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Q3 2025 DONALDSON COMPANY INC EARNINGS CALL

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An LSEG Business



CORPORATE PARTICIPANTS

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- **Tod Carpenter** *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*
- **Brad Pogalz** *Donaldson Company Inc - Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Angel Castillo** *Morgan Stanley - Analyst*
- **Bryan Blair** *Oppenheimer & Co. - Analyst*
- **Dan Rizzo** *Jefferies - Analyst*
- **Rob Mason** *Robert W. Baird & Company - Analyst*
- **Tim Thein** *Raymond James - Analyst*
- **Adam Farley** *Stifel, Nicolaus & Company - Analyst*

PRESENTATION

Operator

(Operator Instructions)

Good morning and welcome to Donaldson's third quarter fiscal 2025 earnings conference call and webcast. (Operator Instructions) Today's conference is being recorded.

I would now like to turn the call over to Sarika Dhadwal, Senior Director of Investor Relations and ESG. Please go ahead.

Sarika Dhadwal *Donaldson Company Inc - Senior Director of Investor Relations and ESG*

Good morning. Thank you for joining Donaldson's third quarter fiscal 2025 earnings conference call. With me today are Tod Carpenter, Chairman, President and CEO; and Brad Pogalz, Chief Financial Officer. This morning, Tod and Brad will provide a summary of our third quarter performance and our updated outlook for fiscal 2025. During today's call, we will discuss non-GAAP or adjusted results.

For third quarter 2025 non-GAAP results exclude pre-tax charges of \$62 million for the impairment of certain intangible assets for our two upstream bioprocessing businesses, Univercells Technologies and Solaris. Results also exclude pre-tax charges of \$4.2 million for restructuring related to footprint optimization and cost reduction initiatives, \$800,000 for business development and a \$1.2 million gain on the sale of fixed assets.

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 will now turn the call over to Tod.

Tod Carpenter *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*

Thanks, Sarika. Good morning. This quarter, the Donaldson team once again showcased our ability to deliver record sales and record adjusted earnings withstanding macro uncertainty, including fluid tariff policies and end market pressures, supported by the durability and strength of our razor to sell razor blade model, excluding currency impact, we grew sales in all three segments.

I am proud of our results. With our solid financial performance, the strength of our balance sheet and an unwavering confidence in our ability to create long-term value, we repurchased an above average number of shares in the quarter.

In addition, last week, we announced an 11% increase in our quarterly dividend. Donaldson Company is in a position of strength. Earnings growth has outpaced sales growth for seven quarters in a row due in large part to operating margin expansion.

We continue to make long-term investments in the company with sharp prioritization of technology opportunities and targeted capital expenditures, and we deploy a significant amount of cash to our shareholders through dividends and share repurchase. That has been our story, and that will continue to be our story.

Before getting into highlights from this quarter, I would like to acknowledge yesterday's announcement on the appointment of Rich Lewis as Chief Operating Officer, effective August 1. His current role as President of Life Sciences and his track record of delivering operational success throughout his 23 year Donaldson tenure, including as President of Mobile Solutions, position him well for success, and I look forward to partnering with Rich to further strengthen our execution across the organization.

Now I'll cover some highlights from this quarter within each of our segments. In mobile solutions, sales grew in constant currency, driven by our aftermarket business as we continue to gain share and post solid growth across all regions and across both, the OE and independent channels.

As a reminder, recurring revenue from aftermarket parts makes up between 75% and 80% of sales in this segment. It is this solid foundation that helps us withstand the natural cycles in new equipment production. Additionally, while our first-fit businesses are currently facing cyclical headwinds in more developed regions, we remain optimistic about growth in large and growing markets, such as India due to recent wins.

Our industrial solutions, volume growth and pricing drove a solid sales increase and as expected, profitability improved sequentially, returning to above 18%, a level consistent with our long-term target. Our aerospace and defense business continues to outperform with sales now at an all-time high. The team has worked hard to navigate supply chain bubbles and deliver our technology-led products to our customers.

Our connectivity strategy remains a priority, and we are in the final stages of launching our new technologies, including next-generation controllers and gateways, which will enhance our offerings across Industrial Filtration Solutions, or IFS, businesses.

Our services business is performing well, and our most recent acquisition, EZFlow, once again performed above our expectations this quarter and posted a record April. In Life Sciences, we are now operating with a leaner, more focused cost structure from which we are better positioned to leverage sales growth.

Our larger legacy disk drive and food and beverage businesses are performing well while our newer Bioprocessing businesses are working to bring new products to market. Recall that our Isolere Bio business in October of 2024 announced the availability of its research grade IsoTag AAV reagent.

This quarter, we took another important step towards scaling and commercializing this product, announcing the availability of the manufacturing grade product, which is used to address bottlenecks in customers' good manufacturing processes, streamline purification and bring certain gene therapies to patients in need.

Now some consolidated company highlights. Sales rose 1% year over year to \$940 million, where modest volume growth was offset by a currency translation headwind, allowing pricing to push us forward. Operating margin in the quarter improved 80 basis points over 2024, driven by expense leverage. Adjusted EPS was \$0.99, up approximately 8% versus prior year.

I want to provide some additional details on tariffs. The impact of tariffs on this quarter's net results was immaterial. And based on what is implemented today, we expect the net impact on our profit to remain immaterial. The reason we have this view is because of how we operate. Structurally, Donaldson is well equipped to successfully navigate the current dynamic global tariff environment.

Our operating model provides some natural hedging from tariff impacts. First, about 75% of our footprint is region to support region manufacturing and distribution. Second, our largest exposure is from Mexico to the US, where approximately 85% of goods we ship are USMCA qualified, and our teams are working to accelerate additional qualifications where there are opportunities. Also, in thinking about Donaldson's tariff exposure, it is important to note the US is a net exporter.

On an annualized basis, we estimate the total impact of tariff costs on Donaldson today to be around \$35 million, which we expect to offset through supply chain and price adjustments, including the application of surcharges.

While navigating the ever-changing tariff dynamics, our global operations teams focus on working down backlogs and delivering on customer commitments. Overall, on-time delivery rates remain at high levels. Throughout the quarter, we maintained expense discipline while still investing in strategically important areas. We focused our capital expenditures and R&D investments, which continued across all segments.

During the quarter, we also released our fiscal 2024 sustainability report, which illustrates how our environment and social efforts are driving cost savings, strengthening customer relationships and reinforcing our long-term competitiveness.

Key updates include our virtual power purchase agreement, where we teamed with PepsiCo to lower US emissions and a 2030 ambition to reduce landfill waste or increased recycling by 3,200 metric tons. These efforts align with the expectations of our global OEM and multinational customers, enhancing our ability to win and expand relationships.

Now I'll provide some detail on third quarter sales. In mobile solutions, total sales were \$583 million, roughly flat with prior year. Aftermarket sales were \$460 million, a 3% increase driven primarily by mid-single-digit growth in our OE channel. Independent channel sales were up low single digits from market share gains.

In our first-fit businesses, end market pressures continue. Off-road sales were \$96 million, down 8% and On-road sales of \$27 million declined 25% primarily due to ongoing and well-documented weakness in the transportation and agriculture markets.

Touching on China for a moment. Mobile solutions China sales were a bright spot in the quarter, increasing 27% from growth in both first-fit and aftermarket. We are pleased with the momentum we are seeing, particularly in off-road as a structural shift to larger, more sophisticated equipment is driving demand for our products. We're optimistic about our long-term growth potential.

Turning to industrial solutions. Industrial sales rose 5% to \$283 million. IFS sales were \$232 million, a 1% increase from prior year with replacement parts sales strength in several key businesses, including power generation, industrial hydraulics and industrial services offsetting new equipment declines.

Aerospace and defense sales grew to a record \$52 million, largely from robust aerospace market demand. In life sciences, sales of \$74 million grew 1% compared with prior year, double-digit sales growth in disk drive and food and beverage replacement parts was partially offset by timing of bioprocessing sales as we had significant project shipments in last year's third quarter.

Overall, I'm very pleased with the results we delivered and look forward to a strong fourth quarter. Fiscal 2025 is forecasted to be another record year for Donaldson, record sales, record operating margin and record adjusted earnings.

Now I'll turn it over to Brad, who will provide more details on the financials. Brad?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Thanks, Tod. Good morning, everyone. We are pleased with our third quarter results. Sales were up due to the strong foundation of recurring revenue and the diverse mix of businesses and geographies where we operate. Profit was up due to revenue growth, expense discipline and prioritized investments, and we made notable contributions to shareholders via repurchase and our recently announced dividend increase.

I want to thank my colleagues around the world who stay focused on our customers and our opportunities for growth amidst this uncertain environment. It's no easy task, and they do these things while keeping a close eye on expenses, profitability and cash, which makes us a strong company we are.

Before going through the details on our performance, I want to touch on the charge we took in the quarter for an impairment of intangible assets. The charge relates to our two upstream bioprocessing businesses, Univercells Technologies and Solaris.

As we have discussed over the last several quarters, results have been pressured by market headwinds, including weak capital spending and longer-than-expected drug development time lines. The situation has not improved with an elongated ramp up in sales

and profitability ultimately leading to an impairment.

That said, we still believe the bioprocessing market presents great opportunities for us, and we will continue to make strategic investments as we look for ways to develop and commercialize new disruptive technologies.

Now turning to a few highlights from the quarter. Note that my profit comments will exclude the impact from the items Sarika referenced earlier. Total sales increased 1%, driven by pricing and volume growth, partially offset by a headwind from currency translation.

Expense leverage drove operating margin up 80 basis points, and adjusted EPS of \$0.99 was 8% above the prior year. Going further into the P&L, gross margin was 34.5%, a decrease of 110 basis points from last year, mainly as a result of higher manufacturing costs, including those related to footprint optimization initiatives. While these projects pressure gross margin in the near term, we are confident they will enhance our long-term profitability. I also want to repeat a point Tod made about tariffs. The impact on gross margin in third quarter was negligible.

And the total annualized impact from the current tariffs is estimated at less than 1% of sales, which is something we believe we can offset. We recognize the importance of this topic, so we wanted to make it clear where we stand today.

Back to the P&L. Third quarter operating expense as a rate of sales improved to 18.2% from 20.1% a year ago. The favorability was driven by a handful of things. We had a reversal of an earnout reserve for our Purilogsics business within life sciences, and we also had lower warranty expense. These factors were further complemented by our ongoing expense discipline, reflecting the sharp prioritization happening across the company.

In terms of segment profitability, mobile solutions pre-tax profit margin was 18.1%, down 30 basis points year over year mainly due to higher manufacturing costs and including those related to footprint optimization projects.

Industrial Solutions pre-tax margin was also 18.1%, down 60 basis points, largely as a result of unfavorable regional and product sales mix. Life Sciences pre-tax margin improved notably to 7.8%, mainly due to the previously mentioned earnout reversal for Purilogsics, which resulted from a longer-than-expected revenue cycle.

Life Sciences profit margin also benefited from the cost optimization initiatives launched earlier this year. While we expect market-based headwinds in our bioprocessing business to continue, we are committed to making selective strategic investments while leveraging the strength of our more mature life sciences businesses.

Now our updated fiscal '25 outlook, First, on sales. We are projecting a full year total sales increase between 1% and 3%, in line with our prior guidance. Pricing is expected to contribute approximately 1% and the impacts from both currency translation and tariffs are expected to be negligible.

For mobile solutions, we're forecasting sales will be flat to up 2% consistent with our previous expectation as higher-margin aftermarket growth is being partially offset by ongoing first-fit pressure. We did modify the on-road forecast with continued weakness in global truck production, resulting in a sales decline in the high teens versus low double digits.

As a side note, I know transportation markets get a lot of attention due to the availability of public data, but I want to remind everyone that the on-road first-fit part of our business hovers between only 3% and 5% of total sales.

We like this space and our deep customer relationships give us confidence that our advanced technologies are excellent solutions now and into the future, but it's important to keep perspective on the impact these truck cycles have on our business.

Moving to off-road. The sales guidance of a mid-single-digit decline stayed the same, primarily due to weak agriculture markets. Our guidance for aftermarket sales is also unchanged at a low single-digit increase versus the prior year, showing the resilience of this important category of business.

In industrial solutions, sales are forecast to grow between 2% and 4%, in line with our previous expectation. We continue to expect IFS sales to increase low single digits with replacement part growth offsetting slower sales of new equipment, which are being pressured by the uncertain economic environment. Aerospace and defense sales are now projected to increase in the low teens, up from high single digits as robust market conditions in both aerospace and defense continue.

In life sciences, our expectation of high single-digit growth is unchanged. The positive momentum in our larger legacy businesses disk drive and food and beverage continues to be partially offset by ongoing weakness in bioprocessing. Consistent with the guidance we laid out at the beginning of the year, we are forecasting full year segment profitability to be roughly breakeven.

From a total company perspective, we are maintaining our forecasted operating margin at record levels between 15.6% and 16.0%. At the midpoint, this would be a 40 basis point year over year expansion, largely as a result of our continued focus on expense management.

Our adjusted EPS guidance of \$3.64 to \$3.70 also reflects a record level. At the midpoint, we raised our forecast \$0.03 from our previous guidance, implying a solid 7% year over year EPS increase that is built on a 2% sales increase.

Despite the economic environment, we demonstrate our ability to drive leverage, and we believe we could further expand that leverage when the economic conditions become more robust. In the meantime, we control what we can, including those key aspects of capital deployment. Cash conversion is expected to be in the range of 80% to 90% this year, consistent with historical averages.

We look to finish the year with fourth quarter conversion higher than year-to-date levels due to normal seasonality and a reduction in working capital, primarily through lower inventory levels as our teams continue to navigate certain supply chain issues.

And then at a high level, strategic capital deployment is always on our minds. Investing for growth remains the top priority. We see opportunities within the company and outside via acquisitions. Inside the company, our capital expenditures for this year are forecast between \$75 million and \$90 million.

We are investing in future growth through capacity expansion, new product development and technology projects. M&A is also an important lever in supporting our future growth, and we are still actively working a pipeline of opportunities.

We are strategic and disciplined with our focus remaining more squarely on opportunities within the life sciences and industrial markets, but the timing of deals can be uncertain, and that guides our actions. We have to protect some level of liquidity to give us flexibility to act when the opportunity arises, and we do this well given the incredible strength of our balance sheet. At the same time, we are committed to the ongoing return of cash to shareholders in a thoughtful and systematic manner.

And I want to provide a couple of updates on that point. First, as Tod mentioned, last week, we announced an 11% increase in our quarterly cash dividend. This level of increase is a testament to our strong operating performance today and our confidence in our future performance and financial strength.

It's also worth highlighting that 2025 is forecast to be Donaldson's 30th year in a row of annual dividend increases. It's a massive accomplishment and limited to a small number of great companies, including our peers in the S&P High Yield Dividend Aristocrat Index. We are proud to be part of this elite group.

My second point on returning cash to shareholders. During the third quarter, we repurchased 2.4% of our outstanding shares for a total of \$192 million, bringing our year-to-date repurchase to 3.3% of outstanding shares. With that level of buyback, we are now increasing our full year expectation to between 3.5% and 4%. Dividends and share repurchase are long-standing components of our capital deployment priorities.

And through these vehicles, we demonstrate our view that Donaldson has a strong foundation and excellent long-term growth prospects. In summary, we performed well so far this year. The outlook we provided today suggests that performance continues in fourth quarter, keeping us on track to deliver record sales and adjusted earnings in fiscal 2025.

Now I'll turn the call back to Tod.

Tod Carpenter *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*

Thanks, Brad. Looking ahead, as I said in my opening comments, Donaldson is playing from a position of strength, and I'm confident that we are well positioned to deliver long-term value through strategic investments, strong execution and disciplined capital deployment. Our team's ability to navigate dynamic market conditions while advancing innovation and growth initiatives gives me optimism as we drive forward to a robust future.

With that, I'll now turn the call back to the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Angel Castillo, Morgan Stanley.

Angel Castillo Morgan Stanley - Analyst

Good morning and thanks for taking my question. And congrats on a strong quarter. Just wanted to maybe unpack a little bit more if we could talk about kind of the gross profit margin dynamic. Particularly, I think there was a little bit of a step down here, I guess, sequentially and year over year, and you talked about some of the pieces.

Can you -- as you look forward, can you talk about kind of the ability to remain price cost neutral? And how you're seeing inflation more broadly in your business and perhaps also kind of quantify maybe how much was just due to footprint optimization initiatives and therefore, might not repeat as we go forward?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Hello. Angel, can you hear me?

Angel Castillo Morgan Stanley - Analyst

Yeah, I can hear you now.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Okay. Sorry about that. We've got some technical difficulties, apologies to the group. So this is Brad. I want to start with the footprint. That was the majority of the decline in gross margin in the quarter. And I want to touch on that really quickly. I'll come back to your other comments about price cost. But as far as the footprint specifically, we're at a point of heavy lifting right now. We've got plant rationalization activities that we kicked off last year.

So one plant in the US is closing and going to another US state. We've got a plant in the UK that's closing, and it's going to East Europe. So this is about driving towards longer-term opportunities, and that's where the activities are happening right now.

As far as price cost, we feel very good about our position to stay neutral on that. We continue to get price. Obviously, the mission for us is to be fair with our customers. We're a premium brand in the markets, and there's a lot of different pricing strategies. But overall, there's no change to our stance here. We will continue to make sure that we hold on to pricing where we can.

Angel Castillo Morgan Stanley - Analyst

That's very helpful. And maybe if we could just expand a little bit more on the footprint side as it relates to CapEx. You lowered the CapEx outlook for the year. Can you talk about maybe what's kind of driving that? And as you think strategically kind of longer term and given some of the administration's kind of proposed tax policies, any shift or potential kind of impact or benefits to your strategy in capital investments as we think kind of going forward or desire to perhaps in size or timing of location of your investments?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Sure, Angel. This is Tod. So we launched CapEx projects when we feel comfortable that we can execute them. Given the dynamic environment of the tariff situation and clearly, supply chain pressures and disruption, we have large teams of people dealing with that on a more priority basis than launching some of the CapEx.

We're also really holding more inventory than we had originally planned this year as a direct result of that, so we can offset supply chain. Remember, our strategy is to always put our customers first. So while we had initially thought that we would be driving

inventory down faster than we are and launching CapEx projects, right now, it's really prudent to focus on executing the businesses for our customers, and that's what you're seeing.

Angel Castillo Morgan Stanley - Analyst

Very helpful. Thank you.

Operator

Bryan Blair, Oppenheimer.

Bryan Blair Oppenheimer & Co. - Analyst

Yeah, good morning.

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Good morning.

Bryan Blair Oppenheimer & Co. - Analyst

So hoping you could offer a little more color on industrial solutions top line trends. Obviously, the segment revenue guide was maintained. So moving parts net, I guess, to the same level. You talked last quarter about the project-driven side of IFS being, I guess, somewhat bifurcated, auto EV being notably weak, but having strength elsewhere. Is that still the case? Is your team seeing any shift in that dynamic?

And then on the connected service revenue, that's, of course, been a good guide for the segment. I think you had called out around 30% year-to-date connected machine growth last quarter. And are you still seeing a similar level of momentum there?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Sure. So at the macro, Brad will get a couple of numbers here or Sarika. But at the macro, this is what's taken place. Within our industrial solutions businesses, the equipment side of the business is a bit more pressured. We still see a large number of quotes coming through.

It's just a little bit slower to turn those into projects, but there is healthy activity out there, just a little bit more careful. Therefore, what you're seeing from our company is more of an aftermarket story. It's also we've been growing share nicely in our, what we call, stationary hydraulics business and put those two together, hydraulics, aftermarket and then now the newer portion of services together, they can really offset any of the other headwinds.

I would note also that in the quarter that power generation, that's a very lumpy business for us. That was a bit more muted comparably year over year. And so as we look forward in the year, we have more projects that we'll be shipping, and that really helps us to sustain the overall forecast within industrial solutions.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Bryan, this is Brad. I just want to add one point. Tod talked about the recurring revenue for mobile solutions in his prepared remarks. But I just want to say to the question about our results, a little over half of the IFS business is replacement parts. So this is again something that gives us quite a good foundation, especially as there's a little bit of a softening on the CapEx.

Bryan Blair Oppenheimer & Co. - Analyst

I appreciate that color. And I'm sorry if I missed the detail. What was the margin impact of reversing the Purilogics earn-out reserves? And then given the prolonged path to bioprocess and commercialization, are the fiscal '26 targets for life sciences still in play?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

The total Purilogics specific was about \$6 million in the quarter, and that's exactly what you said. It's an elongation of the revenue cycle in this business, similar to what we talked about with the other upstream businesses. As far as fiscal '26 targets, we're going through the process of building our plans right now, and that's something where we'll come back to the group with something in the fourth quarter like we typically do.

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Yeah, I do want to point out though that, Bryan, as we continue to work on life sciences as this year evolved, our profitability within the life sciences business has sequentially improved each quarter of the year.

Bryan Blair Oppenheimer & Co. - Analyst

Understood. Thank you again.

Operator

Brian Drab, William Blair.

Unidentified Participant

Hey, good morning. This is Tyler on for Brian. Thanks for taking my question. First, the aftermarket business continues to report growth. Just wondering how well this trend is expected to hold up in the next fiscal year. Not looking for guidance, but the full year guidance right now implies a somewhat deceleration in the fourth quarter, but maybe this is driven by a strong fourth quarter in the prior year. I'm just wondering how does the growth rate trend against the recent strong performance in the next few quarters?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Yeah. So if you just take a look at our company and split it into two halves, the fiscal year, first half is about 48% of our revenue and the second half is 52%. It is -- our mobile solutions aftermarket certainly falls within that cyclicity. Typically, our third and fourth quarters are the strongest of the year.

And so that's the reason why you see a strong performance in the third quarter. We just have good vehicle utilization. And very importantly, our teams are doing an excellent job at share gains within that, giving us confidence that you'll continue to see that in the fourth quarter as well.

Unidentified Participant

Great. And then -- and aerospace and defense continue to be strong as well. What is your visibility like in this segment? Do the comps get tough in fiscal 2026? Or do you have enough project activity in the pipeline to maintain the current pace? Thanks. Sorry, I'm not getting anything back.

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Can you hear me now?

Unidentified Participant

Yeah.

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Okay. Great. So when you look at the visibility of aerospace and defense, we do have long visibility as much as four and five and six quarters on some of the projects. They go multi-year projects. And so we do have good visibility.

The difficulty in that business right now is the uncertainty of the supply chain. And so we have fits and starts within the supply chain activities, making that a little bit more difficult to predict the lumpiness of it at this point in time as well as they have had some swirling conversations of will there be some project cancellations, et cetera.

But project cancellations conversations are one thing to be had in the newspapers. It's another to understand whether they're really getting canceled or not. And we continue to execute all of those. So there's some macro environmental things that are making that a little bit more difficult to predict.

But you roll it all together and the way the team is executing. Our business is really strong, doing an excellent job, taking care of our customers. And as we said, we just shipped a record quarter in our aerospace and defense business.

Unidentified Participant

Okay. Thank you. I'll pass it along.

Operator

Laurence Alexander, Jefferies.

Dan Rizzo Jefferies - Analyst

Hi, this is Dan Rizzo on for Laurence. Just to follow up on that. So you indicated you had a record quarter in A&D. So was there some pull forward there? Because I mean, just based upon -- you kind of talked about this a little bit, based upon the overall 2025 guidance, it seems like there is somewhat of a slowdown in the fourth quarter here year over year?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

We did have some second quarter sales that flocked into the third quarter. And so rather than a pull ahead, it was a little bit of a pushout, if you will. We now -- we were able to get those projects shipped and out, but that's the supply chain disruptions that I've been referencing here.

And we've baked all of that into the guidance in the fourth quarter, and that's how it rolls up. So remember, we did have our aerospace and defense guide go from high single digits last quarter to now be low teens, so it has increased.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Yeah. One thing I'll add, Dan, this is Brad. Just keep in mind, please, that last year, sales in aerospace and defense were up more than 20% in the fourth quarter. So if you just try to smooth that with a two year, the first half and the second half of this year are

looking more comparable than what the math would suggest with the specific quarterly growth rate for fourth quarter this year.

Dan Rizzo Jefferies - Analyst

Okay. No, that's helpful. And then I guess the same thing kind of with aftermarket then because the fourth quarter, I mean, it's still a fairly strong year, but it looks like again -- and this was alluded to before, there was a bit of a, I think, a downturn year over year in the middle based upon your guidance in the fourth quarter, but I guess that would just be attributed to a pretty tough comp, right?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Right, exactly.

Dan Rizzo Jefferies - Analyst

Okay. And then a final question. So with FX, is there a rule of thumb that we should use like changes in the euro, are they changing the, I don't know, the peso or something like that of how it works with the fluctuations that we've seen over the past few months?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Yeah. It's hard because of the basket of currency. So the euro is the most commonly traded outside of the USD, and that's in the neighborhood of 20%. The next closest currencies are some Asian ones that are low single digits.

So you can see that outsized movements in places like South Africa or Brazil create a lot of volatility within the total numbers. So it's hard to give you a heuristic on X percent equals Y percent. But hopefully, that helps some.

Dan Rizzo Jefferies - Analyst

All right, it does. All right. Thanks a lot, guys. I'll turn it over.

Operator

Rob Mason, Baird.

Rob Mason Robert W. Baird & Company - Analyst

Yes, thanks for taking the question and congrats to Rich. I wanted to circle back just on the industrial segment. Maybe I have hone in on IFS in particular. The -- your guidance for the year kind of implies the fourth quarter would be up sequentially.

Tod, you talked about on the power gen side, that being more project driven. Similarly, the new equipment, I guess, in IFS quoting activity is down. So is the step-up that we're seeing in the fourth quarter, is that solely due to power gen, that's the way -- and maybe aftermarket growth? Is that the way to think about that?

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

Three things. One, aftermarket growth. So industrial production continues. We continue to win share due to our connected based strategies. We also have a service-based revenue that's been growing quite nicely. So that connected strategy really is helping to drive our aftermarket growth. So that's the first story. The second is, we've done really well in industrial hydraulics or what we call stationary hydraulics. And we have grown that piece. And then the third piece will be the power generation that you referenced.

Rob Mason Robert W. Baird & Company - Analyst

Okay. And just because that is longer cycle power gen, is that -- do you have visibility that this stretches out over multiple quarters there? Or is that -- I'm just curious if your commentary around lower quoting activity applies to that business also.

Tod Carpenter Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer

We do. We have very long visibility on power generation, some of the longest in the company. And I can tell you, the power generation projects are really being sought after to lock up capacity from us all the way out as far as fiscal year '28.

So that's the kind of conversations that we're having with our customers at this point. Now power generation is clearly in a growth cycle. It's in -- already been for the last two years in a growth cycle. It's really an extended one as you read about in the newspapers, et cetera, and we're benefiting from that as well.

Rob Mason Robert W. Baird & Company - Analyst

Yeah. Okay. And then maybe I may have missed this, Brad, when you were commenting around the footprint optimization, but when would you expect those moves to be complete in terms of just having, I guess, a negative impact on gross margin?

And then if I could layer on another one point just how should we be thinking about the timing of these tariff flow-throughs as well as your mitigation efforts? I know it was negligible in the third quarter, but just over the next few quarters cadence.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Sure. Both important questions. Footprints, a lot of the heavy lifting is going to be done towards the end of this calendar year. There will be some trickle through into next year as we complete the moves. So that's something that we'd expect to happen again in the coming quarters.

Tariffs, the flow-through, you can think about this, give or take 1% of sales, I think \$35 million or so. It's almost ratable at this point based on flow of goods. Now of course, that's the estimate today and things are constantly changing.

But from our seats, and Tod touched on this, the region to support region footprint gives us a great advantage here. And then further, the USMCA qualifications really help us. So we do believe this is something that we can handily offset as a function of pricing or moving supply chain.

Bryan Blair Oppenheimer & Co. - Analyst

Very good. Thank you.

Operator

Tim Thein, Raymond James.

Tim Thein Raymond James - Analyst

Thank you. Good morning. Maybe I'll just package these together. The first question is on maybe just some preliminary thoughts as we look into '26. I know, Tod, you're putting together the plans, but maybe just anything you could offer in terms of, I don't know, maybe markets or geographies that you're maybe more optimistic about and just maybe just again, a high-level thought to the extent you can share that.

And then part two is just on the mobile aftermarket as you look across the -- both the OE and independent channels, any comments just in terms of general inventory levels and where the channel sits from a kind of from a stocking perspective. That's it for me. Thank you.

Tod Carpenter *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah, let me take the inventory question first. So I'll tell you, in the mobile aftermarket, we grew in both the OE and the independent channels within this quarter. Low single digits, low to mid-single digits in both of those.

And as a reminder, our independent channel is 55% of our mobile aftermarket and the OE is 45%. Relative to inventories out there, they feel like they're at pull-through levels. It's very comfortable conversations with both channels. And so that all feels like we will experience the normal cyclicality that we would expect in the fourth quarter.

As far as fiscal '26, obviously, we're going to be smarter in 90 more days given the dynamic environment. But maybe what I'll say is I find it pretty interesting. I hope you find it very interesting that our company just had a record quarter yet again, while our OE end markets have headwinds and declining somewhat in the on-road and the agriculture sectors and yet we still continue to perform very well.

We are poised when the overall economic cycle ticks up to really leverage that. And our company is in a solid, solid position and executing exceptionally well as we look to '26 in our plans. We'll continue to have that in our sights. And that's the type of plan that we'll put together for you, and we'll talk about here in about 90 days.

Tim Thein *Raymond James - Analyst*

All right. Thank you.

Operator

Nathan Jones, Stifel.

Adam Farley *Stifel, Nicolaus & Company - Analyst*

Yeah, thank you. Good morning. This is Adam Farley on for Nathan. I wanted to follow up on the tariff discussion. I realize that it's relatively immaterial on the cost side. But do you have any expectations from lower global growth due to disruption or uncertainty from tariffs? Maybe just any view on potential demand disruption from tariffs?

Tod Carpenter *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*

Tough to say. We continue to react to it, talk to all of our customers, make sure we take care of our customers. It's just tough to say. I think if you take surveys out there, you get a varying degree of opinions for us right now, clearly, the first-fit projects, both in the industrial and mobile are clearly more careful.

But if you say vehicle utilization, our aftermarket pace businesses, our service-based businesses, those kind of activities, they continue to march along pretty well. So it's really tough to say. As far as will there be a pullback, what lies ahead, we're managing carefully just like everyone else and doing a very good job at that.

Adam Farley *Stifel, Nicolaus & Company - Analyst*

All right. I'll leave it there. Thank you for taking my question.

Operator

We have no further questions. I'd like to turn the call back over to Tod Carpenter for closing remarks.

Tod Carpenter *Donaldson Company Inc - Chairman of the Board, President, Chief Executive Officer*

That concludes the call today. Thanks to everyone who participated. We look forward to reporting our fourth quarter and full year fiscal 2025 results in August. Have a great day. Goodbye.

Operator

This concludes today's call. You may now disconnect. And we're now non-private. Have a great day everyone.

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