we feel like that gives us confidence on the movement up. And then in dust collection, IAF in Europe, it's pretty tough there. We do expect conditions to repair slightly going forward. So the comp becomes a little bit easier to give us some tailwinds there.

And then the third thing, very importantly is our connected-based products really are gaining momentum. We put up and stood up about another 1,000 in the last fiscal year. We do see they help us drive Aftermarket and we are gaining share really across the world, largely though in the United States within our Aftermarket execution. And so net-net, when you roll out it together, that gives us the positive outlook for IFS within fiscal '25.

Tim Thein ***Raymond James & Asociates, Inc. - Analyst***

Very good. Thank you. And then just I guess turning to capital deployment with, I guess, half a turn of net leverage obviously in a really good position to be on the offensive. Maybe just with respect to the growth aspirations in life sciences in light of the tougher cyclical backdrop, does it change your motivation or just change your plan in terms of how much you want to invest in that area in light of a market that's maybe shaping up to be tougher than you thought?

And I guess maybe the corollary to that would be, is there potentially less, maybe you're competing for less investment just broadly speaking or is that just not the case and sort of I don't know the open-ended question, but however you want to touch on that. Thank you.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah, let me try to unpack that. There's a lot there. So just generally at the company level relative to capital deployment, our priorities have not changed. I mean, Scott points it out within the script. We specifically will invest back into the company organically and inorganically, we are targeted specifically at Life Sciences as well as service aspects in some pieces of the industrial, primarily life sciences. We like the play that we have within life sciences.

Sure, it's a little bit elongated, but the longer-term returns within that space still look very positive for us as we continue to enter it. As far as opportunities for M&A within the space at this point in time, it has gone, let's say, that's also perhaps a little bit more elongated than it has been in the past, but we saw a very full pipeline. We're still developing good relationships. It's very strategic. I'm very pleased. Nothing changes at all relative to our strategy and we sit in good shape.

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Maybe I can just add on a bit to that. I mean, if you, back to your comment about our half a turn debt level, I mean, we generated cash conversion of 113% last year, 97% this year. We're forecasting in our guide 85% to 95%. So very strong cash flows over the last few years and another strong year projected. I mean we've stomached the acquisitions that we've completed. Bought 2% of our shares increased the dividend and our debt slowly trickles down.

So in the guide, we also noted this year, we are forecasting a share repurchase of 2% to 3% of our shares outstanding. If you look back the last several years, it's been spot-on 2%. And so we've increased that a little bit in light of the very strong cash flows that the company has generated in the last two years and again expected for next year.

So we feel like we're in a really good shape from a strategic capital deployment perspective and that we're really being smart with how we're allocating capital into this business, which is evidenced by the debt slowly coming down. So we feel like we're in a pretty strong position. We do look to execute acquisitions and those you know the timing of which is always something that's impossible to estimate, but we feel like we're in a very strong position and we did slightly tick-up the share buyback guide for this year because of those strong cash flows.

Tim Thein ***Raymond James & Asociates, Inc. - Analyst***

Okay. And I'll squeeze one last one in. And this -- the risk of cutting this or slicing this too finely, but I'll just ask on with respect to the growth in Aftermarket within the Mobile business, does the, the fact that you had the contract win and that share gain that you experienced in the independent channel.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Is that normalizes is there a much of a mix impact in '25 if you have maybe the independent channel doesn't see the level of growth vis-a-vis the OE channel in '25? I know there's some can be some different margin dynamics there, but just curious if that's a meaningful factor in any way.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

I think the more meaningful factor to really take into account here is the OE destocking portion of the mix that you referred to because we do end up lapping when that was -- when that began last fiscal year. And we start to lap that within this fiscal year in Q2.

And so maybe that's something more important than what you're calling out rather to a particular large win on the independent channel. That's something to think about. And you kind of when you roll that within our overall growth rate than expected from that maybe we started from that perspective.

Operator

Nathan Jones, Stifel.

Adam Farley ***Stifel Financial Corp. - Analyst***

Good morning. This is Adam Farley on for Nathan.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Hi, Adam.

Adam Farley ***Stifel Financial Corp. - Analyst***

So gross margin improvement has been very impressive. Besides price cost, what are the main buckets leading to better-than-expected gross margins in the businesses? And any thoughts on expectations for gross margin going forward as the environment normalizes?

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Yeah. I mean, the company has obviously worked very hard on its gross margins over the last several years, getting back to the spikes of inflation that we saw and we just want to have reasonable commercial relationships with our customers. And so if costs are going up, we got to fast price increases on and they do the same to their customers.

And certainly, we think things are stabilizing now. We have some costs still going up, but some going down. So that's a good place to be. I think the world is hopefully normalizing and we've worked hard on all aspects of gross margin to get to a 36.2% gross margin for the fourth quarter and 35.6% for the year is where Donaldson should be right now. We're expecting to maintain that level of gross margins going forward. So we're not projecting any massive increases. Price for next year is forecasted to only be 1% of revenues.

So we're pretty pleased with our gross margin performance. The plants have performed very well. And so hats off to their work to maintain costs and ensure we're executing as efficiently as possible. And then we always have to be able to continue to leverage. You know, what we're doing with higher levels of sales should generate higher levels of property and profitability. We are generating higher levels of sales.

And as things have calmed down now we've really moved back to our traditional roots of improving our cost structure and we did announce a fourth quarter program whereby we're looking at a footprint and cost optimization program and while that won't necessarily provide benefits immediately, longer-term, there'll be benefits from that.

So we're going to keep working on our gross margin. We feel like we're definitely headed in the right direction with how things are performing and that's why we think we can maintain these current levels.

Adam Farley ***Stifel Financial Corp. - Analyst***

That's really helpful. And then just a quick follow-up. What is the on-road product line that is it related to? And do you expect to do any more product-line rationalization?

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah. If you remember a while back, we talked about the exit of some product lines across the company and we have one particular product. It's a DEF tank product that's really not in our core and we've been producing those for years and years and years. And because it's really not a technology-led filtration solution, we're going to move out of that business and work with our customer to transition elsewhere.

And there is a revenue haircut from that. But thinking about the capital we employ, the investments for future, we decided that wasn't strategic to the company. So that's a headwind that we've accounted for in our guidance this year in terms of first-fit sales, but I think it's the right decision for the company.

Operator

Brian Drab, William Blair.

Brian Drab ***William Blair & Company - Analyst***

Hi, good morning. Thanks for taking my questions. I just have a couple at the moment now. I was wondering if you could talk more specifically about the NAPA partnership and what went into that win. Specifically, I'm curious if you could talk about the NAPA Gold product line. What end markets are you getting increased access to? And anything else that you can do just to flesh out that win and add some detail to that.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yes, sure. So just basically, it really hits the strengths of the company as to why we won, right? So one, we have the technologies necessary that they cover across the full portfolio of product that covers all the medium heavy-duty diesel engine opportunities across multiple end market segments like construction, ag, mining, et cetera, and that really targeted because of our catalog.

Second is because of we really take great pride in customer service and customer relationships. And we have taken time to really get a strong relationship and good information share between the two companies, such that our service levels to them are really quite good. And so you roll those things together and it allows us to win this thing over time, and we believe it will allow us to have a strong relationship with them as well. So really place the strengths.

Brian Drab ***William Blair & Company - Analyst***

Yeah. Great. Thank you. And then just to be clear, I see a press release from August, but this is a partnership where you stepped up your business with them prior to August, right. And this has been contributing to the growth in the independent channel.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

It has been -- we felt as though we should put that press release out because it is material and we wanted to signal to everybody that, hey, we do have this program win. And now it is clearly continuing to add to the growth on the independent channel, yes.

Brian Drab ***William Blair & Company - Analyst***

Yeah. Okay. Got it. Thank you. And then we talked a lot about margins, but I just want to ask one more there. I'm not sure that this was discussed in great detail, but I'm just thinking that one of the things that I believe has been helping margins lately is has been the mix, right, between kind of aftermarket and first-fit. First-fit has been a little bit soft. And can you just comment specifically on whether there could be a headwind from the first-fit business eventually recovering and the proportion of sales from first-fit increasing? Thanks.

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Yeah, Brian, I think you have it right. Certainly, our aftermarket sales, which is one of the critical strengths of the company to have two-thirds of your business being replacement parts is really what drives the company. And we want to continue to sell proprietary first-fit solutions because every time we do that, we secure Aftermarket business for many, many years to come.

So as things cycle up and down in off-road and on-road and first-fit sales, obviously tend to cycle, there is a mix impact to that. And if your aftermarket business is growing at a rate much faster than your first-fit businesses, you're going to have margin accretion. And if it

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

switches the other way around, you're going to have some dilution. We think we can continue to weather those storms.

And we've really factored that into our guidance going forward. So we do expect longer-term that certainly the first-fit businesses are not going to be in decline. And certainly there's some well-publicized short-term issues in the first-fit business where you see some of our big customers retrenching just a bit and we expect that to happen for a while and then ultimately return to growth.

And so I think you have it right. We factored those concepts into our guide for next year as well as our revised Investor Day targets where we're taking mobile solutions and industrial solutions up quite a bit. So we feel pretty good about the operating margin even in light of the fact that at some point, first-fit will come back.

Operator

Rob Mason, Baird.

Rob Mason ***Robert W. Baird & Co. Incorporated - Analyst***

Just real quickly, I had a question on the fiscal '25 outlook. How are you thinking about the sales cadence? If you just want to break it down between first half and second half, yeah, if you could just comment on that.

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Sure. We're closer to a 49-51 than we are at 48, our traditional 48-52.

Rob Mason ***Robert W. Baird & Co. Incorporated - Analyst***

I see. Well, that kind of bleeds into my second question. Just around the mobile solutions outlook. The share gains have been notable here. I think you outlined or detailed some would seem like maybe incremental share gains in the off-road business that support the outlook there.

Just that my read is those are somewhat meaningful. Just your customer base is talking about a more pressure there certainly through the back half of the calendar year. Just if you could comment on your thoughts around how you may be performing there versus market volumes within your outlook.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah, we definitely have some share gain there. No question about it. And we did bake that within the guide.

Rob Mason ***Robert W. Baird & Co. Incorporated - Analyst***

Any particular region that bias to?

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Well, they're global-based customers. So when we win, we really win by platform. And so it's tough to specifically, on this particular win say, hey, this is the region because it will be more broad-based.

Rob Mason ***Robert W. Baird & Co. Incorporated - Analyst***

Sure, sure. Okay. And then just last question, stepping back to the 2026 target revisions. Scott, I think in your commentary, you talked about R&D would continue to increase, which is something we would expect. But could you put a little more context around how you think R&D trends over the next couple of years relative to your upwardly revised OP margin guidance and really on more specifically how should we think about that as a percent of sales? Does it go up as a percent of sales? Does it stay where it is?

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

Now Tod and I have been pretty consistent over the years. R&D is of critical importance to Donaldson. We are a technology-led filtration company and when we start thinking about our budget for the next year we really think hard about what monies we want to allocate to R&D and we expect to continue to increase our R&D spend, both in terms of dollars and in terms of rate of sales.

If you look at the you know it does go up and down but in the longer trend is a pretty significant increase over the last few years and we

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

want to continue that. We want to continue to invest in new technologies. We have some great opportunities in life sciences to invest.

You know and we're nearing 3% of sales. And we've been under that and we're going to continue to allocate both capital and expense dollars into R&D because that's really our best opportunity for returns on invested capital is to do it in-house with our spectacular R&D team that we have.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

Yeah. And the way we talk throughout the company is we're a technology-led company. We want to continue to invent cool things. Pretty straightforward.

Rob Mason ***Robert W. Baird & Co. Incorporated - Analyst***

No. Understood. And just one last quick one. Just related to the restructuring that you outlined, Scott, you mentioned that would those benefits would play out over time. Is there something included in the '25 outlook related to the benefits from those or they extend beyond '25?

Scott Robinson ***Donaldson Company Inc - Chief Financial Officer***

No, there would be much impact in '25. We're going to continue to focus on our footprint and cost optimization and there will be some more actions that I'm sure we can identify this year. But they take a while to run through and start to show up. But we're just trying to make the company consistent with our historical approach of things more efficient every year and that takes some investment, but the returns on those investment while not a one-year payback usually shows up in year two or year three for sure.

Operator

That concludes our question-and-answer session. I will now turn the call back over to Tod Carpenter for some final closing remarks.

Tod Carpenter ***Donaldson Company Inc - Independent Director***

That concludes the call today. Thanks to everyone who participated and we look forward to reporting our first quarter fiscal 2025 results in November. Goodbye.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS REFINITIV'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2024 Refinitiv. All Rights Reserved.

©2024 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.