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EDITED TRANSCRIPT

Q2 2026 DONALDSON COMPANY INC EARNINGS CALL

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An LSEG Business



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

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Oliver Jiang** *Morgan Stanley - Analyst*
- **Bryan Blair** *Oppenheimer & Co Inc - Analyst*
- **Timothy Thein** *Raymond James - Analyst*
- **Adam Farley** *Stifel Nicolaus & Company Inc - Analyst*
- **Brian Drab** *William Blair Capital Partners - Equity Analyst*
- **Laurence Alexander** *Jefferies LLC - Analyst*
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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. My name is Krista, and I will be your conference operator today. At this time, I would like to welcome you to Donaldson Company's second-quarter fiscal year 2026 earnings webcast and conference call. (Operator Instructions) Thank you.

I would now like to turn the conference over to Sarika Dhadwal, Head of Investor Relations. Please go ahead.

Sarika Dhadwal *Donaldson Company Inc - Investor Relations*

Good morning. Thank you for joining Donaldson's second-quarter fiscal 2026 earnings conference call. With me today are Tod Carpenter, Chairman, President, and CEO; Rich Lewis, incoming President and CEO; and Brad Pogalz, Chief Financial Officer. This morning, we will provide a summary of our second-quarter performance and our outlook for fiscal 2026.

During today's call, we will discuss non-GAAP or adjusted results. For second-quarter 2026, non-GAAP results exclude pre-tax charges of \$6.7 million, including \$2.9 million of restructuring and other, and \$3.8 million of business development charges. This compares to prior-year pre-tax charges of \$6.6 million, including \$2.2 million of restructuring and other, and \$4.4 million of business development charges. 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, everyone. Donaldson Company achieved record sales in the second quarter as we worked hard to meet strong customer demand across all three of our segments. Our underlying business is robust, as evidenced by our high backlogs and continued strong order intake. While we face short-term execution challenges in our Industrial segment, we saw strength in areas such as independent aftermarket within Mobile Solutions and Food and Beverage and Disk Drive within Life Sciences. We also announced the acquisition of Facet, the largest acquisition in company history, which I will discuss in a few minutes.

Entering the second half of the year, I have confidence in the strength of our organization and our commitment to deliver on our updated fiscal 2026 outlook, which represents record sales of approximately \$3.8 billion with operating margin and adjusted earnings per share at all-time highs. Throughout our history, our talented global teams have demonstrated a commitment to deliver for all of our stakeholders, including our customers, shareholders, and employees. We continually do this through our leadership position in filtration built on decades of solving our customers' most difficult filtration problems; our best-in-class technology, uniquely powerful because we focus on filtration capabilities and then leverage these technologies across markets; our ability to help customers meet evolving environmental and operational goals by helping to protect equipment, processes, and people, and our clear strategic and balanced growth strategy. This is how we have and will continue to win.

In late January, we announced our next President and CEO, Rich Lewis, effective next week on March 2. This transition reflects a long-term succession planning process that comes at a time when we are well positioned for the future, thanks to the talent, dedication, and discipline of our global team. Rich has been with Donaldson since 2002 and has been our Chief Operating Officer since August. On behalf of the entire organization, I want to congratulate him, and I look forward to his future success.

Before I turn it over to Rich to discuss our second-quarter results in more detail, I want to touch on our recent acquisition of Facet which we are very excited about. This acquisition complements and expands Donaldson's product portfolio, bringing high-performance fuel and fluid filtration capabilities for mission-critical applications and broadening our exposure to durable end markets such as Aerospace and Defense and Power Generation. Importantly, approximately 70% of Facet's revenue are driven by recurring regulated replacement part sales, a nice fit with our already large composition of replacement parts. Facet makes us stronger, adding nearly \$110 million in sales with gross margins and EBITDA margins significantly above our current company average. The company has low capital intensity and strong cash flows. We look forward to welcoming the Facet team to Donaldson and reporting on our combined performance.

Now I will turn it over to Rich who will talk more about the second-quarter highlights, and then Brad will take us through the financials in more detail. Rich?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Thanks, Tod. Good morning, everyone. First, I'd like to thank Tod for his leadership and congratulate him on his successful Donaldson career, including his impact as CEO over the past 11 years. I am honored to step into the CEO role and look forward to working alongside our broader leadership team to build on our momentum and deliver for our stakeholders. I also look forward to my continued partnership with Tod as he transitions to the Executive Chairman position. Now I will cover our second-quarter results. At a high level, sales were a record \$896 million, 3% above prior year with growth across all three segments. Currency translation and pricing benefits were partially offset by volume declines in both Mobile and Industrial Solutions.

Operating margin was 14%, down from 15.2% a year ago as a result of gross margin pressure. Volume deleveraging combined with concentrated operational inefficiencies related to our production shifts to support higher demand in Power Generation and footprint optimization costs negatively impacted gross margin in the quarter. Adjusted earnings per share were \$0.83, flat versus the record achieved in 2025.

Now looking at our segments, Mobile Solutions sales were \$557 million, up 2%, driven by currency benefits. Aftermarket sales were \$447 million, up 1%, with high single-digit growth in our independent channel offset by OE channel declines. Overall, we are benefiting from share gains and increases in global vehicle utilization. On the first-fit side, Off-Road sales of \$86 million increased 8% as we cycle against weak market conditions from the prior year, particularly in agriculture. On-Road sales of \$23 million decreased 9% as a result of continued declines in global truck production.

Touching on our Mobile business in China, sales were up 18% due to strength in Off-Road and Aftermarket. This marks our sixth consecutive quarter of growth in China, and we are optimistic about future opportunities in this important market. In Industrial Solutions, sales were \$260 million, a 2% increase compared with 2025 driven by currency benefits. IFS sales of \$223 million grew 7% from continued strength in Power Generation, particularly in North America and Europe, and demand for new equipment remains significant.

Rounding out our Industrial Solutions performance, Aerospace and Defense sales were \$37 million, down 19% versus the prior year due to project timing primarily in defense. In Life Sciences, sales of \$80 million increased 16% year over year largely as a result of robust growth in Food and Beverage and Disk Drive. In Food and Beverage, our largest business within Life Sciences, new equipment sales grew substantially in all regions, laying the foundation for future replacement parts sales growth. We continue to win including in areas such as liquid cooling for data centers, and we are winning with key OEMs and channel partners through strong sales processes and technology-led products.

Given our second-quarter results and our expectations for the second half of the year, we are updating our margin and earnings outlook for fiscal 2026. At the midpoint of our revised guidance ranges, we continue to expect a record year for Donaldson, now inclusive of record sales of \$3.8 billion and sales growth in each of our segments consistent with our previous expectations. Operating margin expansion of 50 basis points to an all-time high of 16.2%, including second-half operating margin consistent with our prior guidance. Earnings per share of \$3.97, roughly 8% above prior year, and free cash flow conversion of approximately 90% which provides us capital allocation optionality to return value to our shareholders.

In summary, I am proud of the agility and resilience displayed by the Donaldson team as we navigate some short-term operational headwinds to set ourselves up for stronger performance over the long term.

With that, I will now turn it over to Brad who will provide more details on the financials and our outlook for fiscal 2026. Brad?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Thanks, Rich. Good morning, everyone. I want to start by thanking the Donaldson team. They demonstrated tremendous agility as we worked to deliver for our customers while making progress on several big projects, including the work done on the Facet acquisition. Facet will be an important addition to our company. We expect to close in the next couple of quarters, and as Tod mentioned, Facet will make us stronger strategically and financially. Beyond Facet, we are focused on delivering the strong second-half performance reflected in our guidance, but first, a summary of our results. Note that my profit comments exclude the impact from the non-recurring charges Sarika referenced earlier.

Total sales increased 3%, and adjusted EPS of \$0.83 was flat year over year. Operating margin declined 120 basis points to 14% due primarily to the impact from discrete operational issues on gross margin. Second-quarter gross margin was 33.7%, down 150 basis points from the prior year and below our expectations. About 60 basis points of the total gross margin decline was due to deleveraging from lower volume in the Mobile and Industrial segments. We anticipated some year-over-year gross margin pressure in the quarter as there were certain businesses, particularly OE Aftermarket and Defense, with difficult comparisons from last year, but the timing of orders and deliveries had a greater impact than planned. For the second half of fiscal '26, we expect the volume pressures to abate based on our strong backlogs and the leverage that comes with our typical second half sales step-up.

Second quarter gross margin was also impacted by inefficiencies driven by changes we are making to our manufacturing footprint. One item that spiked this quarter relates to Power Generation and specifically the production of our large turbine systems. To meet the super-cycle demand and deliver on customer-specific requirements of producing in North America, last year we began producing these large systems for the first time at one of our facilities in Mexico. The combination of a protracted startup process in Mexico and surging demand resulted in a gross margin headwind of about 40 basis points in the quarter. We have plans in place to accelerate our improvement and expect to make progress in the second half of this fiscal year.

Another area where we expect improvement in the second half relates to our ongoing footprint optimization initiatives. This fiscal year is an important milestone for this work, with the most significant projects expected to be completed by fiscal year end. In the quarter, we had about 30 basis points of gross margin pressure as we go through the final stages of a plant closure in the US and associated transfer of production. Once through this heavy-lift period, we will begin to realize cost benefits later in this fiscal year and into the future.

While gross margin in the second quarter was not to our expectation, the drivers of the performance reflect short-term headwinds from the work we are doing to establish long-term efficiencies in several of our most important businesses. Our forecast

contemplates sequential improvement in gross margin and full-year expansion. I'm confident we will deliver on that target. At the same time, our team continues to do an excellent job managing our operating expenses. As a rate of sales, operating expenses improved to 19.7% from 20% a year ago, reflecting benefits from the structural cost optimization initiatives launched during the prior fiscal year as well as continued expense discipline. We're prioritizing opportunities while conserving where we can providing necessary offsets to the footprint work we're doing.

In terms of segment profitability, Mobile Solutions pre-tax profit margin was 16.8%, down 60 basis points from prior year primarily due to volume deleveraging in the Aftermarket OE channel and footprint optimization efforts. Industrial Solutions pre-tax margin was 11.9%, down from 16.1% in 2025, stemming from the previously mentioned operational inefficiencies and footprint optimization costs. With improving plant efficiency and benefits from leverage on higher sales, we expect Industrial pre-tax operating margin to step up notably in the second half. Life Sciences pre-tax margin improved to 9.3% from a loss of about 1% a year ago. Strong sales in our higher-margin Food and Beverage and Disk Drive businesses and benefits from a more focused expense structure following optimization programs a year ago drove the improvement.

Turning to our fiscal 2026 outlook, first on sales, we are reaffirming our consolidated sales guidance of 1% to 5% growth with stronger-than-expected sales in Mobile Solutions and Life Sciences being offset by lower Industrial Solutions sales. Our forecast assumes pricing and currency translation will each contribute about 1% to growth. Withing Mobile Solutions, we are increasing our growth forecast to a range between 2% and 6% compared with flat to up 4% previously primarily due to favorable currency. We are raising our guidance for Aftermarket and now expect sales up mid-single-digits versus our previous low single-digit forecast primarily due to strength in our independent channel from currency, pricing, and volume.

Consistent with our prior guidance, Off-Road sales remain on track to grow mid-single-digits mainly due to a modest rebound following significant declines in agriculture a year ago. On-Road sales are expected to be flat for the year, also in line with our prior guidance due to muted global truck production. In Industrial Solutions, sales are forecast between a decline of 1% and an increase of 3% versus the previous expectation for growth between 2% and 6%. Sales of IFS are now expected to grow in the low single-digits down from mid-single-digits previously due largely to declines in sales of dust collection and industrial hydraulics systems. Aerospace and Defense sales are projected to decline mid-single-digits versus flat previously due to the timing of certain programs. In Life Sciences, we are increasing our sales forecast as benefits from favorable currency translation are expected to complement already strong Food and Beverage and Disk Drive momentum.

To that end, we project sales to increase between 5% and 9% versus a 1% to 5% increase previously. We expect benefits from sales leverage and continued cost discipline to generate full-year, pre-tax margin in the mid to high-single-digits up from mid-single-digits previously. Given our second-quarter performance and our outlook for the balance of the year, we revised our operating margin guidance to a range between 16% and 16.4%, a decline of 30 basis points at the midpoint from our prior forecast. Despite the temporary gross margin headwinds in the second quarter, the full-year operating margin forecast still reflects a record level and, at the midpoint, an incremental margin approaching 35%.

With that change, we now expect fiscal 2026 EPS between \$3.93 and \$4.01 per share. At the midpoint of \$3.97, we are projecting EPS growth of 8% on 3% sales growth. Our earnings guidance contemplates a second-half step-up in sales supported by our strong backlogs as well as gross margin expansion resulting from the operating improvements I discussed earlier.

Now onto our balance sheet and cash flow outlook. Our capital expenditures are expected to be between \$60 million and \$75 million with focused investments including new products and technologies across all verticals. We continue to project cash conversion in the range of 85% to 95%, an improvement versus 2025 and consistent with historical averages. The balance sheet remains a strength of Donaldson's with our net leverage ratio currently at 0.7 times. Adjusting for the Facet acquisition, Donaldson would have a net leverage ratio of approximately 1.7 times, still leaving us ample financial flexibility to thoughtfully invest for our future growth.

As we think about shareholder value creation for the long term, our capital allocation priorities are unchanged. First, reinvest back into the company. We are the leader in technology-led filtration and intend on maintaining our position. R&D investments in strategically important, high-growth, high-margin areas where we have a clear path to win will drive our success. Our longer term efforts are also supported by ongoing working capital investments and capital expenditures.

Our second capital deployment priority is disciplined M&A. We actively work through a pipeline of opportunities. Discipline is key to our approach. We are excited about our Facet acquisition and look forward to pursuing additional opportunities that meet our strategic and financial criteria. We're creating long-term value through our growth investments but also through the return of cash to our shareholders.

Our third capital allocation priority is dividends. Calendar year 2025 was our 70th year in a row of paying dividends and the 30th in a row of increasing our dividend. We have every intention of maintaining our status as a proud member of the S&P High-Yield Dividend Aristocrat Index. Share repurchase is our fourth capital deployment priority, and it has always been the variable component.

Given the pending close on our acquisition of Facet, we do not expect to repurchase additional shares in the balance of this fiscal year. Year-to-date, we have repurchased 1.2% which offsets dilution, and our focus now is using the strength of our business to rapidly pay down debt. Looking beyond the quarter, the underlying fundamentals of our business are strong, and we have the right priorities in place to deliver another year of profitable growth and value creation.

Now I'll turn the call back to Tod.

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

Thanks, Brad. As I sit and reflect today, I am particularly pleased with Donaldson Company's continued evolution as a premier global provider of technology-led filtration solutions, and I am excited for the opportunities that lie ahead. It has been a privilege to be part of this organization for the last 30 years and an honor to have led the company for the last 11. I'll not be far away as I take on the role of Executive Chairman. I am highly confident in our teams around the globe who make Donaldson what it is and who I know will reach new heights under Rich's leadership.

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.

Oliver Jiang *Morgan Stanley - Analyst*

This is Oliver on for Angel today. Can I just double click on A&D? I know you guys guided down here for '26. Is that because of projects shifting into 2027 or something to do with underlying demand? And then how should we think about your guide versus what you are seeing for Facet? Is that just a product of different portfolios and aftermarkets?

Richard Lewis *Donaldson Company - President & Incoming Chief Executive Officer*

Hey, good morning, Oliver. This is Rich. I'll take your first question. So when you think about A&D, we're coming off record sales levels the last couple of years, and clearly, we've had suppressed revenue in the first half of the year. It's really a combination of two things. So we've got timing issues on some of our military projects. These can be lumpy. We've also had supply chain challenges as well. They're ongoing.

I would say that, overall, we are very comfortable with the order intake, and if you think about the backlog of this business post October, it's up over 20%. So orders are coming in nicely. We feel really good that the second half run rate is going to be significantly improved. The name of the game is really going to be working with our suppliers and making sure we can ship all the orders.

Some of these suppliers are single sourced, directed buys. We are trying to qualify new suppliers. These projects can take quite some time, but overall, it's really about muscling through this order book. So we'll see a significant step up in the second half.

And then as far as Facet goes, we do play in different parts of the market, and they're exposed to different types of -- they're more military fixed-wing. They're also a lot of marine where we tend to be more ground vehicle. And so we play in different parts of the

market, but we'll start to see improved performance in the second half on the revenue.

Oliver Jiang Morgan Stanley - Analyst

Great. That's really helpful. And then just maybe one follow-up on Industrial. I know some footprint changes this quarter. Do you kind of expect that to continue or abate somewhat into fiscal 3Q and 4Q? And then can you talk just a little bit about what that buys you in terms of power gen? Does that potentially expand throughput or potentially even a bigger portfolio there? So any color there would be helpful.

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Sure. Yeah, let's take the footprint optimization work. I know we've been talking about this for a while. These projects are pretty complex. They typically last 12 to 24 months.

We have had an accelerated amount of activity in this space over the last couple of years. Just to put it into perspective, we have four plant closures that we've been working on, none of which touch power gen. It's other parts of the industrial business. Two of these are in their final phase, which basically means the plants are closed, the assets have been transferred to the new location, and they're working through the learning curve and the productivity increase. We would expect that work to come to a conclusion through the balance of the fiscal year.

We also have two other ones. We will close those plants in quarter three. And they'll be working through the learning curve and the productivity increase in Q4. Maybe a way to think about it is you'll start to see the benefit, the margin improvement benefit in our guide in F27. We also do these projects for a couple of reasons. We're trying to reduce our asset base, and we're also trying to reduce or improve our risk profile.

So we believe these projects ultimately will be very successful, but we do have a few more months here of work ahead of us.

Operator

Bryan Blair, Oppenheimer.

Bryan Blair Oppenheimer & Co Inc - Analyst

Tod, congratulations on a very successful career, including over a decade as CEO. And Rich, congrats on the nod.

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

Thanks, Bryan.

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Thanks, Bryan.

Bryan Blair Oppenheimer & Co Inc - Analyst

Of course. I was hoping that you guys could offer a little more color on how IFS orders trended through fiscal Q2 and then what your team is seeing thus far in Q3. Year-on-year growth was stronger sequentially aligning with the prior guidance framework of mid-single-digit growth. Power gen, some inefficiencies in the second quarter, certainly a good guide in terms of growth path. Brad, I know you called out dust collection and hydraulic systems as the areas of relative weakness. I guess, if you offer some finer points on whether there is accelerated weakness through fiscal Q2 into Q3 in those areas, or you're simply taking a more cautious or conservative stance on continued macro uncertainty?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah. So maybe I'll take the business side, the macro, and then if Brad wants to add anything on the numbers, he can weigh in as well. So if we sort of disaggregate IFS, you mentioned that Power Gen is clearly very, very strong right now. Just at a big picture, we're booked through the end of the fiscal, and we've loaded fairly solid bookings already into the next two fiscal years. So we're feeling really good about the demand on Power Gen.

And it's pretty broad-based. We're seeing it across sort of the compressed gas side on the oil and gas piece and on peak and base load energy generation. A lot of that's tied to the data center push that's going on.

On the IFS side, yeah, we're seeing -- it's a bit mixed. Globally, we see relatively decent order patterns outside of the Americas. The Americas have been pretty soft. And we're still seeing a fair bit of quoting activity in the Americas. I think the uncertainty in the economy is driving people to be cautious on pulling the trigger on POs.

On the -- I would say, across the board, if you look at replacement parts, those continue to perform very well. We see good utilization rates and good order intake on the replacement side.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Bryan, this is Brad. And I'll just add, I think as you look at the first couple of quarters, dust collection is about where it was in the second quarter in terms of the overall year-over-year conditions. So not much to comment there, but I do want to underscore a point Rich made. This is really about our new systems and the first-fit side of the business. The machines are still running.

Aftermarket is still doing well in IFS, and we've got good opportunities there with our placement. It's just about getting these capital expenditure decisions of our customers to break free a little bit.

Bryan Blair Oppenheimer & Co Inc - Analyst

Understood. That's helpful color. Facet is an intriguing deal for your team, certainly mix enhancing. Can you speak to the historical growth rates of the asset, whether we should expect accelerated growth under Donaldson ownership? If so, what the drivers are there?

And then how we should think about P&L impact looking to fiscal '27? I know you had said closed within the next couple of quarters, so sometime in the fiscal back half. But if we look to next year, how should we think about the impact?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah. Maybe just -- I'll just take a step back if it's okay and just talk a little bit about Facet from a broader perspective. I mean, we're really excited about Facet potentially join the Donaldson family. Obviously, we'll continue to work through the regulatory process to close this deal in the next couple of quarters. But this is a business that we've been following and frankly, admiring for a long time.

It's a perfect fit for what we're trying to do on an M&A side. So it's high-level recurring filtration revenue. They've got a durable competitive advantage given the sort of the regulatory nature of their end market, and it sits in a high-margin, high-growth business. We'll talk about the growth rates here in a second. And as we've gotten to know the team there, we think it's also a very good fit culturally, really good folks, very committed to their customers, and deep, deep knowledge.

Now the growth rates, so as we put in the deck that we posted out on our website, yeah, they're high single digits, and it's a mix of volume and pricing. And we would expect that to continue. They have a lot of potential growth opportunities outside of their core military and commercial markets on the aerospace side. And those are a lot of markets that we play well in on our industrial. So we hope over time that we'll find significant growth synergies.

We have not baked that into our expectations. That's all upside. But yeah, it's going to be a good fit for us, and we're really excited about it.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Bryan, on the P&L side then, obviously, we expect to close in a couple of quarters. So nothing factored into the fiscal '26 guidance that you mentioned fiscal '27. As we think ahead, I think the important point that we said in the prepared remarks is that it's mix positive on our most important operating metrics: gross margin and EBITDA. Obviously, this is a business then that will work to integrate properly. We don't expect much in the way of cost synergies, a few million dollars, but more from procurement because it sits in a unique spot relative to where we sit in these markets.

So I think overall, we'll give more detail with fiscal '27 guidance, but we're excited about this from the strategic side that Rich mentioned and the financial implications to Donaldson.

Operator

Tim Thein, Raymond James.

Timothy Thein Raymond James - Analyst

Congrats again to both Rich and Todd. And Todd, I'm hopeful that you're able to observe its turnaround and go for basketball and retirement.

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Thanks, Tim.

Timothy Thein Raymond James - Analyst

Yeah, only one way to go. The question is on the mobile business. And just in terms of the -- based on the full-year guide, it implies that the growth in that line picks up a little bit in the second half. Maybe you can just talk about -- you mentioned the strength, continued strength in the independent channel, just maybe what you're seeing and hearing from the OEM dealers.

And then looking out a bit, how do you expect that -- eventually the first-fit business hopefully rebounds. How would you expect kind of the interplay between those two? Maybe just what you've observed historically when you start to see the first fit side begin to pick up. That's the first question.

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Maybe let me break this down. Let's talk about the replacement parts side for a second. So as you pointed out, the replacement part orders through our independent channel have been very strong. We still continue to see that performance continuing. No slowdown there at all.

When we think about the OE side, this year, we returned to, what I would call, a sort of typical normal year-end, their fiscal year-end inventory management practices. So we did see a pretty good pull back relative to the prior year where we actually saw people stocking up, which was pretty atypical. So year-over-year, it was a pretty drastic change.

What we always look for is when you come out of those holidays, what happens with your backlogs, and we saw a sharp increase. Unlike our independent aftermarket, which is really you get orders, you ship them within 24 hours, our OE partners do give us really good visibility on lead times. And we've seen a sharp increase in our hard backlogs on the OE. So we're really confident the second half will be a significant improvement there.

Maybe touching on the first-fit markets. If you think about ag and truck, they still continue to be performing near what we would call bottom of the cycle. We're monitoring this closely because when these markets come back, and hopefully, this answer your question, they come back aggressively. I think 20% to 30%. And we want to be really ready to make sure we address our customers' needs.

So we're staying very tight with our customers on that. I will say we're seeing signs of pockets or optimism in ag with some increased order intake on the first-fit side with select OEs, but it's not broad-based at this point.

Also, in the truck market, we're having signals from some of our truck manufacturers that in the second half of calendar year '26, so which would be our fiscal year '27, they're planning for increased truck builds. I would say we remain cautious on this and being ready for the upturn because when it does happen, it happens aggressively. But that's how we characterize the markets as we sit here today.

Timothy Thein Raymond James - Analyst

Yeah. That's great. That's super helpful. And then maybe, I don't know, Brad, just how to think about the -- it's kind of a multipronged answer. But just as that growth -- again, if you kind of outlined if and when that begins to come in, how to think about just the mix impact on margins in that segment?

Again, I'm sure there's multiple variables that go into that. But any help you can give on that in terms of how we should be thinking about the incrementals as that mix eventually kind of normalizes?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Sure. Well, you hit the main point. It is multivariable, but there's a mix impact as we sell more to the OEs and especially on the new equipment as that comes back. But honestly, that's something, to Rich's point, that we're getting ready for. And while we may have a little bit of a rate mix impact that we talk about in future quarters, the earnings will flow to the bottom line from that. And I think we'll get very nice leverage on it as it moves through the P&L.

And then the other side, and I just want to -- it's a modest tangent to your question, but to the point Rich made and about these markets, I think we will also see some bounce back in the Mobile Solutions segment in the quarter. There was a part of my script where I talked about the volume deleveraging. This will bounce back. So when we think specifically about the second half of the year, we would expect Mobile Solutions profit acceleration from here as the volume starts to come in as well.

Operator

Adam Farley, Stifel.

Adam Farley Stifel Nicolaus & Company Inc - Analyst

Bradley, can we go back to the operating efficiencies and power generation? I just wanted to put a finer point on what exactly happened there? What's the underlying cause? And then just expectations on how that kind of ramps going forward.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Yeah. So I gave you the macro perspective on Power Gen. So clearly, the demand is very strong. We're in the middle of sort of rebalancing our product portfolio across both sites, so we can maximize output. So we've moved production into our facility in Monterrey, Mexico.

We've ramped that facility's capacity up significantly through a combination of process improvements to increase flow and a dramatic increase in staffing. And so we're working through the learning curve and onboarding these employees. A lot of the hiring is behind us, and now it's really about training and onboarding these employees in the third quarter here. We do expect output from this site to continue to improve with this increased capacity, and their productivity will continue to get better throughout the fiscal year.

Adam Farley Stifel Nicolaus & Company Inc - Analyst

And then maybe one more on the pending acquisition of Facet. Could you maybe talk about the total addressable market for Facet, Facet's market position, and maybe primary competitors in the space?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah. So from a competitor standpoint, they're one of the leaders. There's a couple historic players that lead in this space. And then it fragments from there. They play in a lot of different markets.

And so they're in the commercial, the marine, and military space. We believe there's a lot of headroom for continued growth. And some of the interesting opportunities are actually in what I would consider maybe our core industrial markets, which would be relatively new to them. And so yeah, there's a lot of space for us to grow this business over the coming years.

Operator

Brian Drab, William Blair.

Brian Drab William Blair Capital Partners - Equity Analyst

Congratulations, Todd and Rich. I'll follow up more with both of you later and save the sentimental stuff for the nonpublic call.

Some of the strongest growth lately has been coming from the Life Sciences segment, of course. And I was wondering if you could just talk a little bit about that disk drive business. I know you've talked about the HAMR technology in the past that's driving incremental demand for your products.

What is the -- even though the growth is so strong lately, I'm wondering, could that accelerate? Could that business be much bigger? And how tied are you to the data center build-out? And can you just talk a little bit about the business, who your customers are and what the TAM is for you in that space?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yes, Brian. As you point out, the Life Science business has been doing very well. We restructured that business last year to bring more focus. And the two largest businesses, food and bev and disk drive, have been really excelling.

On the disk drive side, if you think about what's driving a lot of that demand, it is AI and cloud storage. There's a strong demand for drives in more and more dense storage. HAMR clearly addresses that. I would say our growth is a combination of market comeback and share gains. And we do believe that the market has runway to grow.

A lot of our customers are building at very high utilization rates right now. And so as they bring on more capacity the demand feels like it's there for the foreseeable future. So HAMR has been a big success so far. We've ramped that business up with one of our OE customers this year, and we look forward to that continuing to gain market penetration.

Brian Drab William Blair Capital Partners - Equity Analyst

And your technology or products that you're -- that's used in that application is what exactly? Can you just remind me?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah. So it's a filter in the early days. It was a filter to remove particles much like some of the air filters. But as these drives have become way more sophisticated, now we're doing absorption technologies that really take out harmful gases and fumes. These drives are very, very, very sensitive.

And that's part of our share gain in this space as the technology continue to increase we were able to continue to differentiate our capabilities and take additional market share there.

Brian Drab William Blair Capital Partners - Equity Analyst

And then is there any detail that you can give on your liquid cooling exposure? I know you mentioned it today on the call again, but what products, technologies are you supplying there? And what's the potential addressable market for Donaldson there?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah. So on the liquid cooling, it's really an extension of the products that we sell in the food and bev. Their products have applicability in several other process filtration applications. And this is one. We've seen a sharp uptick in interest.

A lot of these data centers are converting from air cooling to liquid cooling. And our products fit very nicely with that. It's a pretty fragmented market right now because there's really no clear standards on the systems. And so I'd say it's a bit early to judge how big it's going to be. But certainly, we're seeing a lot of activity and a lot of interest in that space.

Operator

Laurence Alexander, Jefferies.

Laurence Alexander Jefferies LLC - Analyst

Just two quick ones. First, on the Power Gen side, can you give some perspective on how you think the competitive market has changed, the competitive landscape has changed since the last cycle? And do you -- how much more capacity expansion do you think you would need to do to keep up with the order books that have been announced by the equipment makers?

And secondly, on the acquisition, what's your timeframe for the acquisition to get to an acceptable return on capital?

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

So I'll take the Power Gen, and then I'll let Brad address the second question. So from a Power Gen perspective, yeah, I mean the demand is very, very high. I would say the dynamic that's different now is because, as you're aware, we sort of narrowed our focus after the last cycle. We're seeing, I would say, more interest in being fair and balanced with the commercial deals. And so we'll continue to take orders that make sense for us commercially.

We're increasing our capacity in our Mexico facility fairly significantly. And so we believe we're in a good position from addressing our customers' needs. They have many other constraints besides our product. And so it feels like we're well aligned with what their build capability is right now.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Laurence, this is Brad. In terms of the returns, this is much more of a strategic acquisition than a synergy play. And with that, thinking about it on a cash basis, probably more at our cost of capital in the five-year time horizon. But I think the really positive side of this business is it's throwing off cash immediately. We get to earnings accretion pretty rapidly. We said year two. And of course, our goal is to make that even faster.

Operator

Rob Mason, Baird.

Robert Mason Robert W. Baird & Co Inc - Senior Research Analyst

And Todd, Rich, I'll offer my congrats on passing the baton there as well. Rich, I think in your comments earlier, you talked about the second-half margin outlook had not really changed in the updated guidance. But it does sound like there's more work to do on the footprint optimization effort to -- just kind of give us a feel for the confidence level around the ability to ramp margins whether that means the third quarter margin step up more meaningfully or if that happens more in the fourth. Ad just -- yeah, again, just kind of the confidence level to keep that margin, second-half margin outlook intact just given the second quarter challenges.

Richard Lewis Donaldson Company - President & Incoming Chief Executive Officer

Yeah, I think -- I mean, you hit on it, Rob. Clearly, we need to see the volume come back in our OE and Aerospace and Defense businesses. We have those backlogs. So we feel really confident on that part. We'll have to continue to fight through the supply chain issues on the A&D, but the team is really focused on that, and they're working hand in hand with our suppliers. So that part of it, we feel pretty strongly that we're in a good position.

The restructuring work, as I mentioned, a couple of these are done. And so we should start to see the costs go down and some of the benefits start to feather in. The other two are still ongoing in Q3. Probably the risk there is if there is a delay or there's any unexpected problems. But right now, we're on track. And certainly, we would expect to have those finished up here by the end of the fiscal for sure.

And then Power Gen, as we mentioned, we've doubled the workforce down there just in our first quarter. And so we feel good. The turnover is low. The staffing is starting to become productive. So we need to see continued progress on that in the second half.

But based on all the observations with the team, we're well on track for them to continue to accelerate improvement through the second half of the year.

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Rob, I'm going to add one point, too. And I think an important note here is as we look at the second half step up, some of that comes with expense leverage as well. We've got really good controls over what's going on with expenses in the company. When you think about the improvement in the second half, a big portion of that also comes from the natural leverage.

So as Rich said, we've got the backlog to deliver the sales. We'll keep expenses at a rate that's, give or take, are at a dollar level. It's, give or take, where we were in the first half. So there's the leverage that comes with that, too.

Robert Mason Robert W. Baird & Co Inc - Senior Research Analyst

Okay. Very good. That was actually my next question. Just the jumping off point there, given second-quarter OpEx anyway was step down sequentially.

Maybe just last question. Just thought process, again, a smaller business, I understand on the first-fit side. We're certainly aware of the on-road, the truck challenges. But this -- it does -- to reach flat for the year, does kind of infer that you see some recovery in that business? I mean, should we just be putting all that recovery in the fourth quarter? When I say recovery, sequentially in the fourth quarter?

Brad Pogalz Donaldson Company Inc - Chief Financial Officer

Yes. I think the move towards the second half and late in the second half is it. I will -- I mean, of course, Rich said this earlier about the trough. We're seeing some green shoots out there. I think the public data sources that many of us follow suggest even an increase in truck production, in Class 8 heavy-duty in North America this year.

So there are some things that give us encouragement. On top of it, we talked last quarter about some of the moves of programs within this business that we've won. I think that's an important part of our first business is. We're still gaining share with the OEs. So to the extent that production comes back, that's just incremental growth for us.

Operator

And that concludes our question-and-answer session. And I will now turn the conference back over to Rich Lewis for closing comments.

Richard Lewis *Donaldson Company - President & Incoming Chief Executive Officer*

That concludes our call today. Thanks to everyone who participated. We look forward to reporting our third-quarter fiscal 2026 results in June. Goodbye.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation, and you may now disconnect.

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