



INDUSTRIAL

strength

Eleven Record Years

Donaldson Company, Inc., is a leading worldwide manufacturer of filtration systems and replacement parts. The company's product mix includes air and liquid filters and exhaust and emission control products for mobile equipment; in-plant air cleaning systems; air intake systems and exhaust products for industrial gas turbines; and specialized filters for such diverse applications as computer disk drives, aircraft passenger cabins and semiconductor processing. Products are manufactured at more than three dozen Donaldson plants around the world and through five joint ventures.

Our financial objective is to build shareholder value through superior share price appreciation and consistent dividend payouts. We believe value is created by delivering consistent, double-digit growth in earnings per share. Growth will be achieved by aggressively pursuing new opportunities in our existing and related markets. Consistency will be reinforced by maintaining a diversified portfolio of related filtration businesses around the world.

Mission Statement To provide superior return for our shareholders, through consistent, long-term earnings growth built on global leadership in filtration solutions thereby creating security, opportunity and challenge for our employees.

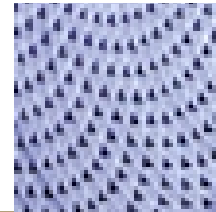
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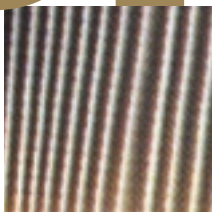
Industrial strength. It's a good descriptor of Donaldson, a strong, rock-solid company with

11 consecutive years of double-digit earnings growth. A company that has grown and diversified into numerous industries with a wide geographic reach.

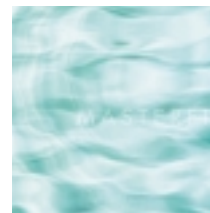
Industrial strength also highlights the Industrial side of our business (dust collection, gas turbine systems and special applications), which by the end of the current fiscal year will make up an estimated 43 percent of total revenues, up nine percentage points from just three years ago. Although our Engine business continues its solid growth, we anticipate Industrial will grow twice as fast due to tremendous international opportunities and untapped market segments.



industrial **STRENGTH**



We'll capitalize on the opportunities by focusing on our core strengths: customer relationships, technology and international presence. Some examples... our relationship with General Electric has enabled us to benefit from their explosive growth in the gas turbine business. The same holds true with IBM in the disk drive arena. Our acquisition of England-based DCE is providing solid infrastructure in Europe for future acquisitions, not to mention the growth of our dust collection business. And in the technology field, our proprietary Eon™ fine fiber technology – the crown jewel of Donaldson technology that enables us to create self-cleaning filters – has been a big boost, enabling us to create unique solutions and ultimately solidifying client relationships. In the following pages, we've highlighted a few of our Industrial businesses, as well as a story focusing on expansion on the Engine side – all demonstrating our potential as an industry leader poised for growth.





STRATEGIC *acquisition*

Complementary Products. Complementary Markets. Combined Force.

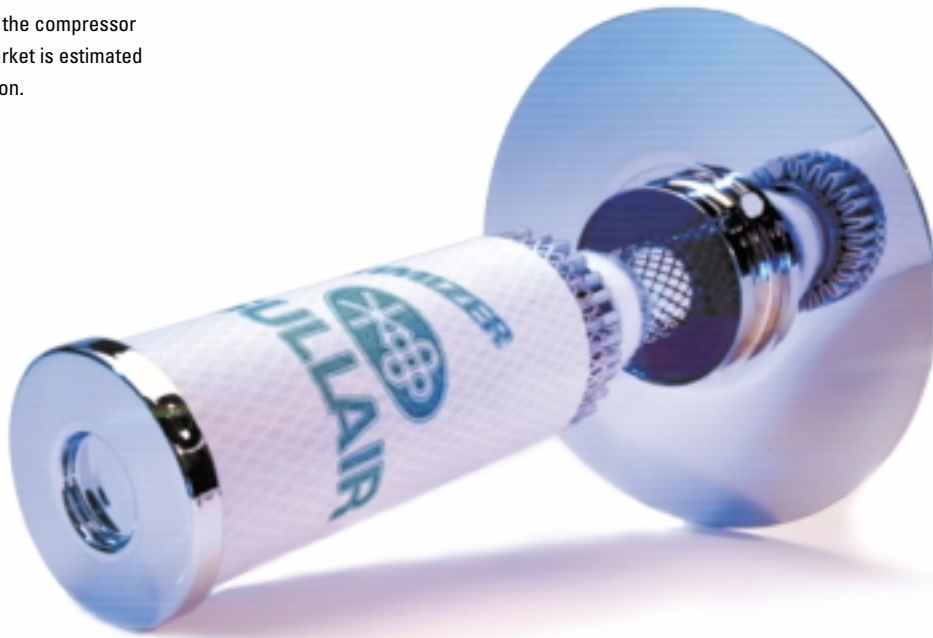
It is the perfect fit – Donaldson's Torit® business and DCE, a major player in the European industrial dust collection industry. In February 2000, the two combined when Donaldson acquired DCE, creating a new entity – Donaldson Dust Collection. Both Torit and DCE design, manufacture and market in-plant air filtration and pollution control systems and products. Torit's strength is in North America where we primarily offer products configured with replaceable cylindrical filter cartridges. DCE, headquartered in Leicester, England, sells filter-bag-configured products, with approximately 70 percent of revenue coming from the United Kingdom and Europe.

Together, Torit and DCE are complementary companies, with complementary products and markets. Customers receive greater access to Donaldson's products and services, and Donaldson benefits from new markets. The end result? Broad geographic range and unparalleled product strength that enable us to develop the right industrial dust collection configuration for any customer application.



Fact: Donaldson provides filtration solutions to a wide range of applications and dust collection markets around the globe.

Fact: Worldwide, the compressor filtration market is estimated at \$150 million.



Delivering Comprehensive Compressor Filtration Solutions

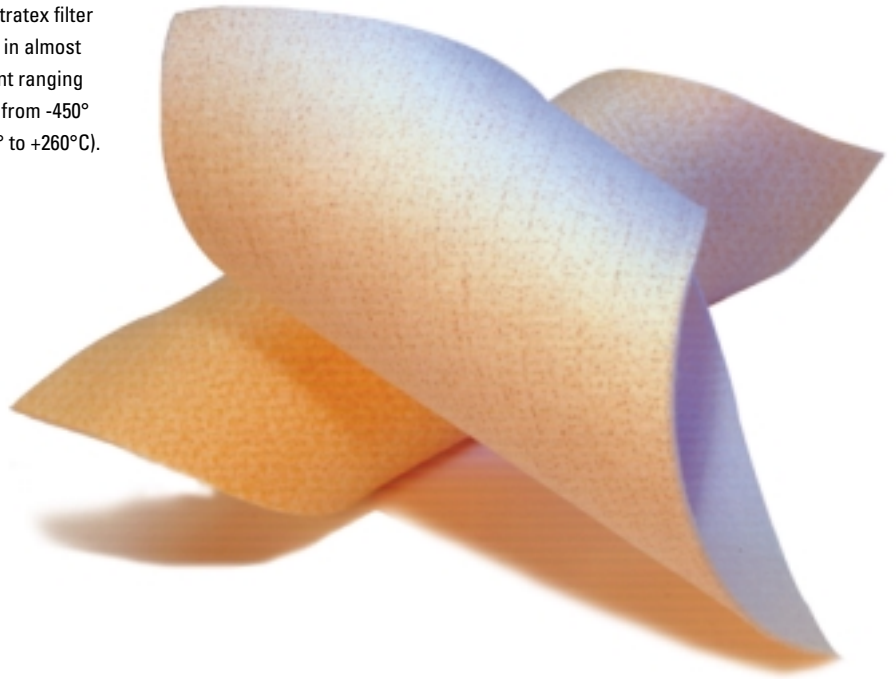
When Donaldson acquired privately owned AirMaze® in November 1999, it not only gained broad access to the compressor filtration market, we gained a technology leader in filtration solutions as well. Donaldson is now the premier provider of air/oil separators to compressor OEMs in the United States, in addition to offering its extensive range of existing compressor filtration products. Our line of air/oil separators is used throughout construction and manufacturing in both portable and stationary air compressors, which drive things like air-tools and assembly lines. Our strong domestic market presence allows us to offer comprehensive filtration solutions to a range of new customers and OEMs. What's more, with Donaldson's global reach and experience in marketing to international customers, our worldwide opportunities are extensive and untapped. Utilizing an experienced engineering staff, we will innovate and apply technology to offer the most advanced compressor filtration products.

market

LEADERSHIP



Fact: Donaldson's Tetratex filter media is stable in almost any environment ranging in temperature from -450° to +500°F (-270° to +260°C).



From Waterproof Clothing to Pollution Control

Comprised of millions of small, randomly connected fibers, Donaldson's Tetratex® membrane repels water while allowing air and moisture vapor to flow freely through the membrane. The Tetratex™ business unit produces membranes in a broad range of pore structures at made-to-order lengths, which can be bonded to an array of fabric and filtration materials. This makes it ideal for a wide variety of applications including industrial dust collection and fabric for high-performance garments. We expect continued high growth from this business as it expands its share in filtration and fabric markets worldwide. Tetratex is a departure from our normal business model in that it produces and markets filter media rather than filtration products.

versatile

MEMBRANE





HIGH *power*

Meeting Energy Needs Worldwide

Industry deregulation, outdated equipment and an insatiable need for power are taxing today's energy infrastructure. This has fueled growing demand for energy-producing gas turbines, which are low-cost and highly efficient power sources – resulting in a 39 percent increase in gas turbine systems business in 2000. Donaldson designs and manufactures filtration systems and silencing products that protect combustion turbines and other rotating equipment used in power generation, oil and gas production, and transmission and petrochemical industries. Our customers include leading gas turbine OEMs General Electric and Siemens Westinghouse, as well as other independent power producers and end-users in emerging economies. We expect high demand for our systems and products to continue through 2001 and beyond. As cost effective and efficient energy sources become even more important in the future, Donaldson plans to be there with progressive filtration solutions.

Fact: World electricity consumption is projected to increase by 60 percent from 1997 to 2020*



*International Energy Outlook 2000, Energy Information Administration



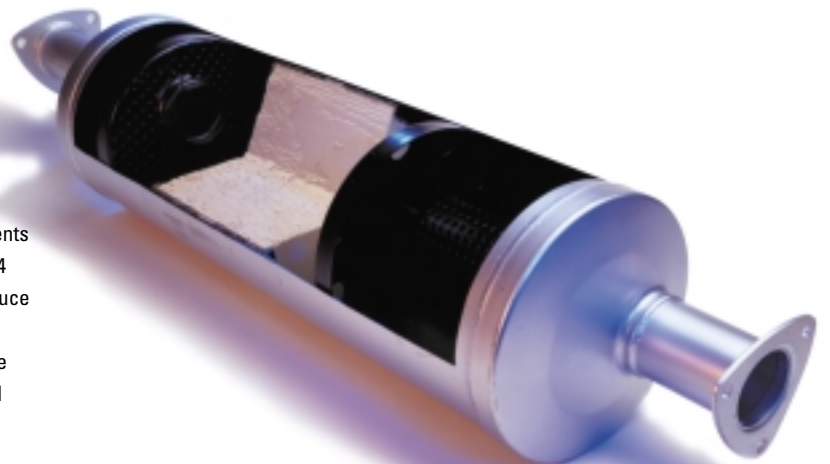
CLEANER *air*

Helping Customers Meet EPA Requirements

In its persistent effort to improve the quality of air we breathe, the EPA continues to impose regulations that further reduce harmful emissions related to diesel engine use in the United States. Other regulatory bodies are making similar demands internationally. These step reductions mean manufacturers must reduce levels of nitrogen oxide and particulate in emissions by 2004 and again in 2007. That's good news for the environment and for Donaldson. To help engine and truck manufacturers meet regulations, we're responding with a "total filtration" approach including enhanced air, liquid and exhaust products. Higher performing products with improved technology will provide better filtration levels and longer wear. And the higher performance translates into higher value products.

Regulations focusing specifically on exhaust may lead to a tremendous market potential for exhaust systems and an increase in the amount of Donaldson product on each vehicle. In addition, regulations now applicable to new on-road vehicles will eventually affect off-road and older vehicles, greatly expanding our opportunities for both first-fit and retrofit products.

Fact: The proposed EPA requirements for 2007 (as compared to 2004 requirements) will further reduce by 90 percent the levels of nitrogen oxide and particulate released into the air by diesel engines.



Fact: Donaldson sells more than 250 million disk drive filters per year.



New Initiatives in an Emerging Region

The Asia Pacific region is known for its developing economies, untapped markets and tremendous opportunities for growth. And while many companies are just beginning to capitalize on the potential, Donaldson has been committed to the region for more than 30 years, with a presence today in Japan, China, Australia, India, South Korea, Indonesia and Singapore. In fiscal 2000, we began to see a resurgence in the Asia Pacific economy, which has languished in recent years. Sales from our disk drive filtration products manufacturing facility in Wuxi, China increased dramatically, and we began consolidation efforts to revitalize business in Japan. We made a significant investment to open a new headquarters in Singapore that unites all of our operations in Asia Pacific and provides central leadership for ongoing initiatives. Additionally, we enhanced manufacturing and sales facilities in Australia. As the Asia Pacific economy continues to ramp up, Donaldson is poised to capitalize on the opportunities and expand.

eastern
SYNERGY



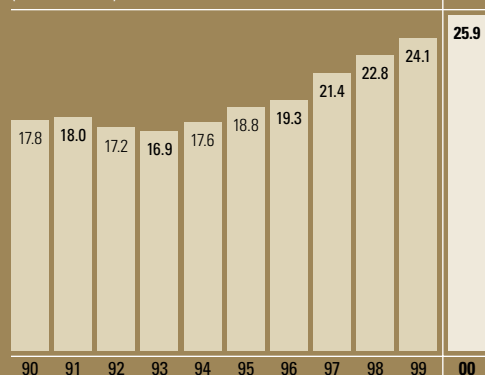
Financial Highlights

Donaldson Company, Inc. and Subsidiaries

Year ended July 31	2000	1999	Change
Net sales (000s)	\$1,092,294	\$944,139	15.7%
Net earnings (000s)	\$70,233	\$62,447	12.5%
Return on sales	6.4%	6.6%	(.2) pts
Return on average shareholders' equity	25.9%	24.1%	1.8 pts
Long-term capitalization ratio	24.9%	24.8%	.1 pts
Diluted earnings per share	\$1.51	\$1.31	15.3%
Dividends paid per share	\$.27	\$.23	17.4%
Shareholders' equity per share	\$6.27	\$5.69	10.2%
Diluted shares outstanding (000s)	46,664	47,793	(2.4)%
Employees at year-end	8,478	7,056	20.2%
Sales per employee (000s)	\$128.8	\$133.8	(3.7)%

Return on Equity

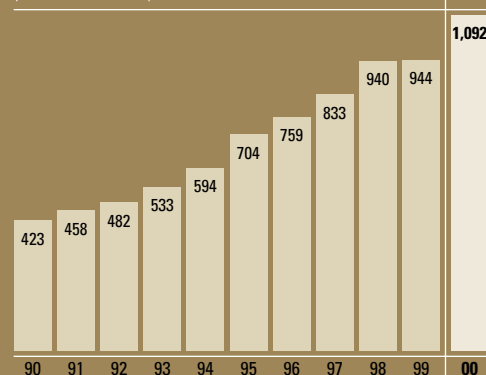
(% Per annum)



Donaldson Company is delivering shareholder value through consistently high returns on shareholders' equity.

Net Sales

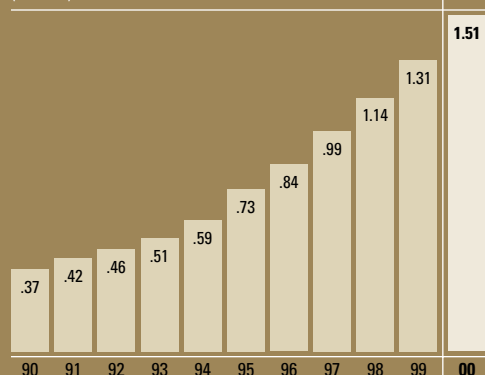
(Millions of dollars)



Donaldson has posted 17 consecutive years of revenue increases.

Earnings Per Share

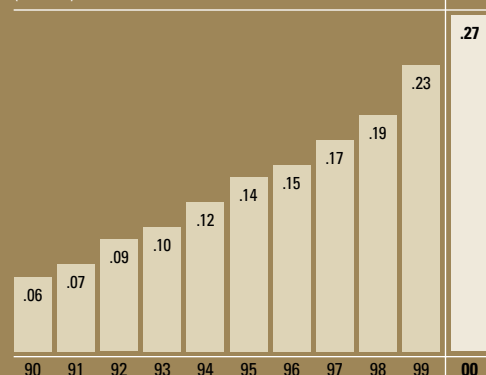
(Dollars)



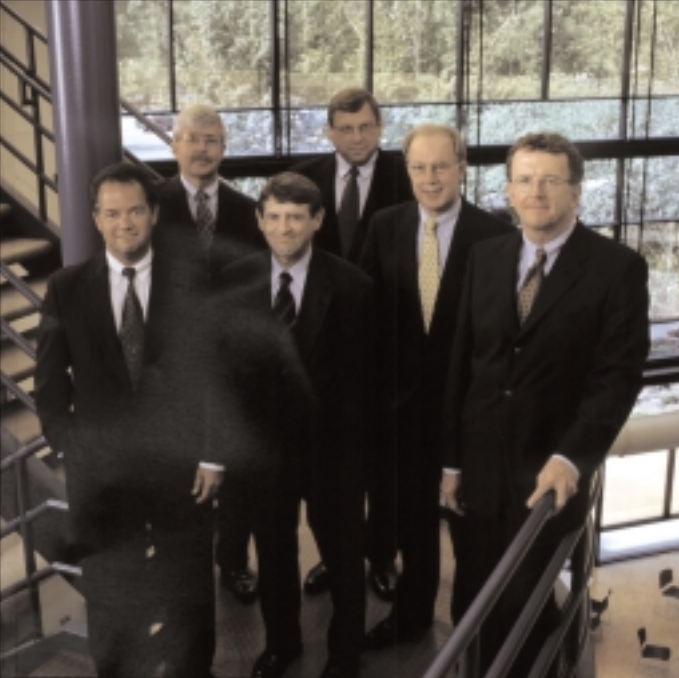
Earnings per share were up 15 percent in 2000, the 11th consecutive year of double-digit increases in EPS.

Dividends Per Share

(Dollars)



Dividends paid per share increased 17 percent in 2000. The company distributes about 20 percent of net income to shareholders through regular quarterly dividends.



Pictured from left to right:

James R. Giertz

Senior Vice President, Commercial and Industrial

William M. Cook

Senior Vice President, International

Lowell F. Schwab

Senior Vice President, Operations

Nickolas Priadka

Senior Vice President, Engine Systems and Parts

Thomas W. VanHimbergen

Senior Vice President and Chief Financial Officer

William G. Van Dyke

Chairman, President and Chief Executive Officer

Fiscal 2000 was another strong year for us. We crossed the \$1 billion revenue mark with sales growth of 16 percent and delivered on our promise of double-digit earnings growth for the 11th consecutive year. These results are evidence that the people who are this company have done a lot of things right, and I thank them for their dedication, commitment and hard work.

Our fundamental financial model is that consistent, above-average earnings growth will bring above-average returns to our shareholders. For the last 11 years we've posted sales growth averaging 10 percent and never-miss, double-digit earnings growth averaging 17 percent. By my assessment, our people have done a fine job of executing the game plan. With return to shareholders over that period well above 20 percent, the model would seem to hold up pretty well. But the stock has not appreciated for three years, while EPS marched forward at a steady 15 percent per year.

The stock market's unwillingness to recognize our performance compelled us to carefully examine whether our model is outdated. In sum, we don't think so. If this business isn't "all about" cash flow and long-term return on investment (we use consistent, long-term EPS growth as a proxy for these), then we don't understand the game. The stock market will swing for us and against us, but we'll hold to our long-term view: if we continue to perform every year as we have, our shareholders will win.

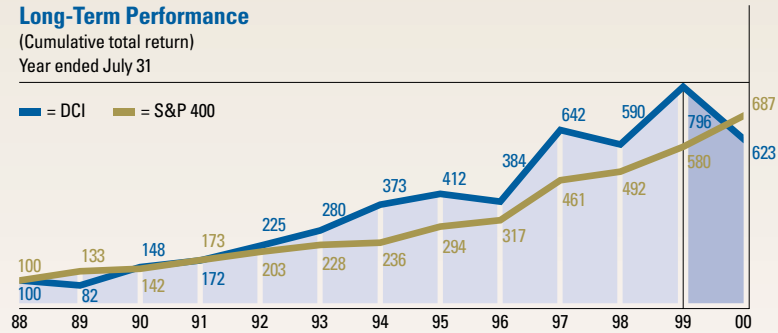
HIGHLIGHTS We've helped to ensure our success – and remove cyclicality from our performance – by diversifying our business over the years. Since the mid-'80s, we've used our highly successful franchise in diesel engine filtration to fund expansion into other filtration markets. The payback is that while the Engine Products segment remains the keel of our ship, logging double-digit growth in 2000, the Industrial Products segment in the current year will deliver an estimated 43 percent of Donaldson's revenue and almost half of its operating profit.

Long-Term Performance

(Cumulative total return)

Year ended July 31

— = DCI — = S&P 400



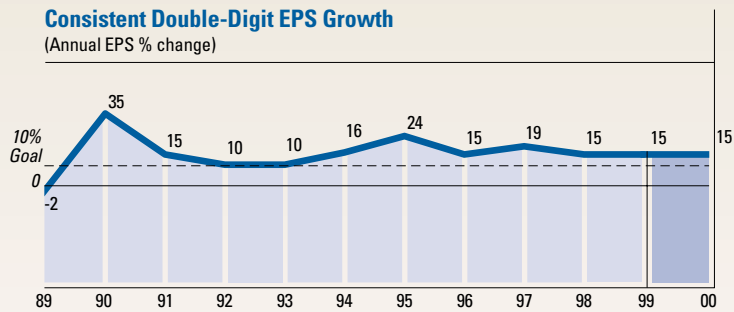
We're highlighting the Industrial Products group with our *Industrial Strength* theme for this year's report to give you a good sense of our current strength on this side of the business and our future opportunities. We're not yet to our revenue target of 50 percent Industrial, but we've made good progress from the mid-'80s when that sector contributed only 15 percent of sales.

Engine's strong showing in 2000, despite a 6 percent decline in the transportation business, reflects continued share gains in the aftermarket unit, as well as a double-digit rebound from last year in the off-road group. Concurrently, Industrial posted double-digit growth in both gas turbines and disk drives. In each case, strong underlying market growth was accompanied by significant Donaldson share gains.

On the international front, we had a banner year. Europe turned in a powerful performance with impressive revenue and profit gains across all business units. Asia Pacific, buoyed by our operations in China, likewise posted strong sales and profit growth; however, Japan continues to drift in the doldrums.

Two acquisitions during the year – AirMaze, a supplier of air/oil separators and heavy-duty air and liquid filters, and DCE, a global leader in industrial dust collection – added \$57 million to our portfolio. You will find more detailed information about these acquisitions on pages 2 and 3 of our report. Generally, we expect acquisitions to continue to provide about a third of our targeted 10 to 12 percent revenue growth over the long term. The fragmented filtration industry continues to offer acquisition opportunities that match up well with Donaldson's broad global base and established market positions.

LOOKING AHEAD The coming year looks to be the logical extension of the one past. We expect continued strong financial performance and market share gains from gas turbine. Our significant infrastructure investments over the last several years have left us uniquely positioned to respond to today's unprecedented demand for gas turbines.



We anticipate that the sharp downturn in North American heavy trucks will likely continue. However, because our first-fit sales in this sector are less than 10 percent of our total, the downturn slows rather than threatens another successful year. This makes the case for the diversification we've relentlessly pursued for so many years.

Aftermarket's uptrend, past and future, is closely linked to e-commerce. Now in the third year since the launch of its DYNAMIC™ online order-processing tool, aftermarket is handling more than 50 percent of its orders electronically. In the year ahead, we'll look intently at how we can utilize this powerful tool in other areas of our business.

We'll also continue our efforts to assimilate and leverage the operations we've acquired in the last few years. With multiple plants and operations around the world, DCE's integration promised to be hard work, and it has lived up to that promise. That said, Donaldson has the only global franchise in the dust collection industry and the two best known brand names in Torit and DCE. The inevitable surprises that come with an acquisition have been overwhelmingly positive, and we're excited about the upside potential, particularly in the international arena.

Overall, it's an exciting time for Donaldson. Today's remarkably rapid pace of change means the only sure thing in the coming year is the unexpected. But, that doesn't leave us confused about our objective.

We look forward to delivering our 12th consecutive year of double-digit growth in 2001.

Thank you for your continuing support.

Sincerely,

William G. Van Dyke

Chairman and Chief Executive Officer

ENGINE PRODUCTS *Operating Segment*

2000 Revenue: \$674 million

	End-Markets	Representative Customers	2000 Revenue	Product Families			
	<p>OFF-ROAD EQUIPMENT: Products sold to industrial equipment OEMs for agriculture, construction, mining and other industrial applications.</p>	<p>Caterpillar, John Deere, Komatsu and Volvo Construction Equipment</p>	<p>IN MILLIONS \$193</p>	Engine Intake Air Filtration Systems	Exhaust Systems	Hydraulic Filtration Systems	Cabin Air Filters
	<p>DEFENSE: Products sold to military contractors supplying land-based military equipment.</p>	<p>General Dynamics, Stewart & Stevenson</p>					
	<p>TRUCKS: Products sold to manufacturers of medium- and heavy-duty trucks.</p>	<p>Freightliner, Paccar, Volvo, Scania, Renault and Mitsubishi</p>	<p>\$153</p>				
	<p>AUTOMOTIVE: Products sold to manufacturers of passenger cars, SUVs and light-duty commercial vehicles.</p>	<p>General Motors, DaimlerChrysler, Ford, Audi and Hino</p>					
	<p>AFTERMARKET: Broad line of replacement filters and hard parts for all of the equipment applications noted above.</p>	<p>Original equipment dealers (such as Freightliner dealers or Caterpillar dealers), independent distributors and private label accounts</p>	<p>\$328</p>				

INDUSTRIAL PRODUCTS *Operating Segment*

2000 Revenue: \$418 million

Products	2000 Revenue	Applications	Routes to Market
 <p>DUST COLLECTION: Under the trade names Torit, DCE and Aercology, Donaldson provides equipment to control and capture process dust, fumes and mist in manufacturing and industrial processing plants. In addition, a full line of replacement filter cartridges, bags and spare parts are offered.</p>	<p>IN MILLIONS</p> <p>\$193</p>	<p>Product is applied in a wide variety of industrial settings including metal working plants, paint operations, welding stations, woodworking shops and food processing plants.</p>	<p>Dedicated field sales force coordinates multiple selling channels to end-user including: direct selling, distribution, installers, OEM accounts and telemarketing.</p>
 <p>GAS TURBINE SYSTEMS: Donaldson provides complete systems to deliver clean air to combustion turbines. Products include self-cleaning filter units, static air filter units, inlet ducting and silencing, evaporative coolers, chiller coils, inlet heating and anti-icing systems. Also, a full line of replacement filters and parts is offered.</p>	<p>\$117</p>	<p>Essentially all combustion turbines require inlet air filtration and noise attenuation systems. These turbines provide base electricity, peaking capacity, remote power generation for special applications such as pipelines and off-shore oil drilling platforms.</p>	<p>Products are primarily sold to gas turbine OEMs (e.g., General Electric, Alstom Power, Siemens Westinghouse). Replacement parts are sold direct to end-users.</p>
 <p>SPECIAL APPLICATIONS: Donaldson provides a wide range of high efficiency media, filters and filtration systems for various commercial, industrial and product applications.</p>	<p>\$108</p>	<p>Products for the computer disk drive market include particulate filters, desiccant pouches and chemical adsorbing filter pouches. Customers include major disk drive manufacturers such as IBM, Seagate and Western Digital.</p>	<p>Products are sold to disk drive manufacturers by a direct sales force supported by product development and application engineers.</p>
		<p>Products for special market applications include aircraft cabin air filters, chemical filter systems for semi-conductor processing facilities, as well as other filters for process-critical applications.</p>	<p>Products are primarily sold direct to end-users.</p>
		<p>Donaldson sells expanded PTFE membrane through its Tetratex unit. Primary applications for this membrane are industrial dust collection, product recovery applications and specialty fabrics.</p>	<p>Membrane and laminates are sold to various filter and garment manufacturers.</p>
		<p>Donaldson sells a broad line of filters and housings for industrial hydraulic and lubricating fluids.</p>	<p>Products are sold through an extensive network of industrial distributors.</p>

Management's Discussion and Analysis

Results of Operations

The following discussion of the company's financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto (including Note H, Segment Reporting) and other financial information included elsewhere in this Report.

Fiscal 2000 Compared to Fiscal 1999 The company exceeded one billion dollars in sales in 2000, reporting record sales of \$1.092 billion. This was an increase of 15.7 percent over prior-year sales of \$944.1 million. Businesses acquired in this fiscal year contributed \$56.7 million of revenues for the year. Excluding the impact of acquisitions, sales for the year ended July 31, 2000 were up 9.7 percent over the prior year. Sales for the Engine Products segment of \$674.0 million were up 10.2 percent over the prior year. Sales for the Industrial Products segment of \$418.3 million were up 25.7 percent over the prior year. Overall, growth was strong across essentially all the markets within both the Engine Products and Industrial Products segments with the exception of a 5.9 percent decline in sales of transportation products within the Engine Products segment, reflecting a slowdown in the North America heavy-duty truck market and a decrease in automotive sales due to the loss of the CK platform business. Continued increases in sales for the gas turbine systems and special application products reflected continued high demand in those markets. The increase in sales also reflected strengthening in other markets such as dust collection, engine aftermarket and off-road products.

Domestic Engine Products sales were up 8.7 percent from the prior year. This increase was led by strong sales in engine aftermarket products, which increased domestically by 23.6 percent including businesses acquired during the year. Exclusive of acquisitions, domestic aftermarket product sales increased 10.4 percent. Domestic sales in off-road equipment products were also strong with an increase of 14.7 percent from the prior year reflecting growth in the agricultural, mining and large equipment markets compared to the prior year. Domestic sales in transportation products were down 1.8 percent with mixed results coming from an increase of 10.2 percent in domestic truck sales offset by a sharp decline in domestic automotive sales. Domestic Industrial Products sales increased 17.8 percent from the prior year including businesses acquired during the year.

Exclusive of acquisitions, domestic Industrial Products sales were still strong with an increase of 15.6 percent. This increase was led by continued strong sales of gas turbine systems products (55.4 percent increase from the prior year) reflecting continued demand for large turbines in North America. Domestic dust collection product sales grew at a more modest rate with an increase of 7.2 percent while increases in special applications products increased only slightly overall.

In U.S. dollars, total international sales increased 23.0 percent from the prior year. Excluding the negative impact of foreign currency translation of \$12.3 million, sales increased 26.8 percent over the prior year. Total international Engine Products sales were up 13.3 percent compared to the prior year despite lower overall sales of automotive products. International sales of off-road products and aftermarket products were strong, posting increases of 21.9 percent and 20.1 percent from the prior year, respectively. International Industrial Products sales were up 39.0 percent from the prior year including businesses acquired during the year. Businesses acquired during the year contributed \$28.7 million of international sales in the Industrial Products segment. Excluding these sales, the Industrial Products segment showed an increase of 15.9 percent in international sales from the prior year. A sharp increase in international sales in dust collection products was due largely to acquisitions during the year but excluding acquisitions, sales still showed an increase of 6.7 percent. Also contributing to the increase in international sales for the Industrial Products segment were disk drive products and gas turbine products with increases of 18.8 percent and 14.9 percent, respectively, over the prior year.

The company reported record net earnings for 2000 of \$70.2 million compared to \$62.4 million in 1999, an increase of 12.5 percent. Net earnings per share - diluted were \$1.51, up 15.3 percent from the prior year and reflects revenue growth as well as the impact of the company's stock repurchase program. An increase in sales levels from the prior year and the benefit from continued cost reduction efforts were the primary reasons for the higher earnings. The Industrial Products segment contributed almost half of the operating profit and all of the earnings growth for 2000. International operating income totaled approximately 62.1 percent and 57.6 percent of consolidated operating income in 2000 and 1999, respectively.

Gross margin for 2000 increased to 30.0 percent compared to 29.2 percent in the prior year. The increase in gross margin for the year reflects the growth in net sales achieved in both operating segments of the company as well as the positive impact of the continuous focus on productivity improvements.

Operating expenses as a percentage of sales for 2000 and 1999 were 20.3 percent and 19.8 percent, respectively. Operating expenses in 2000 totaled \$221.9 million compared to \$187.3 million in 1999, an increase of \$34.6 million, or 18.5 percent. The increase in operating expenses relative to the prior year reflects higher sales levels and the impact of the acquired businesses. Selling expenses in 2000 increased \$17.1 million, primarily due to the higher sales levels. General and administrative expenses increased \$13.8 million from the prior year due to several factors including increased programming and information technology costs associated with Year 2000 efforts, increases in workers' compensation, increases in medical costs and employee compensation. In addition, there was \$1.8 million of goodwill amortization related to the businesses acquired during the year.

Interest expense increased \$2.9 million, or 41.3 percent, primarily due to an increase in debt for the financing of acquisitions in the year as well as an increase in short-term borrowing. Other income totaled \$4.6 million in 2000 compared to other income of \$7.8 million in the prior year. The major components of other income in 2000 were: interest income of \$2.7 million, earnings from non-consolidated joint ventures of \$4.4 million, charitable contributions of \$0.9 million, loss on sale of fixed assets of \$1.0 million, and other miscellaneous income and expense items netting to \$0.6 million of miscellaneous expense.

The effective income tax rate of 30.0 percent in 2000 was unchanged from the 30.0 percent tax rate in 1999. The company anticipates that its effective income tax rate will remain at approximately 30.0 percent in 2001.

Total backlogs of \$331.3 million were up 16.8 percent from the prior year-end. Hard order backlogs, goods scheduled for delivery in 90 days, were \$183.7 million and \$157.1 million at July 31, 2000 and 1999, respectively. Hard order backlog for the Engine Products segment decreased slightly from 1999. This decrease resulted from a decrease in backlog for truck and automotive products of 32.1 percent, offset by double-digit increases in both aftermarket products and off-road equipment products of 22.2 percent and 15.5 percent, respectively. Hard order backlog for the Industrial Products segment increased \$28.2 million from 1999. This increase was due to significant increases in backlog for both dust collection and gas turbine products of 81.1 percent and 45.6 percent, respectively, followed by a more modest increase in special application products of 6.6 percent.

Fiscal 1999 Compared to Fiscal 1998 The company reported record sales in 1999 of \$944.1 million, a slight increase over prior-year sales of \$940.4 million. Sales for the Engine Products segment of \$611.0 million were down 1.7 percent over the prior year. Sales for the Industrial Products segment of \$333.0 million were up 4.6 percent from the prior year. Overall, end-market conditions varied widely for the various products and geographic locations. Demand in some markets, such as agricultural equipment, was down sharply, while other markets, such as gas turbine systems, experienced rapid growth. Most of the markets served by the company experienced sluggish growth or modest contractions in demand.

Domestic Engine Products sales were down 3.0 percent from the prior year. This decrease is primarily due to an ongoing weakness in the agricultural equipment markets and, to a lesser extent, lower production of mining and large equipment resulting in a decrease in sales in off-road equipment products of 9.5 percent. This decrease was offset by an increase in sales of truck products of 13.6 percent from the prior year. Domestic Industrial Products sales increased 6.7 percent. This increase was led by strong sales of gas turbine systems products (38.5 percent increase from the prior year) as well as modest sales growth in dust collection products. This increase was partially offset by lower sales in special applications products.

In U.S. dollars, total international sales increased 1.0 percent from the prior year. Excluding the negative impact of foreign currency translation of \$1.2 million, sales increased 1.4 percent over the prior year. Total international Engine Products sales were up 0.9 percent compared to the prior year despite lower overall sales of off-road and truck products. Aftermarket product sales showed an increase of 8.2 percent over the prior year largely due to increased activity in Mexico. Total international Industrial Products sales increased 1.2 percent from the prior year. This increase was primarily a result of an increase in sales of filters for computer disk drives partially offset by a decrease in sales of gas turbine systems products of 24.0 percent.

The company reported record net earnings for 1999 of \$62.4 million compared to \$57.1 million in 1998, an increase of 9.5 percent. Net earnings per share - diluted were \$1.31, up 14.9 percent from the prior year and reflects the impact of the company's stock repurchase program. The increase in net earnings, with only a slight increase in net sales, was primarily due to cost reduction and productivity initiatives, an increase in other income as discussed below and a reduction in the effective income tax rate. International operating income totaled approximately 57.6 percent and 50.3 percent of consolidated operating income in 1999 and 1998, respectively.

Gross margin for 1999 increased to 29.2 percent compared to 28.0 percent in the prior year. Gross margin improved over the course of the year; gross margin in the second half of 1999 was 30.3 percent. The improvement in gross margin reflects the positive impact of cost reduction and productivity initiatives partially offset by the negative impact of lower production volumes in some facilities.

Operating expenses as a percentage of sales for 1999 and 1998 were 19.8 percent and 18.8 percent, respectively. Operating expenses in 1999 totaled \$187.3 million compared to \$176.5 million in 1998, an increase of \$10.8 million, or 6.1 percent. Selling expenses in 1999 decreased \$2.1 million, reflecting the positive impact of cost reduction and productivity initiatives, while general and administrative expenses increased \$12.8 million consisting primarily of increases in product liability expense, legal expense, system and programming costs and employee compensation. In addition, there were \$2.8 million of costs related to the closing of the Oelwein plant.

Interest expense increased \$2.3 million, or 49.7 percent, primarily due to the increase in long-term debt for the full year. Other income totaled \$7.8 million in 1999 compared to other income of \$4.3 million in the prior year. The major components of other income in 1999 were: interest income of \$1.4 million, earnings from non-consolidated joint ventures of \$3.6 million, gain on sale of assets and product lines of \$0.9 million, and other miscellaneous items of \$1.9 million.

The effective income tax rate of 30.0 percent in 1999 was lower compared to 34.0 percent in 1998, primarily due to lower international taxes and foreign tax credits from foreign dividends. The company anticipates that its effective income tax rate will remain at 30.0 percent in 2000.

Total backlogs of \$283.7 million were up 16.6 percent from the prior year-end. Hard order backlogs, goods scheduled for delivery in 90 days, were \$157.1 million and \$138.8 million at July 31, 1999 and 1998, respectively. Hard order backlog for the Engine Products segment increased \$7.7 million from 1998. This increase was due primarily to an increase in backlog for truck and automotive products of 25.5 percent, offset by a decrease in off-road equipment products backlog of 8.2 percent. Hard order backlog for the Industrial Products segment increased \$10.7 million from 1998. This increase was due to significant increases in backlog for both gas turbine and special applications products of 53.0 percent and 58.6 percent, respectively, offset by a decrease in dust collection products backlog of 19.1 percent.

Liquidity and Capital Resources

Financial Condition At July 31, 2000, the company's capital structure was comprised of \$85.3 million of current debt, \$92.6 million of long-term debt and \$280.2 million of shareholders' equity. The ratio of long-term debt to total long-term capital was 24.9 percent and 24.8 percent at July 31, 2000 and July 31, 1999, respectively.

Total debt outstanding increased \$70.6 million to \$178.0 million outstanding at July 31, 2000. The increase resulted from an increase in short-term borrowings outstanding at the end of the year of \$64.7 million as compared to the prior year. Additionally, during the year the company obtained \$8.0 million in Industrial Development Revenue Bond Financing for the construction of a new manufacturing facility of which \$5.7 million was outstanding as of July 31, 2000.

The company has a multi-currency revolving credit facility totaling \$100.0 million with a group of banks and an additional \$35.0 million available for use under uncommitted facilities which provide unsecured borrowings for general corporate purposes. There was \$62.6 million outstanding under these facilities at July 31, 2000. The company believes that the combination of present capital resources, internally generated funds, and unused financing sources are more than adequate to meet cash requirements for 2001.

Shareholders' equity increased \$17.4 million in 2000 to \$280.2 million. The increase was primarily due to current year earnings of \$70.2 million offset primarily by \$35.9 million of treasury stock repurchases and \$12.4 million of dividend payments.

Cash Flows During 2000, \$88.3 million of cash was generated from operating activities, compared with \$99.8 million in 1999 and \$37.0 million in 1998. The decrease in 2000 was primarily due to an increase in inventory of \$26.2 million during the year in contrast to the prior year when inventory decreased. In addition, increased earnings offset by changes in other working capital items resulted in increased operating cash flow in 2000.

In addition to cash generated from operating activities, the company obtained an additional \$66.3 million in short-term debt and \$1.2 million in net long-term debt. These cash flows were used primarily to support \$36.4 million for capital expenditures, \$35.9 million for stock repurchases and \$12.4 million for dividend payments. Cash and cash equivalents decreased \$17.8 million during 2000.

Capital expenditures for property, plant and equipment totaled \$36.4 million in 2000, compared to \$29.5 million in 1999 and \$54.7 million in 1998. Capital expenditures primarily related to productivity enhancing investments at various plants worldwide and continuing upgrades to the U.S. information systems.

Capital spending in 2001 is planned to be \$55.0 million. Significant planned expenditures include the further upgrade of U.S. information systems and investment in manufacturing equipment and tooling. It is anticipated that 2001 capital expenditures will be financed primarily from funds from operations.

Dividends The company's dividend policy is to maintain a payout ratio which allows dividends to increase with the long-term growth of earnings per share, while sustaining dividends in down years. The company's dividend payout ratio target is 20.0 percent to 25.0 percent of the average earnings per share of the last three years. The current quarterly dividend of 7 cents per share equates to 21.2 percent of the 1998 through 2000 average net earnings per share.

Share Repurchase Plan In November 1998, the Board of Directors authorized the company to repurchase 5.0 million shares of common stock. At July 31, 2000, the company had approximately 2.0 million remaining shares under the repurchase authorizations. Management and the Board of Directors believe the share repurchase program is an excellent means of returning value to the shareholders.

In 2000, the company repurchased 1.7 million shares of common stock on the open market for \$35.9 million, at an average price of \$21.65 per share. The company repurchased 2.4 million shares for \$44.5 million in 1999 and 1.3 million shares for \$33.3 million in 1998.

Environmental Matters The company has established reserves for potential environmental liabilities and plans to continue to accrue reserves in appropriate amounts. While uncertainties exist with respect to the amounts and timing of the company's ultimate environmental liabilities, management believes that such liabilities, individually and in the aggregate, will not have a material adverse effect on the company's financial condition or results of operations.

New Accounting Standards The company will adopt Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities – an amendment of FASB Statement No. 133," which is effective beginning fiscal 2001. SFAS 133 requires a company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the hedged assets, liabilities or firm commitments are recognized through earnings or in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The company has determined that the effect of adopting SFAS 133 and SFAS 138 is immaterial to the earnings and the financial position of the company as of August 1, 2000.

The company has adopted Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," effective beginning fiscal 2000. This SOP provides guidance on accounting for the costs of computer software developed or obtained for internal use. The company has determined that the effect of SOP 98-1 is immaterial to the earnings and the financial position of the company.

Market Risk The company's market risk includes the potential loss arising from adverse changes in foreign currency exchange rates and interest rates. The company manages foreign currency market risk, from time to time, through the use of a variety of financial and derivative instruments. The company does not enter into any of these instruments for trading purposes to generate revenue. Rather, the company's objective in managing these risks is to reduce fluctuations in earnings and cash flows associated with changes in foreign currency exchange rates. The company uses forward exchange contracts and other hedging activities to hedge the U.S. dollar value resulting from anticipated foreign currency transactions. The company's market risk on interest rates is the potential increase in fair value of long-term debt resulting from a potential decrease in interest rates. See further discussion of these market risks below.

Foreign Currency In 2000, the U.S. dollar was mixed relative to the currencies of foreign countries where the company operates. A stronger dollar generally has a negative impact on international results because foreign-currency denominated earnings translates into less U.S. dollars; a weaker dollar generally has a positive translation effect.

It is not possible to determine the true impact of foreign currency translation changes; however, the direct effect on net sales and net earnings can be estimated. For 2000, the impact of foreign currency translation resulted in a decrease in net sales by \$12.3 million and a decrease in net earnings by \$16.5 million. During 1999, the impact of foreign currency translation resulted in a decrease in net sales by \$1.2 million and an increase in net earnings by \$0.8 million.

The company maintained significant assets and operations in Europe, countries of the Asia-Pacific Rim, South Africa and Mexico. As a result, exposure to foreign currency gains and losses exists. A portion of foreign currency exposure is hedged by incurring liabilities, including bank debt, denominated in the local currency where subsidiaries are located.

The subsidiaries of the company purchase products and parts in various currencies. As a result, the company may be exposed to cost increases relative to local currencies in the markets to which it sells. To mitigate such adverse trends, the company, from time to time, enters into forward exchange contracts and other hedging activities. Also, foreign currency positions are partially offsetting and are netted against one another to reduce exposure.

Some products made in the United States are sold abroad, primarily in Canada. As a result, sales of such products are affected by the value of the U.S. dollar relative to other currencies. Any long-term strengthening of the U.S. dollar could depress these sales. Also, competitive conditions in the company's markets may limit its ability to increase product pricing in the face of adverse currency movements.

Interest At July 31, 2000, the fair value of the company's long-term debt approximates market. Market risk is estimated as the potential decrease in fair value resulting from a hypothetical one-half percent increase in interest rates and amounts to approximately \$3.6 million.

Forward-Looking Statements

The company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is making this cautionary statement in connection with such safe harbor legislation. This Annual Report to Shareholders, any Form 10-K, Form 10-Q or Form 8-K of the company or any other written or oral statements made by or on behalf of the company may include forward-looking statements which reflect the company's current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "project," "should" and similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All forecasts and projections in this Annual Report are "forward-looking statements," and are based on management's current expectations of the company's near-term results, based on current information available pertaining to the company, including the risk factors noted below.

The company wishes to caution investors that any forward-looking statements made by or on behalf of the company are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and other risk factors include, but are not limited to: changing economic and political conditions in the United States and in other countries, changes in governmental spending and budgetary policies, governmental laws and regulations surrounding various matters such as environmental remediation, contract pricing, and international trading restrictions, customer product acceptance, continued access to capital markets and foreign currency risks. For a more detailed explanation of the foregoing and other risks, see exhibit 99, which is filed with the Securities and Exchange Commission. The company wishes to caution investors that other factors may in the future prove to be important in affecting the company's results of operations. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or a combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Investors are further cautioned not to place undue reliance on such forward-looking statements as they speak only to the company's views as of the date the statement is made. The company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Consolidated Statements of Earnings

Donaldson Company, Inc. and Subsidiaries

(Thousands of dollars, except share and per share amounts) Year ended July 31,

	2000	1999	1998
Net sales	\$1,092,294	\$944,139	\$940,351
Cost of sales	764,773	668,458	677,089
Gross Margin	327,521	275,681	263,262
Selling, general and administrative	194,623	163,688	152,954
Research and development	27,304	23,603	23,509
Operating Income	105,594	88,390	86,799
Interest expense	9,880	6,993	4,671
Other (income) expense	(4,619)	(7,813)	(4,313)
Earnings Before Income Taxes	100,333	89,210	86,441
Income taxes	30,100	26,763	29,390
Net Earnings	\$ 70,233	\$62,447	\$ 57,051
Weighted Average Shares – Basic	45,716,482	46,899,127	49,332,266
Weighted Average Shares – Diluted	46,664,196	47,793,180	50,229,005
Net Earnings Per Share – Basic	\$ 1.54	\$ 1.33	\$ 1.16
Net Earnings Per Share – Diluted	\$ 1.51	\$ 1.31	\$ 1.14

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Balance Sheets

Donaldson Company, Inc. and Subsidiaries

(Thousands of dollars, except share amounts) At July 31,

2000

1999

ASSETS

Current Assets

Cash and cash equivalents	\$ 24,149	\$ 41,944
Accounts receivable, less allowance of \$4,380 and \$4,341	202,361	178,419
Inventories		
Raw materials	45,064	32,722
Work in process	20,171	13,758
Finished products	54,128	35,618
Total Inventories	119,363	82,098
Deferred income taxes	18,411	14,911
Prepays and other current assets	11,195	9,016
Total Current Assets	375,479	326,388

Property, Plant and Equipment, at cost

Land	7,432	7,166
Buildings	119,203	105,913
Machinery and equipment	333,310	296,038
Construction in progress	9,756	12,308
	469,701	421,425
Less accumulated depreciation	(265,156)	(239,245)

	204,545	182,180
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Deferred Income Taxes

	408	-
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Intangible Assets	63,885	10,984
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Other Assets	25,340	22,694
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	\$ 669,657	\$ 542,246
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LIABILITIES AND SHAREHOLDERS' EQUITY

Current Liabilities

Short-term borrowings	\$ 85,034	\$ 20,287
Current maturities of long-term debt	279	409
Trade accounts payable	82,320	63,361
Accrued employee compensation and related taxes	29,759	23,720
Income taxes payable	58	4,448
Accrued liabilities	27,974	22,680
Other current liabilities	10,298	7,150

Total Current Liabilities	235,722	142,055
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Long-term Debt	92,645	86,691
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Deferred Income Taxes	-	132
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Other Long-term Liabilities	61,125	50,605
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Commitments and Contingencies (Note J)

Shareholders' Equity

Preferred stock, \$1.00 par value, 1,000,000 shares authorized, none issued	-	-
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Common stock, \$5.00 par value, 80,000,000 shares authorized, 49,655,954 shares issued in 2000 and 1999	248,280	248,280
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Additional paid-in capital	2,018	1,611
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Retained earnings	143,125	87,909
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Accumulated other comprehensive income	(10,523)	(5,670)
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Treasury stock – 4,998,342 and 3,458,670 shares in 2000 and 1999, at cost	(102,735)	(69,367)
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Total Shareholders' Equity	280,165	262,763
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	\$ 669,657	\$ 542,246
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The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

Donaldson Company, Inc. and Subsidiaries

(Thousands of dollars) Year ended July 31,

	2000	1999	1998
OPERATING ACTIVITIES			
Net earnings	\$ 70,233	\$ 62,447	\$ 57,051
Adjustments to reconcile net earnings to net cash provided by operating activities			
Depreciation and amortization	34,326	27,686	25,272
Write-down of impaired assets	-	-	1,000
Equity in earnings of affiliates	74	(2,187)	(1,944)
Deferred income taxes	(449)	489	4,226
Other	2,454	10,344	(6,817)
Changes in operating assets and liabilities, net of acquired businesses			
Accounts receivable	(6,441)	(13,244)	(6,780)
Inventories	(26,227)	21,382	(20,037)
Prepays and other current assets	(4,913)	(3,095)	417
Trade accounts payable and other accrued expenses	19,261	(4,066)	(15,350)
Net Cash Provided by Operating Activities	88,318	99,756	37,038
INVESTING ACTIVITIES			
Purchases of property and equipment, net	(36,417)	(29,539)	(54,705)
Acquisitions and investments in affiliates	(88,220)	(230)	(920)
Net Cash Used in Investing Activities	(124,637)	(29,769)	(55,625)
FINANCING ACTIVITIES			
Proceeds from long-term debt	5,752	35,546	50,000
Repayments of long-term debt	(4,522)	(404)	(2,890)
Change in short-term borrowings	66,328	(24,422)	4,582
Payment received from ESOP	-	-	2,730
Purchase of treasury stock	(35,923)	(44,535)	(33,250)
Dividends paid	(12,384)	(10,830)	(9,630)
Exercise of stock options	326	1,617	2,619
Net Cash (Used in) Provided by Financing Activities	19,577	(43,028)	14,161
Effect of exchange rate changes on cash	(1,053)	(1,084)	6,217
Increase (Decrease) in Cash and Cash Equivalents	(17,795)	25,875	1,791
Cash and Cash Equivalents, Beginning of Year	41,944	16,069	14,278
Cash and Cash Equivalents, End of Year	\$ 24,149	\$ 41,944	\$ 16,069

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

Donaldson Company, Inc. and Subsidiaries

(Thousands of dollars, except per share amounts)	<i>Common Stock</i>	<i>Additional Paid-in Capital</i>	<i>Retained Earnings</i>	<i>Accumulated Other Comprehensive Income</i>	<i>Treasury Stock</i>	<i>Receivable from ESOP</i>	<i>Total</i>
BALANCE JULY 31, 1997	\$ 135,317	\$ 6,212	\$ 167,444	\$ 934	\$ (63,312)	\$(2,730)	\$ 243,865
Comprehensive income							
Net earnings			57,051				57,051
Foreign currency translation				(6,069)			(6,069)
Comprehensive income							50,982
Treasury stock acquired					(33,250)		(33,250)
Stock options exercised		143	(5,145)		3,135		(1,867)
Performance awards		(1,546)	594		1,349		397
Payment received from ESOP						2,730	2,730
Tax reduction – employee plans		2,444					2,444
Two-for-one stock split	112,963	(6,054)	(170,349)		63,440		–
Cash dividends (\$.19 per share)			(9,630)				(9,630)
BALANCE JULY 31, 1998	248,280	1,199	39,965	(5,135)	(28,638)	–	255,671
Comprehensive income							
Net earnings			62,447				62,447
Foreign currency translation				(535)			(535)
Comprehensive income							61,912
Treasury stock acquired					(44,535)		(44,535)
Stock options exercised		149	(3,499)		3,004		(346)
Performance awards		(1,071)	(174)		802		(443)
Tax reduction – employee plans		1,334					1,334
Cash dividends (\$.23 per share)			(10,830)				(10,830)
BALANCE JULY 31, 1999	248,280	1,611	87,909	(5,670)	(69,367)	–	262,763
Comprehensive income							
Net earnings			70,233				70,233
Foreign currency translation				(4,853)			(4,853)
Comprehensive income							65,380
Treasury stock acquired					(35,923)		(35,923)
Stock options exercised		(727)	(2,633)		2,555		(805)
Tax reduction – employee plans		1,134					1,134
Cash dividends (\$.27 per share)			(12,384)				(12,384)
BALANCE JULY 31, 2000	\$248,280	\$2,018	\$143,125	\$(10,523)	\$(102,735)	\$ –	\$280,165

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

Donaldson Company, Inc. and Subsidiaries

Note A

Summary of Significant Accounting Policies

Description of Business Donaldson Company, Inc., is a leading worldwide manufacturer of filtration systems and replacement parts. The company's product mix includes air and liquid filters and exhaust and emission control products for mobile equipment; in-plant air cleaning systems; air intake systems and exhaust products for industrial gas turbines; and specialized filters for such diverse applications as computer disk drives, aircraft passenger cabins and semiconductor processing. Products are manufactured at more than three dozen Donaldson plants around the world and through five joint ventures.

Principles of Consolidation The consolidated financial statements include the accounts of Donaldson Company, Inc. and all majority-owned subsidiaries (the company). All significant intercompany accounts and transactions have been eliminated. The company also has four joint ventures that are not majority-owned; three are accounted for on the equity method and one on the cost method. Additionally, the company has one majority-owned joint venture. Certain amounts in prior periods have been reclassified to conform to the current presentation. The reclassifications had no impact on the net earnings as previously reported.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign Currency Translation For most foreign operations, local currencies are considered the functional currency. Assets and liabilities are translated using the exchange rates in effect at the balance sheet date. Results of operations are translated using the average exchange rates prevailing throughout the period. Translation gains or losses, net of applicable deferred taxes, are accumulated in the foreign currency adjustment in accumulated other comprehensive income in shareholders' equity. Foreign currency transaction losses of \$0.2 million in 2000, gains of \$0.2 million in 1999 and losses of \$1.4 million in 1998 are included in earnings before income taxes.

Cash Equivalents The company considers all highly liquid temporary investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents are carried at cost which approximates market value.

Inventories Inventories are stated at the lower of cost or market. Domestic inventories are valued using the last-in, first-out (LIFO) method, while the international subsidiaries use the first-in, first-out (FIFO) method. Inventories valued at LIFO were approximately 52 percent and 53 percent of total inventories at July 31, 2000 and 1999, respectively.

The FIFO cost of inventories valued under the LIFO method exceeded the LIFO carrying values by \$21.2 million and \$19.7 million at July 31, 2000 and 1999, respectively.

Property, Plant and Equipment Property, plant and equipment are stated at cost. Additions, improvements or major renewals are capitalized, while expenditures that do not enhance or extend the asset's useful life are charged to operating expense as incurred. Depreciation is computed principally by use of declining balance methods on facilities and equipment acquired on or prior to July 31, 1992. The company adopted the straight-line depreciation method for all property acquired after July 31, 1992. Accelerated depreciation methods are generally used for income tax purposes.

The estimated useful lives of property, plant and equipment are as follows:

Buildings	10 to 40 years
Machinery and equipment	3 to 10 years

Intangible Assets Intangible assets, primarily consisting of goodwill, are amortized on a straight-line basis over periods ranging up to 20 years.

Impairment of Long-Lived Assets The company reviews the long-lived assets, including identifiable intangibles and associated goodwill, for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the assets and any related goodwill, the carrying value is reduced to the estimated fair value as measured by the discounted cash flows.

Income Taxes Deferred tax assets and liabilities are recognized for the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be reversed.

Comprehensive Income The company adopted Statement of Financial Accounting Standards (SFAS) 130, “Reporting Comprehensive Income,” in the first quarter of fiscal 1999. Comprehensive income consists of net income and foreign currency translation adjustments and is presented in the Consolidated Statements of Changes in Shareholders’ Equity. Accumulated other comprehensive income consists only of accumulated foreign currency translation adjustment. The adoption of SFAS 130 has no impact on the company’s net earnings or shareholders’ equity.

Earnings Per Share The company follows SFAS 128, “Earnings per Share,” to present earnings per share calculations.

The company’s basic net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares. The company’s diluted net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares and dilutive shares relating to stock options.

The following table presents information necessary to calculate basic and diluted earnings per share:

(In thousands, except per share amounts)	2000	1999	1998
Weighted average shares – basic	45,716	46,899	49,332
Dilutive shares	948	894	897
Weighted average shares – diluted	46,664	47,793	50,229
Net earnings for basic and diluted earnings per share computation	\$70,233	\$62,447	\$57,051
Net earnings per share – basic	\$ 1.54	\$ 1.33	\$ 1.16
Net earnings per share – diluted	\$ 1.51	\$ 1.31	\$ 1.14

Treasury Stock Repurchased Common Stock is stated at cost and is presented as a separate reduction of shareholders’ equity.

Research and Development All expenditures for research and development are charged against earnings in the year incurred.

Stock-Based Compensation SFAS 123, “Accounting for Stock-Based Compensation,” encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to

Employees,” and related Interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the company’s stock at the date of the grant over the amount an employee must pay to acquire the stock. Compensation cost for performance equity units is recorded based on the quoted market price of the company’s stock at the end of the period.

Revenue Recognition Revenue is recognized when product is shipped and invoiced or performance of services is complete.

Product Warranties The company provides for estimated warranty costs and accrues for specific items at the time their existence is known and the amounts are determinable.

New Accounting Standards The company will adopt Statement of Financial Accounting Standards (SFAS) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities – an amendment of FASB Statement No. 133,” which is effective beginning fiscal 2001. SFAS 133 requires a company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the hedged assets, liabilities or firm commitments are recognized through earnings or in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative’s change in fair value will be immediately recognized in earnings. The company has determined that the effect of adopting SFAS 133 and SFAS 138 is immaterial to the earnings and the financial position of the company as of August 1, 2000.

The company has adopted Statement of Position (SOP) No. 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,” effective beginning fiscal 2000. This SOP provides guidance on accounting for the costs of computer software developed or obtained for internal use. The company has determined that the effect of SOP 98-1 is immaterial to the earnings and the financial position of the company.

Note B

Acquisitions, Plant Closure and Plant Opening

Acquisitions All acquisitions were accounted for as purchases. The purchase prices assigned to the net assets acquired were based on the fair value of such assets and liabilities at the respective acquisition dates. The operating results of these acquired companies have been included in the consolidated statement of earnings from the dates of acquisition. Consolidated pro forma earnings and earnings per share would not be materially different from the reported amounts for all years presented.

During the second quarter of fiscal 2000, the company completed the purchase of all of the outstanding shares of AirMaze Corporation, for \$31.9 million in cash. AirMaze is a privately held supplier of heavy-duty air and liquid filters, air/oil separators and high purity air filter products. AirMaze has manufacturing facilities in Stow, Ohio and Greeneville, Tennessee. The excess of purchase price over the fair values of the net assets acquired was \$27.2 million and has been recorded as goodwill which is being amortized on a straight-line basis over 20 years. AirMaze operations are a part of the company's Engine Products segment.

During the third quarter of fiscal 2000, the company acquired the DCE dust control business of Invensys plc, for \$56.4 million. DCE, headquartered in Leicester, England (UK) with smaller facilities in Germany and the United States and assembly operations in South Africa, Australia and Japan, is a major participant in the global dust collection industry. The excess of purchase price over the fair values of the net assets acquired was \$31.5 million and has been recorded as goodwill which is being amortized on a straight-line basis over 20 years. DCE operations are a part of the company's Industrial Products segment.

The purchase price allocations for AirMaze and DCE are based on preliminary estimates of the fair value of assets and liabilities and are subject to change.

Plant Closure During 2000, the company closed its manufacturing facilities located in Oelwein, Iowa. The closure of the facility was completed by the end of the calendar year. A pretax charge of \$2.8 million was recorded in fiscal 1999 in general and administrative expense in the company's consolidated statement of earnings. The charge was primarily related to severance

and other employee related costs associated with the elimination of approximately 125 positions. As of July 31, 2000, \$0.2 million remains as a liability which relates to costs associated with building maintenance.

Plant Opening During 2000, the company opened a new manufacturing facility in Auburn, Alabama. The facility was constructed to produce mufflers for the truck manufacturers located in the southwestern U.S. region and employs approximately 100 employees.

Note C

Credit Facilities

In December 1997, the company amended and renewed a five-year multi-currency revolving facility with a group of participating banks under which it may borrow up to \$100.0 million. The agreement provides that loans may be made under a selection of currencies and rate formulas including Base Rate Advance or Eurocurrency Rate Advance. The interest rate on each advance is based on certain adjusted leverage and debt-to-capitalization ratios. Facility fees and other fees on the entire loan commitment are payable for the duration of this facility. There was \$50.0 million outstanding under this credit facility at July 31, 2000 and no amounts outstanding at July 31, 1999, leaving \$50.0 million and \$100.0 million available for further borrowing under such facility at July 31, 2000 and 1999, respectively. The weighted average interest rate on short-term borrowings outstanding at July 31, 2000 was 6.83 percent.

At July 31, 2000, there was an additional \$35.0 million available for use under uncommitted facilities which provide unsecured borrowings for general corporate purposes. There was \$12.6 million outstanding under these facilities at July 31, 2000 and no amounts outstanding under these facilities at July 31, 1999. The weighted average interest rate on short-term borrowings outstanding at July 31, 2000 was 6.89 percent.

International subsidiaries may borrow under various credit facilities. As of July 31, 2000 and 1999, borrowings under these facilities were \$22.4 million and \$20.3 million, respectively. The weighted average interest rate on these international borrowings outstanding at July 31, 2000 and 1999 was 4.07 percent and 3.04 percent, respectively.

Note D

Long-Term Debt

Long-term debt consists of the following:

(Thousands of dollars)	2000	1999
6.20% Unsecured senior notes due July 15, 2005, interest payable semi-annually, principal payment of \$23.0 million is due July 15, 2005	\$23,000	\$23,000
6.31% Unsecured senior notes due July 15, 2008, interest payable semi-annually, principal payment of \$27.0 million is due July 15, 2008	27,000	27,000
6.39% Unsecured senior notes due August 15, 2010, interest payable semi-annually, principal payments of \$5.0 million, to be paid annually commencing August 16, 2006	25,000	25,000
1.9475% Guaranteed senior note due January 29, 2005, interest payable semi-annually, principal amount of 1.2 billion Yen is due January 29, 2005	10,962	10,358
Variable Rate Industrial Development Revenue Bonds ("Lower Floaters") due September 1, 2024, principal amount of \$8.0 million, interest payable monthly, and an interest rate of 4.40% as of July 31, 2000	5,667	–
Other	1,295	1,742
Total	92,924	87,100
Less current maturities	279	409
Total long-term debt	\$92,645	\$86,691

Annual maturities of long-term debt for the next five years are \$0.3 million in 2001 and \$34.0 million in 2005. Annual maturities in 2002, 2003 and 2004 are not significant. The company estimates that the carrying value of long-term debt approximates its fair market value.

Total interest paid relating to all debt was \$ 9.1 million, \$6.0 million and \$4.6 million in 2000, 1999 and 1998, respectively. In addition, total interest expense recorded in 2000, 1999 and 1998 was \$9.9 million, \$7.0 million and \$4.7 million, respectively. Certain note agreements contain debt covenants related to working capital levels and limitations on indebtedness. Further, the company is restricted from paying dividends or repurchasing Common Stock if its tangible net worth (as defined) does not exceed certain minimum levels. At July 31, 2000, under the most restrictive agreement, tangible net worth exceeded the minimum by \$70.4 million.

Note E

Employee Benefit Plans

Pension Plans Donaldson Company, Inc. and certain of its subsidiaries have defined benefit pension plans for substantially all hourly and salaried employees. The domestic plan provides defined benefits pursuant to a cash balance feature whereby a participant accumulates a benefit comprised of a percentage of current salary which varies with years of service, interest credits and transition credits. The international plans generally provide pension benefits based on years of service and compensation level. The company's general funding policy is to make contributions as required by applicable regulations. The assets are primarily invested in diversified equity and debt portfolios. In 2000, the actuarial valuation date was changed from July 31 to April 30. This change did not have a material impact on the actuarial valuation.

Cost for the company's domestic pension plans includes the following components:

(Thousands of dollars)	2000	1999	1998
Net periodic cost:			
Service cost	\$ 6,025	\$ 5,609	\$ 4,833
Interest cost	9,506	9,188	8,465
Expected return on assets	(11,081)	(10,006)	(8,838)
Transition amount amortization	(1,097)	(1,097)	(1,097)
Prior service cost amortization	64	30	(18)
Actuarial loss amortization	71	1,094	259
Curtailment loss	–	684	–
Net periodic benefit cost	\$ 3,488	\$ 5,502	\$ 3,604

The funded status of the company's domestic pension plans as of April 30, 2000 and July 31, 1999, is as follows:

(Thousands of dollars)	2000	1999
Change in benefit obligation:		
Benefit obligation at beginning of year	\$131,996	\$121,213
Adjustment for change in measurement date	1,841	N/A
Benefit obligation, new measurement date	133,837	N/A
Service cost	6,025	5,609
Interest cost	9,506	9,188
Plan amendments	568	1,338
Actuarial (gain)/loss	(11,025)	1,392
Benefits paid	(7,663)	(6,744)
Benefit obligation at April 30 and July 31	\$131,248	\$131,996
Change in plan assets:		
Fair value of plan assets at beginning of year	\$130,387	\$123,956
Adjustment for change in measurement date	17,461	N/A
Fair value of plan assets, new measurement date	147,848	N/A
Actual return on plan assets	(2,072)	9,282
Company contributions	2,132	3,893
Benefits paid	(7,663)	(6,744)
Fair value of plan assets at April 30 and July 31	\$140,245	\$130,387
Reconciliation of funded status:		
Funded (unfunded) status	\$ 8,997	\$ (1,609)
Unrecognized actuarial (gain) loss	(11,678)	1,885
Unrecognized prior service cost	2,472	1,968
Unrecognized net transition obligation	(3,769)	(4,866)
Net amount recognized in consolidated balance sheet	\$ (3,978)	\$ (2,622)
Amounts recognized in consolidated balance sheet consist of:		
Prepaid benefit cost	\$ 4,614	\$ 3,500
Accrued benefit liability	(8,592)	(6,122)
Additional minimum liability	(280)	(653)
Intangible asset	280	653
Net amount recognized in consolidated balance sheet	\$ (3,978)	\$ (2,622)

The projected benefit obligation and accumulated benefit obligation for domestic pension plans with accumulated benefit obligations in excess of plan assets were \$7.8 million and \$4.6 million, respectively, as of April 30, 2000 and \$7.9 million and \$4.4 million, respectively, as of July 31, 1999. There was no fair value of plan assets for domestic pension plans with accumulated benefit obligations in excess of plan assets as of April 30, 2000 and July 31, 1999, respectively.

Weighted-average actuarial assumptions	April 30 2000	July 31 1999	July 31 1998
Discount rate	8.00%	7.50%	7.25%
Expected return on plan assets	9.00%	9.00%	9.00%
Rate of compensation increase	6.00%	6.00%	6.00%

Pension expense related to international plans were \$2.5 million, \$2.5 million and \$1.7 million for 2000, 1999 and 1998, respectively.

401(k) Savings Plan The company provides a contributory employee savings plan which permits participants to make contributions by salary reduction pursuant to section 401(k) of the Internal Revenue Code. The company's contributions under this plan are based on the level of employee contributions including a variable contribution based on performance of the company. Total contribution expense was \$4.2 million, \$4.9 million and \$2.9 million for the years ended July 31, 2000, 1999 and 1998, respectively.

Shareholders' Equity

Stock Rights On January 12, 1996, the Board of Directors of the company approved the extension of the benefits afforded by the company's existing rights plan by adopting a new shareholder rights plan. Pursuant to the new Rights Agreement, dated as of January 12, 1996, by and between the company and Norwest Bank Minnesota, National Association, as Rights Agent, one Right was issued on March 4, 1996 for each outstanding share of Common Stock, par value \$5.00 per share, of the company upon the expiration of the company's existing Rights. Each of the new Rights entitles the registered holder to purchase from the company one one-thousandth of a share of Series A Junior Participating Preferred Stock, without par value, at a price of \$130.00 per one one-thousandth of a share. The Rights, however, will not become exercisable unless and until, among other things, any person acquires 15 percent or more of the outstanding Common Stock of the company. If a person acquires 15 percent or more of the outstanding Common Stock of the company (subject to certain conditions and exceptions more fully described in the Rights Agreement), each Right will entitle the holder (other than the person who acquired 15 percent or more of the outstanding Common Stock) to purchase Common Stock of the company having a market value equal to twice the exercise price of a Right. The new Rights are redeemable under certain circumstances at \$.01 per Right and will expire, unless earlier redeemed, on March 3, 2006.

Employee Incentive Plans In November 1991, shareholders approved the 1991 Master Stock Compensation Plan. The Plan extends through December 2001 and allows for the granting of nonqualified stock options, incentive stock options, restricted stock, stock appreciation rights (SARs), dividend equivalents, dollar-denominated awards and other stock-based awards. The 1980 Master Stock Compensation Plan allows for the granting of nonqualified stock options and incentive stock options. Both plans allow for the granting of performance awards to a limited number of key executives. The awards are payable in Common Stock and are based on a formula which measures performance of the company over a three-year period. Performance award expense totaled \$1.7 million and \$0.7 million in 2000 and 1998, respectively. There was no performance award expense in 1999. Options under both Plans are granted to key employees at or above 100 percent of the market price at the date of grant. Options are exercisable for up to 10 years from the date of grant.

Stock Options Stock options issued during fiscal 1999 and 2000 become exercisable for non-executives in each of the following three years, in an equal number of shares each year and become exercisable for executives immediately upon the date of grant. Stock options issued during fiscal 1997 and 1998 become exercisable in each of the following three years, in an equal number of shares each year, for both executives and non-executives. Stock options issued prior to fiscal 1997 for non-executives and during fiscal 1996 for executives become exercisable in a four-year period in an equal number of shares each year. Prior to fiscal 1996, stock options vested immediately for executives. At July 31, 2000, options to purchase 3,652,936 shares are outstanding under these plans.

In fiscal 1997, the company adopted the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123 encourages entities to adopt a fair value-based method of accounting for employee stock compensation plans, but allows companies to continue to account for those plans using the accounting prescribed by APB Opinion 25, "Accounting for Stock Issued to Employees." The company has elected to continue to account for stock-based compensation using APB 25, making pro forma disclosures of net earnings and earnings per share as if the fair value-based method had been applied. Accordingly, no compensation expense has been recorded for the stock option plans. Had compensation expense for the stock option plans been determined under SFAS 123 in fiscal 2000, 1999 and 1998, the company's net income and earnings per share would have been approximately \$67.7 million and \$1.45, \$61.1 million and \$1.28, and \$55.7 million and \$1.11, respectively. The pro forma effect on net income and earnings per share is not representative of the pro forma net earnings in future years because it does not take into consideration pro forma compensation expense related to grants made prior to 1996.

For purposes of computing compensation cost of stock options granted, the fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: risk free interest rate of 6.50 percent, 5.50 percent and 5.63 percent in 2000, 1999 and 1998, respectively; two or seven year lives in 2000, two, three, or seven year lives in 1999 and three, six, seven, or nine year lives in 1998; expected volatility of 29.7 percent, 26.3 percent and 22.5 percent in 2000, 1999 and 1998, respectively; and 1 percent expected dividend yield in 2000, 1999 and 1998. Black-Scholes is a widely accepted stock option pricing model; however, the ultimate value of stock options granted will be determined by the actual lives of options granted and the actual future price levels of the company's common stock.

The weighted average fair value for options granted during fiscal 2000, 1999 and 1998 is \$7.49, \$5.62 and \$6.35 per share, respectively.

The number and option price of options granted under these plans were as follows:

	Options Outstanding	Weighted Average Exercise Price
Outstanding at July 31, 1997	3,317,308	\$ 10.98
Granted	472,595	22.83
Exercised	(419,728)	8.40
Canceled	(21,999)	14.98
Outstanding at July 31, 1998	3,348,176	12.95
Granted	495,149	20.10
Exercised	(432,505)	8.65
Canceled	(28,498)	18.35
Outstanding at July 31, 1999	3,382,322	14.50
Granted	489,086	23.01
Exercised	(204,004)	10.09
Canceled	(14,468)	20.41
Outstanding at July 31, 2000	3,652,936	\$15.86

At July 31, 2000 and 1999 there were 3,109,926 and 2,451,657 options exercisable, respectively. Shares reserved at July 31, 2000 for outstanding options and future grants were 9,237,912.

The following table summarizes information concerning currently outstanding and exercisable options:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$5 to \$10	718,592	1.24	\$ 8.85	718,592	\$ 8.85
\$10 to \$15	1,096,624	3.90	12.30	1,092,624	12.30
\$15 to \$20	841,251	7.22	18.23	697,835	17.86
\$20 and above	996,469	8.22	22.82	600,875	22.83
	3,652,936	5.32	\$15.86	3,109,926	\$14.79

Note G

Income Taxes

The components of earnings before income taxes are as follows:

(Thousands of dollars)	2000	1999	1998
Earnings before income taxes:			
United States	\$ 54,913	\$55,811	\$60,673
Foreign	45,420	33,399	25,768
Total	\$100,333	\$89,210	\$86,441

The components of the provision for income taxes are as follows:

(Thousands of dollars)	2000	1999	1998
Income Taxes:			
Current:			
Federal	\$18,192	\$16,717	\$15,931
State	2,361	2,471	1,837
Foreign	9,996	7,086	7,396
	30,549	26,274	25,164
Deferred:			
Federal	52	426	3,410
State	3	24	195
Foreign	(504)	39	621
	(449)	489	4,226
Total	\$30,100	\$26,763	\$29,390

The tax effects of temporary differences that give rise to deferred tax assets and liabilities are as follows:

(Thousands of dollars)	2000	1999	1998
Deferred tax assets:			
Compensation and retirement plans	\$ 12,839	\$ 8,950	\$ 5,705
Accrued expenses	7,818	9,617	8,365
Brazilian asset write-down	–	–	720
NOL carryforwards	6,120	3,560	2,070
Inventories	1,526	1,595	1,095
Investment in joint venture	754	588	1,195
Cumulative translation adjustment	4,574	2,494	2,646
Other	3,162	3,267	3,630
Gross deferred tax assets	36,793	30,071	25,426
Valuation allowance	(2,445)	(2,432)	(1,172)
Net deferred tax assets	34,348	27,639	24,254
Deferred tax liabilities:			
Depreciation and amortization	(14,626)	(11,235)	(8,573)
Other	(903)	(1,625)	(2,224)
Gross deferred tax liabilities	(15,529)	(12,860)	(10,797)
Net deferred tax assets	\$ 18,819	\$ 14,779	\$ 13,457

The following table reconciles the U.S. statutory income tax rate with the effective income tax rate:

	2000	1999	1998
Statutory U.S. federal rate	35.0%	35.0%	35.0%
State income taxes	1.5	1.8	1.4
Foreign taxes at lower rates	(6.1)	(5.5)	(1.3)
Other	(.4)	(1.3)	(1.1)
	30.0%	30.0%	34.0%

At July 31, 2000, certain international subsidiaries had available net operating loss carryforwards of approximately \$10.0 million to offset future taxable income. The majority of such carryforwards expire after 2002. Unremitted earnings of international subsidiaries amounted to approximately \$104.6 million at July 31, 2000. The majority of those earnings are intended to be indefinitely reinvested and, accordingly, no deferred U.S. income taxes have been provided. If a portion were to be remitted, foreign tax credits would substantially offset any resulting incremental U.S. income tax liability. It is not practicable to estimate the amount of unrecognized taxes on these undistributed earnings due to the complexity of the computation.

The company made cash payments for income taxes of \$24.6 million, \$20.8 million and \$22.5 million in 2000, 1999 and 1998, respectively.

Note H

Segment Reporting

The company adopted SFAS 131, “Disclosures about Segments of an Enterprise and Related Information,” effective with fiscal year-end 1999. This standard requires companies to disclose selected financial data by operating segment. A segment is defined as a component with business activity resulting in revenue and expense that has separate financial information evaluated regularly by the company’s chief operating decision maker in determining resource allocation and assessing performance.

The company has identified two reportable segments: Engine Products and Industrial Products. Segment selection was based on the internal organizational structure, management of operations and performance evaluation by management and the company's Board of Directors.

The Engine Products segment sells to original equipment manufacturers (OEMs) in the construction, industrial, mining, agriculture and transportation markets and to independent distributors, OEM dealer networks, private label accounts and large private fleets. Products include air intake systems, exhaust systems, liquid filtration systems and replacement filters.

The Industrial Products segment sells to various industrial end-users, OEMs of gas-fired turbines, OEMs and end-users requiring highly purified air. Products include dust, fume and mist collectors, static and pulse-clean air filter systems and specialized air filtration systems.

Corporate and Unallocated include corporate expenses determined to be non-allocable to the segments, interest income and expense, non-operating income and expense, and expenses not allocated to the business segments in the same period. Assets included in Corporate and Unallocated principally are cash and cash equivalents, inventory reserves, certain prepaids, certain investments, other assets and assets allocated to intercompany transactions.

The company has developed an internal measurement system to evaluate performance and allocate resources based on profit or loss from operations before income taxes. The company's manufacturing facilities serve both reporting segments. Therefore, the company uses a complex allocation methodology to assign costs and assets to the segments. A certain amount of costs and assets are assigned to intercompany activity and are not assigned to either segment. Certain accounting policies applied to the reportable segments differ from those described in the summary of significant accounting policies. The reportable segments account for receivables on a gross basis and account for inventory on a standard cost basis.

Segment allocated assets are primarily accounts receivable, inventories and property, plant and equipment. Reconciling items included in Corporate and Unallocated are created based on accounting differences between segment reporting and the consolidated, external reporting as well as internal allocation methodologies.

Segment detail is summarized as follows (in thousands):

	<i>Engine Products</i>	<i>Industrial Products</i>	<i>Corporate & Unallocated</i>	<i>Total Company</i>
2000				
Net sales	\$673,982	\$418,312	\$ -	\$1,092,294
Depreciation and amortization	20,959	8,509	4,858	34,326
Equity in earnings of unconsolidated affiliates	4,392	-	-	4,392
Earnings before income taxes	57,453	53,862	(10,982)	100,333
Assets	320,805	172,837	176,015	669,657
Equity investments in unconsolidated affiliates	13,600	-	-	13,600
Capital expenditures, net of acquired businesses	22,236	9,028	5,153	36,417
1999				
Net sales	\$ 611,378	\$ 332,761	\$ -	\$ 944,139
Depreciation and amortization	18,486	7,506	1,694	27,686
Equity in earnings of unconsolidated affiliates	3,610	-	-	3,610
Earnings before income taxes	61,896	36,373	(9,059)	89,210
Assets	327,035	160,201	55,010	542,246
Equity investments in unconsolidated affiliates	13,833	-	-	13,833
Capital expenditures, net of acquired businesses	19,723	8,008	1,808	29,539
1998				
Net sales	\$ 622,096	\$ 318,255	\$ -	\$ 940,351
Depreciation and amortization	16,551	6,437	2,284	25,272
Equity in earnings of unconsolidated affiliates	3,654	-	-	3,654
Earnings before income taxes	62,987	29,057	(5,603)	86,441
Assets	321,872	151,221	39,894	512,987
Equity investments in unconsolidated affiliates	11,414	-	-	11,414
Capital expenditures, net of acquired businesses	35,826	13,934	4,945	54,705

Geographic sales by origination and property, plant and equipment (in thousands):

	<i>Net Sales</i>	<i>Property, Plant & Equipment – Net</i>
2000		
United States	\$ 690,899	\$135,480
Europe	206,429	37,698
Asia Pacific	166,221	22,304
Other	30,745	9,063
Total	\$1,092,294	\$204,545
1999		
United States	\$ 616,254	\$ 122,513
Europe	166,431	28,616
Asia Pacific	138,453	21,911
Other	23,001	9,140
Total	\$ 944,139	\$ 182,180
1998		
United States	\$ 615,770	\$ 119,623
Europe	160,211	29,620
Asia Pacific	139,606	18,848
Other	24,764	10,776
Total	\$ 940,351	\$ 178,867

There were no sales over 10 percent of net sales to one customer in 2000. Sales to one customer accounted for 11 percent of net sales in 1999 and 1998.

Note I

Quarterly Financial Information (Unaudited)

(Thousand of dollars, except per share amounts)	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
2000				
Net Sales	\$246,550	\$259,256	\$285,277	\$301,211
Gross Margin	73,881	79,595	84,812	89,233
Net Earnings	17,008	17,406	17,450	18,369
Diluted Earnings Per Share	.36	.37	.38	.40
Dividends Declared Per Share	.07	.07	.07	.07
1999				
Net Sales	\$ 225,431	\$ 220,249	\$ 244,219	\$ 254,240
Gross Margin	62,329	62,262	74,212	76,878
Net Earnings	13,369	13,172	17,418	18,488
Diluted Earnings Per Share	.28	.27	.37	.39
Dividends Declared Per Share	.06	.06	.06	.06

Note J

Commitments and Contingencies

The company is involved in litigation arising in the ordinary course of business. In the opinion of management, the outcome of litigation currently pending will not materially affect the company's results of operations, financial condition or liquidity.

Report of Independent Public Accountants

**To the Shareholders and Board of Directors
of Donaldson Company, Inc.**

We have audited the accompanying consolidated balance sheet of Donaldson Company, Inc. (a Delaware corporation) and subsidiaries as of July 31, 2000, and the related consolidated statements of earnings, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of Donaldson Company, Inc. and subsidiaries as of July 31, 1999 and 1998, were audited by other auditors whose report dated September 8, 1999, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Donaldson Company, Inc. and subsidiaries as of July 31, 2000, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Minneapolis, Minnesota,

August 29, 2000

Eleven-Year Comparison of Results

Donaldson Company, Inc. and Subsidiaries

(Thousands of dollars, except per share amounts)

	2000	1999	1998	1997
OPERATING RESULTS				
Net sales	\$1,092,294	\$944,139	\$940,351	\$833,348
Gross margin	\$ 327,521	275,681	263,262	250,273
Gross margin percentage	30.0%	29.2%	28.0%	30.0%
Operating income	\$ 105,594	88,390	86,799	82,715
Operating income percentage	9.7%	9.4%	9.2%	9.9%
Interest expense	\$ 9,880	6,993	4,671	2,358
Earnings before income taxes	\$ 100,333	89,210	86,441	79,094
Income taxes	\$ 30,100	26,763	29,390	28,474
Effective income tax rate	30.0%	30.0%	34.0%	36.0%
Net earnings	\$ 70,233	62,447	57,051	50,620
Return on sales	6.4%	6.6%	6.1%	6.1%
Return on average shareholders' equity	25.9%	24.1%	22.8%	21.4%
Return on investment	19.4%	19.0%	20.5%	20.8%
FINANCIAL POSITION				
Total assets	\$ 669,657	542,246	512,987	467,501
Current assets	\$ 375,479	326,388	300,817	283,367
Current liabilities	\$ 235,722	142,055	165,068	177,346
Working capital	\$ 139,757	184,333	135,749	106,021
Current ratio	1.6	2.3	1.8	1.6
Current debt	\$ 85,313	20,696	45,896	42,674
Long-term debt	\$ 92,645	86,691	51,553	4,201
Total debt	\$ 177,958	107,387	97,449	46,875
Shareholders' equity	\$ 280,165	262,763	255,671	243,865
Long-term capitalization ratio	24.9%	24.8%	16.8%	1.7%
Property, plant and equipment, net	\$ 204,545	182,180	178,867	154,595
Net expenditures on property, plant and equipment	\$ 36,417	29,539	54,705	47,327
Depreciation and amortization	\$ 34,326	27,686	25,272	21,494
SHAREHOLDER INFORMATION				
Net earnings per share – Diluted	\$ 1.51	1.31	1.14	.99
Dividends paid per share	\$.27	.23	.19	.17
Shareholders' equity per share	\$ 6.27	5.69	5.28	4.93
Shares outstanding (000s)	44,658	46,197	48,382	49,452
Common stock price range, per share				
High	\$ 24 ¹³ / ₁₆	25%	27% ₁₆	20%
Low	\$ 19 ¹ / ₈	14% ₁₆	18% ₁₆	12%

Amounts are adjusted for all stock splits and reflect adoption of SFAS 128.

Operating income is gross margin less selling, general and administrative, and research and development expense.

Return on investment is net earnings divided by average long-term debt plus average shareholders' equity.

Long-term capitalization ratio is long-term debt divided by long-term debt plus shareholders' equity.

⁽¹⁾ Excludes the cumulative effect of an accounting change of \$2,206, or \$.08 per share, in 1994.

	1996	1995	1994	1993	1992	1991	1990
	\$758,646	\$703,959	\$593,503	\$533,327	\$482,104	\$457,692	\$422,885
	222,874	197,979	166,599	152,236	133,574	129,858	121,454
	29.4%	28.1%	28.1%	28.5%	27.7%	28.4%	28.7%
	75,642	65,531	52,079	45,246	41,249	41,304	44,354
	10.0%	9.3%	8.8%	8.5%	8.6%	9.0%	10.5%
	2,905	3,089	3,362	2,723	2,681	3,526	3,731
	71,120	63,172	50,193	44,682	41,721	39,385	34,875
	27,684	24,636	18,244	16,468	15,952	15,337	13,849
	38.9%	39.0%	36.3%	36.9%	38.2%	38.9%	39.7%
	43,436	38,536	31,949 ⁽¹⁾	28,214	25,769	24,048	21,026
	5.7%	5.5%	5.4%	5.3%	5.3%	5.3%	5.0%
	19.3%	18.8%	17.6%	16.9%	17.2%	18.0%	17.8%
	18.5%	17.6%	16.0%	15.0%	14.8%	14.9%	14.2%
	402,850	381,042	337,360	300,217	286,348	253,194	245,947
	250,751	247,904	220,308	196,014	187,360	169,398	168,522
	138,578	123,747	115,757	93,666	89,956	77,537	79,917
	112,173	124,157	104,551	102,348	97,404	91,861	88,605
	1.8	2.0	1.9	2.1	2.1	2.2	2.1
	13,145	20,800	16,956	7,595	11,425	6,380	11,384
	10,041	10,167	16,028	18,920	23,482	25,673	28,320
	23,186	30,967	32,984	26,515	34,907	32,053	39,704
	228,880	221,173	189,697	174,008	160,303	138,947	128,787
	4.2%	4.4%	7.8%	9.8%	12.8%	15.6%	18.0%
	124,913	110,640	99,559	90,515	84,899	72,863	68,290
	39,297	25,334	24,642	15,005	15,538	16,208	16,055
	21,674	20,529	16,365	14,752	14,047	12,187	10,857
	.84	.73	.59 ⁽¹⁾	.51	.46	.42	.37
	.15	.14	.12	.10	.09	.07	.06
	4.52	4.23	3.58	3.19	2.91	2.51	2.23
	50,650	52,370	53,020	54,564	55,138	55,478	57,728
	14	14	13 ¹ / ₆	10 ¹ / ₆	7 ¹ / ₆	6 ¹ / ₆	5 ¹ / ₆
	11 ¹ / ₆	10 ¹ / ₆	9 ¹ / ₆	7	5 ¹ / ₆	4 ¹ / ₆	2 ¹ / ₆

Corporate and Shareholder Information

NYSE Listing

The common shares of Donaldson Company, Inc. are traded on the New York Stock Exchange, under the symbol DCI.

Shareholder Information

For any concerns relating to your current or prospective shareholdings, please contact Shareowner Services at (800) 468-9716 or (651) 450-4064.

Dividend Reinvestment Plan

As of September 26, 2000, 1,116 of Donaldson Company's approximately 1,870 shareholders of record were participating in the Dividend Reinvestment Plan. Under the plan, shareholders can invest Donaldson Company dividends in additional shares of company stock. They may also make periodic voluntary cash investments for the purchase of company stock.

Both alternatives are provided without service charges or brokerage commissions. Shareholders may obtain a brochure giving further details by writing Wells Fargo Bank Minnesota, N.A., Shareowner Services, P.O. Box 64854, St. Paul, MN 55164-0854.

Annual Meeting

The annual meeting of shareholders will be held at 10 a.m. on Friday, November 17, 2000, at The Conference Center at Atrium Center, 3105 E. 80th Street, Bloomington, Minnesota. You are welcome to attend.

10-K Reports

Copies of the Report 10-K, filed with the Securities and Exchange Commission, are available on request from Shareholder Services, Donaldson Company, Inc., M.S. 101, P.O. Box 1299, Minneapolis, MN 55440.

Independent Public Accountants

Arthur Andersen LLP, Minneapolis, Minnesota

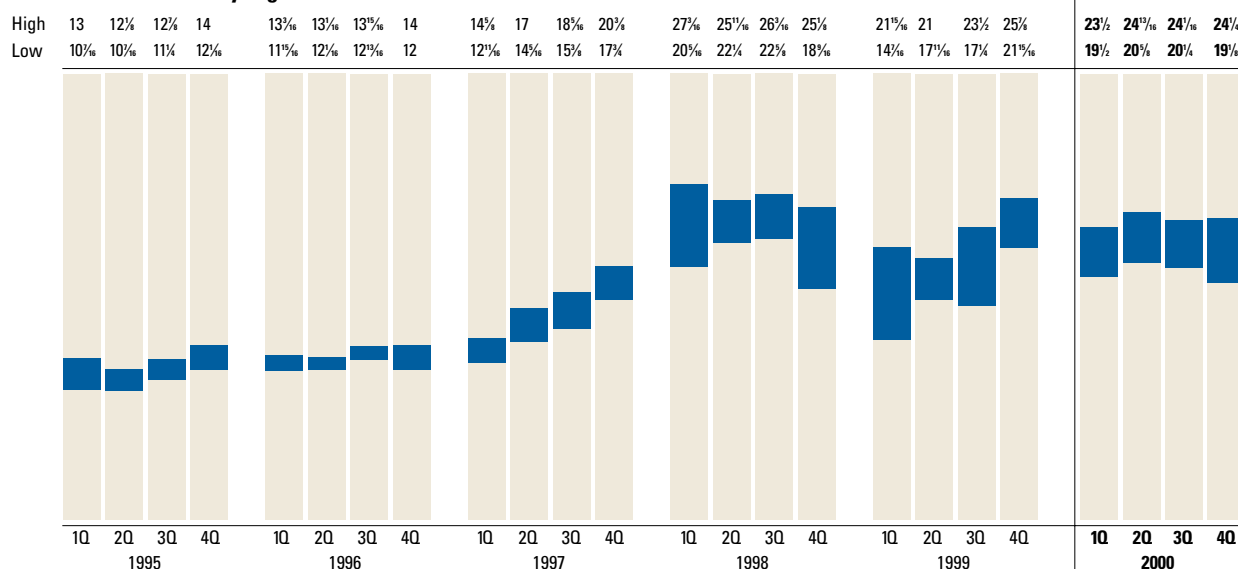
Public Relations Counsel

Padilla Speer Beardsley Inc., Minneapolis, Minnesota

Transfer Agent and Registrar

Wells Fargo Bank Minnesota, N.A., South St. Paul, Minnesota

Six-Year Quarterly High-Low Stock Prices



Board of Directors and Corporate Officers

Board of Directors

F. Guillaume Bastiaens, 57
Vice Chairman,
Cargill Inc., Minneapolis
(Agribusiness).
Director since 1995.^{(2) (3)}

Paul B. Burke, 44
Chairman, President and
Chief Executive Officer,
BMC Industries, Inc., Minneapolis
(Manufacturing).
Director since 1996.^{(1) (3)}

Janet M. Dolan, 51
President and Chief Executive Officer,
Tennant Company, Minneapolis
(Manufacturing).
Director since 1996.^{(2) (3)}

Jack W. Eugster, 55
Chairman, President and
Chief Executive Officer,
The Musicland Group, Inc., Minneapolis
(Consumer Products).
Director since 1993.^{(1) (3)}

John F. Grundhofer, 61
Chairman and Chief Executive Officer,
U.S. Bancorp, Minneapolis
(Financial Services).
Director since 1997.^{(1) (3)}

Kendrick B. Melrose, 60
Chairman and Chief Executive Officer,
The Toro Company, Minneapolis
(Manufacturing).
Director since 1991.^{(1) (2)}

S. Walter Richey, 64
Retired Chairman, President and
Chief Executive Officer,
Meritex, Inc., Minneapolis,
(Distribution Services).
Director since 1991.^{(2) (3)}

Stephen W. Sanger, 54
Chairman and Chief Executive Officer,
General Mills, Inc., Minneapolis
(Consumer Products).
Director since 1992.^{(1) (2)}

William G. Van Dyke, 55
Chairman, President and
Chief Executive Officer,
Donaldson Company, Inc.
Director since 1994.

⁽¹⁾ Human Resources Committee

⁽²⁾ Audit Committee

⁽³⁾ Directors' Affairs Committee

Corporate Officers

William G. Van Dyke, 55
Chairman, President and
Chief Executive Officer.
28 years service.

William M. Cook, 47
Senior Vice President, International.
20 years service.

James R. Giertz, 43
Senior Vice President,
Commercial and Industrial.
7 years service.

Nickolas Priadka, 54
Senior Vice President,
Engine Systems and Parts.
31 years service.

Lowell F. Schwab, 52
Senior Vice President, Operations.
21 years service.

Thomas W. VanHimbergen, 52
Senior Vice President and
Chief Financial Officer.
1 year service.

Dale M. Couch, 57
Vice President and
General Manager, Asia Pacific.
3 years service.

Norman C. Linnell, 41
Vice President, General Counsel and Secretary.
5 years service.

John E. Thames, 50
Vice President, Human Resources.
12 years service.

Geert Henk Touw, 55
Vice President and General Manager,
Europe/Africa/Middle East.
15 years service.

Thomas A. Windfeldt, 51
Vice President, Controller and Treasurer.
20 years service.

Worldwide Operations

World Headquarters

Donaldson Company, Inc.
Minneapolis, Minnesota

U.S. Plants

Auburn, Alabama
Old Saybrook, Connecticut
Dixon, Illinois
Frankfort, Indiana
Cresco, Iowa
Grimmell, Iowa
Louisville, Kentucky
Nicholasville, Kentucky
Port Huron, Michigan
Chillicothe, Missouri
Mooresville, North Carolina
Stow, Ohio
Philadelphia, Pennsylvania
Greeneville, Tennessee
Baldwin, Wisconsin
Stevens Point, Wisconsin

Distribution Centers

Ontario, California
Rensselaer, Indiana
Antwerp, Belgium
Singapore

Joint Ventures

Advanced Filtration Systems Inc.
Champaign, Illinois
MSCA, LLC
Monticello, Indiana
Air Master China Ltd.
Hong Kong, S.A.R., People's Republic of China
Guilin Air King Enterprises Ltd.
Guilin, People's Republic of China
PT Panata Jaya Mandiri
Jakarta, Indonesia

Subsidiaries

Torit Australia Pty. Ltd.
Sydney, Australia
Donaldson Australasia Pty. Limited
Wyong, Australia
Donaldson Sales, Inc.
Barbados
Donaldson Coordination Center, B.V.B.A.
Leuven, Belgium
Donaldson Europe, B.V.B.A.
Leuven, Belgium
DCE Scandinavia APS
Horsholm, Denmark
Donaldson France, S.A.S.
Bron, France
Tecnov Donaldson, S.A.S.
Domjean, France
DCE S.A.
Paris, France
DCE Neotechnik GmbH
Bielefeld, Germany
Donaldson Gesellschaft m.b.H.
Dülmen, Germany
D.I. Filter Systems Pvt. Ltd.
New Delhi, India
PT Donaldson Systems Indonesia
Jakarta, Indonesia
Donaldson Italia s.r.l.
Ostiglia, Italy
Nippon Donaldson Limited
Tokyo, Japan
Donaldson Luxembourg S.a.r.l.
Luxembourg
Donaldson, S.A. de C.V.
Aguascalientes, Mexico

Diemo S.A. de C.V.
Guadalajara, Mexico
Donaldson Filtration Industrial S. de R.L. de C.V.
Monterrey, Mexico
Donaldson Torit B.V.
Haarlem, Netherlands
DCE Benelux B.V.
Krommenie, Netherlands
Donaldson Far East Limited
Hong Kong, S.A.R., People's Republic of China
Donaldson (Wuxi) Filters Co., Ltd.
Wuxi, People's Republic of China
Donaldson Filtration (Asia Pacific) Pte. Ltd.
Singapore
Donaldson Filtration Systems (Proprietary) Ltd.
Cape Town, South Africa
Donaldson Korea Co., Ltd.
Seoul, South Korea
DCE Donaldson Sistemas de Filtracion, S.L.
Barcelona, Spain
Donaldson Filtros Ibérica S.L.
Madrid, Spain
Donaldson Filter Components Limited
Hull, United Kingdom
DCE Donaldson Ltd.
Leicester, United Kingdom
DCE Group Ltd.
Leicester, United Kingdom
Tetratec Europe Limited
Wigan, United Kingdom
Donaldson International, Inc.
U.S. Virgin Islands
Licensee
Parker Hannifin Ind. Com. Ltda.
São Paulo, Brazil



Donaldson
Filtration Solutions

Donaldson Company, Inc.
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Minneapolis, Minnesota
U.S.A.

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Minneapolis, Minnesota
55440 U.S.A.

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