DONALDSON CO INC
Form 10-K
September 28, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the fiscal year ended July 31, 2012 or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from __________ to __________

Commission File Number: 1-7891

DONALDSON COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware	**41-0222640**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1400 West 94th Street, Minneapolis, Minnesota	**55431**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (952) 887-3131

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $5 Par Value	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. x Yes o No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such short period that the registrant was required to submit and post such files) x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

o Yes x No

As of January 27, 2012, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant was $5,280,285,517 (based on the closing price of $35.81 as reported on the New York Stock Exchange as of that date).

As of August 31, 2012, there were approximately 147,576,674 shares of the registrant s common stock outstanding.

Documents Incorporated by Reference

Portions of the registrant s Proxy Statement for its 2012 annual meeting of stockholders (the 2012 Proxy Statement) are incorporated by reference in Part III, as specifically set forth in Part III.

DONALDSON COMPANY, INC.

ANNUAL REPORT ON FORM 10-K

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PART I

Item 1. Business

General

Donaldson Company, Inc. (Donaldson or the Company) was founded in 1915 and organized in its present corporate form under the laws of the State of Delaware in 1936.

The Company is a worldwide manufacturer of filtration systems and replacement parts. The Company s product mix includes air and liquid filtration systems and exhaust and emission control products. Products are manufactured at 40 plants around the world and through three joint ventures. The Company has two reporting segments: Engine Products and Industrial Products. Products in the Engine Products segment consist of air filtration systems, exhaust and emissions systems, liquid filtration systems, and replacement filters. The Engine Products segment sells to original equipment manufacturers (OEMs) in the construction, mining, agriculture, aerospace, defense, and truck markets and to OEM dealer networks, independent distributors, private label accounts, and large equipment fleets. Products in the Industrial Products segment consist of dust, fume, and mist collectors, compressed air purification systems, air filtration systems for gas turbines, PTFE membrane-based products, and specialized air filtration systems for applications including computer hard disk drives. The Industrial Products segment sells to various industrial end-users, OEMs of gas-fired turbines and OEMs and end-users requiring clean air.

The table below shows the percentage of total net sales contributed by the principal classes of similar products for each of the last three fiscal years:

	Year Ended July 31,		
	2012	2011	2010
Engine Products segment			
Off-Road Products	15%	14%	12%
On-Road Products	7%	5%	4%
Aftermarket Products*	36%	38%	37%
Retrofit Emissions Products	1%	1%	1%
Aerospace and Defense Products	4%	5%	6%
*includes replacement part sales to the Company s OEM Customers			
Industrial Products segment			
Industrial Filtration Solutions Products	22%	22%	22%
Gas Turbine Products	7%	7%	8%
Special Applications Products	8%	8%	10%

Total net sales contributed by the principal classes of similar products and financial information about segment operations appear in Note L in the Notes to Consolidated Financial Statements on page 52.

The Company makes its annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports, available free of charge through its website, at www.donaldson.com, as soon as reasonably practicable after it electronically files such material with (or furnishes such material to) the Securities and Exchange Commission. Also available on the Company s website are corporate governance documents, including the Company s code of business conduct and ethics, corporate governance guidelines, Audit Committee charter, Human Resources Committee charter, and Corporate Governance Committee charter. These documents are also available in print, free of charge to any shareholder who requests them. The information contained on the Company s website is not incorporated by reference into this Annual Report on Form 10-K and should not be considered to be part of this Form 10-K.

Seasonality

A number of the Company s end markets are dependent on the construction, agricultural, and power generation industries, which are generally stronger in the second half of the Company s fiscal year. The first two quarters of the fiscal year also contain the traditional summer and winter holiday periods, which are characterized by more Customer plant closures.

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Competition

Principal methods of competition in both the Engine and Industrial Products segments are technology, price, geographic coverage, service, and product performance. The Company competes in a number of highly competitive filtration markets in both segments. The Company believes it is a market leader with many of its product lines. The Company believes within the Engine Products segment it is a market leader in its Off-Road Equipment and On-Road Products lines for OEMs and is a significant participant in the aftermarket for replacement filters. The Engine Products segment s principal competitors include several large global competitors and many regional competitors, especially in the Engine Aftermarket Products business. The Industrial Products segment s principal competitors vary from country to country and include several large regional and global competitors and a significant number of smaller competitors who compete in a specific geographical region or in a limited number of product applications.

Raw Materials

The principal raw materials that the Company uses are steel, filter media, and petroleum based products. Purchased raw materials represents approximately 60 to 65 percent of the Company s cost of goods sold. Of that amount, steel, including fabricated parts, represents approximately 25 percent. Filter media represents approximately 15 to 20 percent and the remainder is primarily made up of petroleum based products and other components. The cost the Company paid for steel during Fiscal 2012, varied by grade, but in aggregate, it slightly decreased in the second half of Fiscal 2012. The Company s cost of filter media also varies by type but it moderated slightly during the fiscal year since reaching a historical high at the end of Fiscal 2011. Petroleum based products were generally flat. Commodity prices in aggregate generally decreased throughout Fiscal 2012 after strong increases in the last half of Fiscal 2011. The impact was moderated by certain long term supply arrangements. However, the full year impact of commodity prices was still unfavorable to Fiscal 2011. The Company anticipates a moderately favorable impact from commodity prices in fiscal 2013, as compared to Fiscal 2012, specifically for steel and media, as these supply arrangements were renewed at lower prices extending through the end of the calendar year. Based on recent market information for purchased commodities, the Company anticipates only modest increases when these purchase arrangements are renewed. The Company strives to recover or offset material cost through selective price increases to its Customers and through the Company s Continuous Improvement initiatives, which include material substitution, process improvement, and product redesigns. The Company experienced no significant supply problems in the purchase of its major raw materials. The Company typically has multiple sources of supply for the raw materials essential to its business, and is not required to carry significant amounts of raw material inventory to secure supplier allotments. However, the Company does stock finished goods inventory at its regional distribution centers in order to meet anticipated Customer demand.

Patents and Trademarks

The Company owns various patents and trademarks, which it considers in the aggregate to constitute a valuable asset, including patents and trademarks for products sold under the Ultra-Web®, PowerCore®, and Donaldson® trademarks. However, it does not regard the validity of any one patent or trademark as being of material importance.

Major Customers

There were no Customers that accounted for over 10 percent of net sales in Fiscal 2012, 2011, or 2010. There was one Customer over 10 percent of gross accounts receivable in Fiscal 2012 and no Customers over 10 percent of gross accounts receivable in Fiscal 2011.

Backlog

At August 31, 2012, the backlog of orders expected to be delivered within 90 days was $403.7 million. All of this backlog is expected to be shipped during Fiscal 2013. The 90-day backlog at August 31, 2011, was $423.8 million. Backlog is one of many indicators of business conditions in the Company s markets. However, it is not always indicative of future results for a number of reasons, including short lead times in the Company s replacement parts businesses and the timing of orders in many of the Company s Engine OEM and Industrial markets.

Research and Development

During Fiscal 2012, the Company spent $59.6 million on research and development activities. Research and development expenses include basic scientific research and the application of scientific advances to the development of new and improved products and their uses. The Company spent $55.3 million and $44.5 million in Fiscal 2011 and Fiscal 2010, respectively, on research and development activities. Substantially all commercial research and development is performed in-house.

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Environmental Matters

The Company does not anticipate any material effect on its capital expenditures, earnings, or competitive position during Fiscal 2013 due to compliance with government regulations regulating the discharge of materials into the environment or otherwise relating to the protection of the environment.

Employees

The Company employed over 13,000 persons in worldwide operations as of August 31, 2012.

Geographic Areas

Financial information about geographic areas appears in Note L of the Notes to Consolidated Financial Statements on page 52.

Item 1A. Risk Factors

There are inherent risks and uncertainties associated with our global operations that involve the manufacturing and sale of products for highly demanding Customer applications throughout the world. These risks and uncertainties could adversely affect our operating performance and financial condition. The following discussion, along with discussions elsewhere in this report, outlines the risks and uncertainties that we believe are the most material to our business at this time. In light of the global economic uncertainty, we want to further highlight the risks and uncertainties associated with: world economic factors that are impacting many regions of the world, the financial condition of our suppliers and Customers, the potential for some Customers to increase their reliance on their own filtration capabilities, currency fluctuations, commodity prices, political factors, the Company s international operations, the reduced demand for hard disk drive products with the increased use of flash memory, highly competitive markets, governmental laws and regulations, including the impact of the various economic stimulus and financial reform measures being contemplated by governments around the world, the implementation of our new information systems, potential global events resulting in instability and unpredictability in the world s markets, including financial bailouts and defaults of sovereign nations, political changes, military and terrorist activities, health outbreaks, natural disasters, and other factors discussed below. 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.

Operating internationally carries risks which could negatively affect our financial performance.

We have sales and manufacturing operations throughout the world, with the heaviest concentrations in the Americas, Europe, and Asia. Our stability, growth, and profitability are subject to a number of risks of doing business internationally that could harm our business, including:

- political and military events,
- legal and regulatory requirements, including import, export, defense regulations, and foreign exchange controls,
- tariffs and trade barriers,
- potential difficulties in staffing and managing local operations,
- credit risk of local Customers and distributors,
- difficulties in protecting intellectual property,
- local economic, political, and social conditions, specifically in China and Thailand where we have significant investments,
- potential global health outbreaks, and
- natural disasters.

Maintaining a competitive advantage requires continuing investment with uncertain returns.

We operate in highly competitive markets and have numerous competitors who may already be well-established in those markets. We expect our competitors to continue improving the design and performance of their products and to introduce new products that could be competitive in both price and performance. We believe that we have certain technological advantages over our competitors, but maintaining these advantages requires us to continually invest in research and development, sales and marketing, and Customer service and support. There is no guarantee that we will

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be successful in maintaining these advantages. We make investments in new technologies that address increased performance and regulatory requirements around the globe. There is no guarantee that we will be successful in completing development or achieving sales of these products or that the margins on such products will be acceptable. Our financial performance may be negatively impacted if a competitor s successful product innovation reaches the market before ours or gains broader market acceptance.

A few of our major OEM Customers also manufacture filtration systems. Although these OEM Customers rely on us and other suppliers for some of their filtration systems, they sometimes choose to manufacture additional filtration systems for their own use. There is also a risk that a Customer could acquire one or more of our competitors.

We may be adversely impacted by changes in technology that could reduce or eliminate the demand for our products. These risks include:

- breakthroughs in technology which provide a viable alternative to diesel engines and
- reduced demand for disk drive products by flash memory or a similar technology, which would eliminate the need for our filtration solutions in disk drives.

We participate in highly competitive markets with pricing pressure. If we are not able to compete effectively our margins and results of operations could be adversely affected.

The businesses and product lines in which we participate are very competitive and we risk losing business based on a wide range of factors including technology, price, geographic coverage, product performance, and Customer service. Large Customers continue to seek productivity gains and lower prices from their suppliers. We may lose business or negatively impact our margins if we are unable to deliver the best value to our Customers.

Demand for our products relies on economic and industrial conditions worldwide.

Demand for our products tends to respond to varying levels of economic, construction, agricultural, mining, and industrial activity in the United States and in other industrialized nations.

Sales to Caterpillar accounted for slightly less than 10 percent of our net sales in Fiscal 2012, 2011, and 2010. An adverse change in Caterpillar s financial performance or a material reduction in our sales to Caterpillar could negatively impact our operating results.

Changes in our product mix impacts our financial performance.

We sell products that have varying profit margins. Our financial performance can be impacted depending on the mix of products we sell during a given period.

Unavailable or higher cost materials could impact our financial performance.

We obtain raw materials including steel, filter media, plastics, and other components from third-party suppliers and tend to carry limited raw material inventories. An unanticipated delay in delivery by our suppliers could result in the inability to deliver on-time and meet the expectations of our Customers. This could negatively affect our financial performance. An increase in commodity prices could also result in lower operating margins.

Difficulties with the Company s information technology systems and security could adversely affect our results.

The Company has many information technology systems that are important to the operation of its businesses. The Company could encounter difficulties in developing new systems, such as the implementation of the global Enterprise Resource Planning system, maintaining and upgrading existing systems, and preventing information security breaches. Such difficulties could lead to significant expenses due to disruption in business operations and could adversely affect the Company s results.

Unfavorable fluctuations in foreign currency exchange rates could negatively impact our results and financial position.

We have operations in many countries. Each of our subsidiaries reports its results of operations and financial position in its relevant functional currency, which is then translated into U.S. dollars. This translated financial information is included in our consolidated financial statements. The strengthening of the U.S. dollar in comparison to the foreign currencies of our subsidiaries could have a negative impact on our results and financial position.

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Acquisitions may have an impact on our results.

We have made and continue to pursue acquisitions. We cannot guarantee that these acquisitions will have a positive impact on our results. These acquisitions could negatively impact our profitability due to operating and integration inefficiencies, the incurrence of debt, contingent liabilities, and amortization expenses related to intangible assets. There are also a number of other risks involved in acquisitions. We could lose key existing Customers, have difficulties in assimilating the acquired operations, assume unanticipated legal liabilities, or lose key employees.

Compliance with environmental and product laws and regulations can be costly.

We are subject to many environmental laws and regulations in the jurisdictions in which we operate. We routinely incur costs in order to comply with these laws and regulations. We may be adversely impacted by new or changing laws and regulations that affect both our operations and our ability to develop and sell products that meet our Customers requirements.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

The Company s principal administrative office and research facilities are located in Bloomington, a suburb of Minneapolis, Minnesota. The Company s principal European administrative and engineering offices are located in Leuven, Belgium. The Company also has extensive operations in the Asia-Pacific region.

The Company s principal manufacturing and distribution activities are located throughout the world. The following is a summary of the principal plants and other materially important physical properties owned or leased by the Company.

Americas	**Europe / Middle East / Africa**
Auburn, Alabama (E)	Kadan, Czech Republic (I)
Riverbank, California (I)*	Klasterec, Czech Republic
Valencia, California (E)*	Domjean, France (E)
Dixon, Illinois	Paris, France (E)*
Frankfort, Indiana	Dulmen, Germany (E)
Cresco, Iowa	Flensburg, Germany (I)
Grinnell, Iowa (E)	Haan, Germany (I)
Nicholasville, Kentucky	Ostiglia, Italy (E)
Bloomington, Minnesota	Cape Town, South Africa
Chesterfield, Missouri (E)*	Johannesburg, South Africa*
Chillicothe, Missouri (E)	Hull, United Kingdom
Philadelphia, Pennsylvania (I)	Leicester, United Kingdom (I)
Greeneville, Tennessee	
Baldwin, Wisconsin	**Australia**
Stevens Point, Wisconsin	Wyong, Australia
Sao Paulo, Brazil (E)*	
Brockville, Canada (E)*	**Asia**
Aguascalientes, Mexico	Hong Kong, China*
Monterrey, Mexico (I)	Wuxi, China
	New Delhi, India
Joint Venture Facilities	Gunma, Japan
Champaign, Illinois (E)	Rayong, Thailand (I)
Jakarta, Indonesia	
Dammam, Saudi Arabia (I)	**Third-Party Logistics Providers**
	Santiago, Chile
Distribution Centers	Wuxi, China
Wyong, Australia	Mumbai, India
Brugge, Belgium	Plainfield, Indiana (I)
Rensselaer, Indiana	Gunma, Japan
Ostiglia, Italy	Singapore
Aguascalientes, Mexico	Greeneville, Tennessee (I)
Johannesburg, South Africa	

The Company s properties are utilized for both the Engine and Industrial Products segments except as indicated with an (E) for Engine or (I) for Industrial. The Company leases certain of its facilities, primarily under long-term leases. The facilities denoted with an asterisk (*) are leased facilities. In Wuxi, China and Bloomington, Minnesota a portion of the activities are conducted in leased facilities. The Company uses third-party logistics providers for some of its product distribution and neither leases nor owns the facilities. The Company considers its properties to be suitable for their present purposes, well-maintained, and in good operating condition.

Item 3. Legal Proceedings

The Company records provisions with respect to identified claims or lawsuits when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Claims and lawsuits are reviewed quarterly and provisions are taken or adjusted to reflect the status of a particular matter. The Company believes the recorded reserves in its consolidated financial statements are adequate in light of the probable and estimable outcomes. Any

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recorded liabilities were not material to the Company s financial position, results of operations or liquidity, and the Company does not believe that any of the currently identified claims or litigation will materially affect its financial position, results of operations or liquidity.

The Company has reached a preliminary agreement to settle the class action lawsuits filed in 2008 alleging that 12 filter manufacturers, including the Company, engaged in a conspiracy to fix prices, rig bids, and allocate U.S. Customers for aftermarket automotive filters. The U.S. cases have been consolidated into a single multi-district litigation in the Northern District of Illinois. The Company denies any liability and has vigorously defended the claims raised in these lawsuits. The settlement will fully resolve all claims brought against the Company in the lawsuits and the Company does not admit any liability or wrongdoing. The settlement is still subject to Court approval and will not have a material impact on the Company s financial position, results of operations, or liquidity.

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

Current information regarding executive officers is presented below. All terms of office are for one year. There are no arrangements or understandings between individual officers and any other person pursuant to which the officer was selected as an executive officer.

Name	Age	Positions and Offices Held	First Fiscal Year Appointed as an Executive Officer
Tod E. Carpenter	53	Senior Vice President, Engine Products	2008
William M. Cook	59	Chairman, President and Chief Executive Officer	1994
Sandra N. Joppa	47	Vice President, Human Resources	2006
Norman C. Linnell	53	Vice President, General Counsel and Secretary	1996
Charles J. McMurray	58	Senior Vice President, Chief Administrative Officer	2003
Mary Lynne Perushek	54	Vice President and Chief Information Officer	2007
James F. Shaw	43	Vice President and Chief Financial Officer	2012
Wim Vermeersch	46	Vice President, Europe and Middle East	2012
Jay L. Ward	48	Senior Vice President, Industrial Products	2006
Debra L. Wilfong	57	Vice President and Chief Technology Officer	2007
Eugene X. Wu	44	Vice President, Asia Pacific	2012

Mr. Carpenter joined the Company in 1996 and has held various positions, including Gas Turbine Systems General Manager from 2002 to 2004; General Manager, Industrial Filtration Systems (IFS) Sales from 2004 to 2006; General Manager, IFS Americas in 2006; Vice President, Global IFS from 2006 to 2008 and Vice President, Europe and Middle East from 2008 to 2011. In October 2011, Mr. Carpenter was appointed Senior Vice President, Engine Products.

Mr. Cook joined the Company in 1980 and has held various positions, including CFO and Senior Vice President, International from 2001 to 2004 and President and CEO from 2004 to 2005. Mr. Cook was appointed Chairman, President and CEO in July 2005.

Ms. Joppa was appointed Vice President, Human Resources in November 2005. Prior to that time, Ms. Joppa held various positions at General Mills, a consumer food products company, from 1989 to 2005, including service as Director of Human Resources for several different operating divisions from 1999 to 2005.

Mr. Linnell joined the Company in 1996 as General Counsel and Secretary and was appointed Vice President, General Counsel and Secretary in 2000.

Mr. McMurray joined the Company in 1980 and has held various positions, including Director, Global Information Technology from 2001 to 2003; Vice President, Human Resources from 2004 to 2005; Vice President, Information Technology, Europe, South Africa, and Mexico from 2005 to 2006; and Senior Vice President and Industrial Products from 2006 to 2011. In 2011, Mr. McMurray was appointed Senior Vice President and Chief Administrative Officer.

Ms. Perushek was appointed Vice President and Chief Information Officer in November 2006. Prior to that time, Ms. Perushek was Vice President of Global Information Technology at H.B. Fuller Company, a worldwide manufacturer of adhesive products, from 2005 to 2006 and Chief Information Officer for Young America Corporation, a marketing company, from 1999 to 2004.

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Mr. Shaw joined the Company in 2004 and has held various positions, including Director Corporate Compliance/Internal Audit and Corporate Controller and Principal Accounting Officer from 2004 to 2011. Mr. Shaw was appointed Vice President and Chief Financial Officer effective November 2011. Prior to joining Donaldson, Mr. Shaw held various positions at Deloitte & Touche, LLP and Arthur Andersen, LLP.

Mr. Vermeersch joined the Company in 1992 and has held various positions, including Director, Gas Turbine Systems, Asia Pacific from 2000 to 2005; Manager Aftermarket and Service IFS, Belgium from 2005 to 2006; Manager IFS, Belgium from 2006 to 2007; Director Gas Turbine Systems, Europe, Middle East and North Africa, from 2007 to 2010; and Director, Engine, Europe, Middle East and North Africa from 2010 to 2011. Mr. Vermeersch was appointed Vice President, Europe and Middle East in January 2012.

Mr. Ward joined the Company in 1998 and has held various positions, including Director, Operations from 2001 to 2003; Director, Product and Business Development, IFS Group from 2003 to 2004; Managing Director, Europe from 2004 to 2006; and Vice President, Europe, and Middle East from 2006 to 2008. Mr. Ward was appointed Senior Vice President, Engine Products in August 2008 and was appointed Senior Vice President, Industrial Products, in October 2011.

Ms. Wilfong was appointed Vice President and Chief Technology Officer in May 2007. Prior to that time, Ms. Wilfong was Director, Research and Development at 3M Company, an international consumer products company, from 2000 to 2007, and served as Director, Research and Development for the 3M Automotive Division from 2006 to 2007.

Mr. Wu was appointed Vice President, Asia Pacific in January 2012. Prior to that time, Mr. Wu was the Global Vice President and President of Asia Pacific at Greif, Inc., a global leader in industrial packaging products and services, from 2005 to 2010; and Chief Advisor to Chairman of the Board of Wanhua Industrial Group, a global chemical industry leader, from 2010 to 2011.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common shares of the Company are traded on the New York Stock Exchange under the symbol DCI. The amount and frequency of all cash dividends declared on the Company s common stock for Fiscal 2012 and 2011 appear in Note Q of the Notes to Consolidated Financial Statements on page 57. The Company s dividend payout ratio target is approximately 25 percent to 30 percent of the average earnings per share of the last three years. This guidance is expected to be used for future dividend payouts. As of September 19, 2012, there were 1,905 shareholders of record of common stock.

The low and high sales prices for the Company s common stock for each full quarterly period during Fiscal 2012 and 2011 were as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2012	$23.19 - 33.33	$30.48 - 36.52	$34.02 - 38.89	$30.51 - 36.82
Fiscal 2011	$20.43 - 25.10	$24.26 - 30.14	$27.30 - 31.45	$27.31 - 31.52

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The following table sets forth information in connection with purchases made by, or on behalf of, the Company or any affiliated purchaser of the Company, of shares of the Company s common stock during the quarterly period ended July 31, 2012.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
May 1 - May 31, 2012	133,773	$	32.83	133,773	6,915,172
June 1 - June 30, 2012	2,949	$	34.19		6,915,172
July 1 - July 31, 2012	1,360,869	$	31.87	1,357,575	5,557,597
Total	1,497,591	$	31.96	1,491,348	5,557,597

(1) On March 26, 2010, the Company announced that the Board of Directors authorized the repurchase of up to 16.0 million shares of common stock. This repurchase authorization, which is effective until terminated by the Board of Directors, replaced the existing authority that was authorized on March 31, 2006. There were no repurchases of common stock made outside of the Company s current repurchase authorization during the quarter ended July 31, 2012. However, the Total Number of Shares Purchased column of the table above includes 6,243 previously owned shares tendered by option holders in payment of the exercise price of options during the quarter. While not considered repurchases of shares, the Company does at times withhold shares that would otherwise be issued under equity-based awards to cover the withholding taxes due as a result of exercising stock options or payment of equity-based awards.

On January 27, 2012, the Company announced that its Board of Directors declared a two-for-one stock split effected in the form of a 100 percent stock dividend. The stock split was distributed March 23, 2012, to stockholders of record as of March 2, 2012. Earnings and dividends per share and weighted average shares outstanding are presented in this Form 10-K after the effect of the 100 percent stock dividend. The two-for-one stock split is reflected in the share amounts in all periods presented in the table above and elsewhere in this annual Form 10-K.

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The graph below compares the cumulative total stockholder return on the Company s common stock for the last five fiscal years with the cumulative total return of the Standard & Poor s 500 Stock Index and the Standard & Poor s Industrial Machinery Index. The graph and table assume the investment of $100 in each of the Company s common stock and the specified indexes at the beginning of the applicable period, and assume the reinvestment of all dividends.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN
Among Donaldson Company, Inc., the S& P 500 Index and the S& P Industrial Machinery Index

	Year Ended July 31,					
	2012	2011	2010	2009	2008	2007
Donaldson Company, Inc.	$ 198.15	$ 159.18	$ 135.06	$ 106.92	$ 125.22	$ 100.00
S&P 500	105.77	96.92	81.00	71.16	88.91	100.00
S&P Industrial Machinery	116.92	111.08	92.12	70.19	91.36	100.00

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Item 6. Selected Financial Data

The following table sets forth selected financial data for each of the fiscal years in the five-year period ended July 31, 2012 (in millions, except per share data):

	Year Ended July 31, 2012	2011	2010	2009	2008
Net sales	$ 2,493.2	$ 2,294.0	$ 1,877.1	$ 1,868.6	$ 2,232.5
Net earnings	264.3	225.3	166.2	131.9	172.0
Diluted earnings per share	1.73	1.43	1.05	0.83	1.06
Total assets	1,730.1	1,726.1	1,499.5	1,334.0	1,548.6
Long-term obligations	203.5	205.7	256.2	253.7	176.5
Cash dividends declared per share	0.335	0.280	0.240	0.230	0.215
Cash dividends paid per share	0.320	0.268	0.235	0.228	0.210

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

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 and other financial information included elsewhere in this report.

Overview

The Company is a worldwide manufacturer of filtration systems and replacement parts. The Company s core strengths are leading filtration technology, strong Customer relationships, and its global presence. The Company operates through two reporting segments, Engine Products and Industrial Products, and has a product mix including air and liquid filtration systems and exhaust and emission control products. As a worldwide business, the Company s results of operations are affected by conditions in the global economic environment. Under normal economic conditions, the Company s market diversification between its OEM and replacement parts Customers, its diesel engine and industrial end markets, and its North American and international end markets has helped to limit the impact of weakness in any one product line, market or geography on the consolidated results of the Company.

The Company reported record sales in Fiscal 2012 of $2,493.2 million, up 8.7 percent from $2,294.0 million in the prior year. The Company s results were negatively impacted by foreign currency translation, which decreased sales by $38.7 million. Excluding the current year impact of foreign currency translation, worldwide sales increased 10.4 percent.

Although net sales excluding foreign currency translation is not a measure of financial performance under GAAP, the Company believes it is useful in understanding its financial results and provides a comparable measure for understanding the operating results of the Company between different fiscal periods excluding the impact of foreign currency translation. The following is a reconciliation to the most comparable GAAP financial measure of this non-GAAP financial measure (in millions):

	Net Sales	Percent Growth in Net Sales
Year ended July 31, 2010	$ 1,877.1	NA
Net sales growth, excluding foreign currency translation impact	367.1	19.6%
Foreign currency translation impact	49.8	2.6%
Year ended July 31, 2011	$ 2,294.0	22.2%
Net sales growth, excluding foreign currency translation impact	237.9	10.4%
Foreign currency translation impact	(38.7)	(1.7)%
Year ended July 31, 2012	$ 2,493.2	8.7%

The Company also reported record net earnings in Fiscal 2012 of $264.3 million, an increase of 17.3 percent from $225.3 million in the prior year. The Company s net earnings were also negatively impacted by foreign currency

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translation, which decreased net earnings by $4.0 million. Excluding the current year impact of foreign currency translation, net earnings increased 19.1 percent.

Although net earnings excluding foreign currency translation is not a measure of financial performance under GAAP, the Company believes it is useful in understanding its financial results and provides a comparable measure for understanding the operating results of the Company between different fiscal periods excluding the impact of foreign currency translation. The following is a reconciliation to the most comparable GAAP financial measure of this non-GAAP financial measure (in millions):

	Net Earnings	Percent Growth in Net Earnings
Year ended July 31, 2010	$ 166.2	NA
Net earnings growth, excluding foreign currency translation impact	53.0	31.9%
Foreign currency translation impact	6.1	3.7%
Year ended July 31, 2011	$ 225.3	35.6%
Net earnings growth, excluding foreign currency translation impact	43.0	19.1%
Foreign currency translation impact	(4.0)	(1.8)%
Year ended July 31, 2012	$ 264.3	17.3%

The Company reported diluted earnings per share of $1.73, a 21.0 percent increase from $1.43 in the prior year.

As discussed above, the Company recorded full year records for net sales and net earnings. In addition, operating margin was a record of 14.6 percent for the year. The Company continued to experience strong operating leverage and the benefits of the Company s ongoing Continuous Improvement initiatives while remaining diligent in managing operating expenses.

Following is financial information for the Company s Engine and Industrial Products segments. Corporate and Unallocated includes corporate expenses determined to be non-allocable to the segments and interest income and expense. See further discussion of segment information in Note L of the Company s Notes to Consolidated Financial Statements.

	Engine Products	Industrial Products	Corporate & Unallocated	Total Company
		(thousands of dollars)		
2012				
Net sales	$ 1,570,140	$ 923,108	$	$ 2,493,248
Earnings before income taxes	227,941	149,249	(6,410)	370,780
2011				
Net sales	$ 1,440,495	$ 853,534	$	$ 2,294,029
Earnings before income taxes	211,255	123,871	(22,863)	312,263
2010				
Net sales	$ 1,126,007	$ 751,057	$	$ 1,877,064
Earnings before income taxes	155,833	91,084	(16,741)	230,176

Many factors contributed to the Company s results for each of the Company s reporting segments for Fiscal 2012, including an improvement in economic conditions in many of the Company s end markets, the Company s program of Continuous Improvement initiatives, better absorption of fixed costs, and emerging market growth.

In the Engine Products segment, the Company experienced increased sales in most end-markets. Earnings before income taxes as a percentage of Engine Products segment sales of 14.5 percent decreased slightly from 14.7 percent in the prior year. The percentage earnings decrease for the twelve months ended July 31, 2012, was driven by a shift in product mix from replacement parts to first fit products, which carry a lower margin, partially offset by the Company s ongoing Continuous Improvement initiatives. The Off-Road Product sales increase was driven by higher demand for

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agriculture and mining equipment, due to stronger commodity prices for most of the fiscal year, and improved sales of heavy construction equipment, which was due to increased global infrastructure spending, especially in emerging economies. On-Road Products sales improved as North America heavy truck build rates continued rebounding. The Aftermarket Products sales increases were driven by continued strength in equipment utilization rates in the mining, construction, and transportation industries offset by weakening conditions in Asia and some moderation in Europe.

In the Industrial Products segment, where many product lines are later economic cycle businesses, sales increased due to strength in the North American manufacturing economy and strong global demand for Gas Turbine Systems products. Earnings before income taxes as a percentage of Industrial Products segment sales of 16.2 percent increased from 14.5 percent in the prior year. The improvement in earnings as a percentage of sales over the prior year was driven by better leverage of fixed operating costs and continued successful execution on larger projects, which was partially offset by the impact of the floods in Thailand. In Industrial Filtration Solutions Products, sales of new dust collection equipment and replacement filters continued to grow. Gas Turbine Products sales increased due to strong Customer demand for large gas turbine power generation projects as a result of increased global electricity requirements. The decrease in sales in Special Applications Products was due to decreased demand for filtration products serving the electronics industries, specifically from the impact of the flood in Thailand, which offset growth in the membrane, imaging, and venting end markets.

Following are net sales by product within both the Engine and Industrial Products segments:

	2012	2011	2010
		(thousands of dollars)	
Engine Products segment:			
Off-Road Products	$ 376,870	$ 327,557	$ 222,329
On-Road Products	163,934	127,107	81,874
Aftermarket Products*	907,306	861,393	691,899
Retrofit Emissions Products	15,354	19,555	17,928
Aerospace and Defense Products	106,676	104,883	111,977
Total Engine Products segment	1,570,140	1,440,495	1,126,007
Industrial Products segment:			
Industrial Filtration Solutions Products	553,453	507,646	423,050
Gas Turbine Products	180,669	154,726	150,131
Special Applications Products	188,986	191,162	177,876
Total Industrial Products segment	923,108	853,534	751,057
Total Company	$ 2,493,248	$ 2,294,029	$ 1,877,064

* Includes replacement part sales to the Company s OEM Customers.

Outlook

Recognizing the increasing levels of high economic uncertainty globally, the Company is planning its total Fiscal 2013 sales to be between $2.6 and $2.7 billion, or up 5 to 9 percent from Fiscal 2012. The Company’s full year Fiscal 2013 operating margin is forecasted to be 14.6 to 15.4 percent. Included in the Company’s forecast are $6 million for an increase in pension expense and $6 million for a Global Enterprise Resource Planning (ERP) project that will be started in Fiscal 2013. The Company’s full year Fiscal 2013 tax rate is projected to be between 28 and 31 percent. The Company forecasts its full year Fiscal 2013 EPS to be between $1.82 and $1.96.

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Fiscal 2012 Compared to Fiscal 2011

Engine Products Segment The Engine Products segment sells to OEMs in the construction, mining, agriculture, aerospace, defense, and truck markets and to independent distributors, OEM dealer networks, private label accounts, and large equipment fleets. Products include air filtration systems, exhaust and emissions systems, liquid filtration systems including hydraulics, fuel, lube, and replacement filters.

Sales for the Engine Products segment were $1,570.1 million, an increase of 9.0 percent from $1,440.5 million in the prior year. Engine Products sales in the United States increased by 11.3 percent in Fiscal 2012 compared to Fiscal 2011. International Engine Products sales increased 6.9 percent from the prior year. The impact of foreign currency decreased total sales by $24.3 million, or 1.7 percent. Earnings before income taxes as a percentage of Engine Products segment sales of 14.5 percent decreased from 14.7 percent in the prior year. The percentage earnings decrease for the twelve months ended July 31, 2012, was driven by a shift in product mix from replacement parts to first fit products, which carry a lower margin, partially offset by ongoing Continuous Improvement initiatives.

Worldwide sales of Off-Road Products were $376.9 million, an increase of 15.1 percent from $327.6 million in the prior year. Sales in the United States increased 17.4 percent over the prior fiscal year. Internationally, sales of Off-Road Products were up 13.5 percent from the prior year, with sales increasing in Europe and Asia by 12.9 percent and 12.3 percent, respectively. The sales increases were driven by higher demand for agriculture and mining equipment, and improved sales of heavy construction equipment.

Worldwide sales of On-Road Products were $163.9 million, an increase of 29.0 percent from $127.1 million in the prior year. On-Road Products sales in the United States increased 39.3 percent from the prior year. International On-Road Products sales increased 15.3 percent from the prior year, driven by increased sales in Asia of 20.8 percent, as a result of the tsunami recovery in Japan. The sales increase in North America was the combined result of an increase in Customer truck build rates and higher filter content per truck. According to published industry data, North American

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Class 8 truck build rates increased 48.5 percent and medium-duty truck build rates increased 24.0 percent over the prior year.

Worldwide Engine Aftermarket Products sales of $907.3 million increased 5.3 percent from $861.4 million in the prior year. Sales in the United States increased 7.7 percent over the prior year. International sales increased 3.5 percent primarily driven by sales increases in Latin America, Europe, and Asia of 15.7 percent, 2.7 percent, and 1.2 percent, respectively. The sales increases in the U.S., Latin America, and Europe were attributable to improved On-Road and Off-Road equipment utilization rates, the Company s increased distribution capabilities, dealer-distributor network growth, improved market position, and the continued increase in the percentage of equipment in the field that uses the Company s proprietary filtration systems. The Company began to see moderation beginning in the second quarter of Fiscal 2012 in the Chinese economy, which negatively impacted Aftermarket Products sales in China as well as other regions of Asia.

Worldwide sales of Retrofit Emissions Products were $15.4 million, a decrease of 21.5 percent from $19.6 million in the prior year. The Company s Retrofit Emissions Products sales are solely in the United States. The sales of these products are highly dependent on government regulations and a lack of funding availability throughout Fiscal 2012.

Worldwide sales of Aerospace and Defense Products were $106.7 million, a 1.7 percent increase from $104.9 million in the prior year. Sales in the United States increased 1.4 percent and international sales increased 2.7 percent over the prior year. The sales increase was due to improvements in Aerospace Products demand which was mostly offset by a continued slowdown in U.S. military activity.

Industrial Products Segment The Industrial Products segment sells to various industrial end-users, OEMs of gas-fired turbines, and OEMs and end-users requiring clean air. Products include dust, fume, and mist collectors, compressed air purification systems, air filtration systems for gas turbines, PTFE membrane-based products, and specialized air and gas filtration systems for various applications including computer hard disk drives and other electronic equipment.

Sales for the Industrial Products segment were $923.1 million, an increase of 8.2 percent from $853.5 million in the prior year. International Industrial Products sales increased 3.9 percent and sales in the United States increased 17.8 percent from the prior year. The impact of foreign currency decreased sales by $14.4 million, or 1.8 percent. Earnings before income taxes as a percentage of Industrial Products segment sales of 16.2 percent increased from 14.5 percent in the prior year. The improvement in earnings as a percentage of sales over the prior year was driven by better leverage of fixed operating costs and the continued successful execution on larger projects, both of which were partially offset by the impact of the flood in Thailand. In addition, the Industrial Products segment did not incur any restructuring expenses as compared to $0.7 million in the prior year.

Worldwide sales of Industrial Filtration Solutions Products of $553.5 million increased 9.0 percent from $507.6 million in the prior year. Sales in the United States, Asia and Europe increased 16.8 percent, 7.8 percent, and 2.4 percent, respectively. The Company continued to experience strong market conditions, especially in the U.S., for its Industrial Filtration Solutions resulting in continued strong demand for the Company s industrial dust collectors and replacement parts. The externally published durable goods index in the United States increased 8.4 percent during Fiscal 2012 as compared to last year.

Worldwide sales of Gas Turbine Products were $180.7 million, an increase of 16.8 percent from $154.7 million in the prior year. Gas Turbine Products sales are typically large systems and, as a result, the Company s shipments and revenues fluctuate from period to period. Sales of large Gas Turbine Products for power generation were stable for the first six months of Fiscal 2012 before increasing in the second half of the fiscal year. The Company also experienced additional demand for its smaller systems used in oil and gas applications and for replacement filters.

Worldwide sales of Special Applications Products were $189.0 million, a 1.1 percent decrease from $191.2 million in the prior year. Domestic Special Application Products sales increased 9.6 percent. International sales of Special Application Products decreased 2.8 percent over the prior year, primarily in Asia which decreased 3.6 percent. The sales decline was due to a decrease in demand for the Company s products serving the electronics industry which was affected by the flooding in Thailand in the second half of calendar 2011.

Consolidated Results The Company reported net earnings for Fiscal 2012 of $264.3 million compared to $225.3 million in Fiscal 2011, an increase of 17.3 percent. Diluted net earnings per share were $1.73, up 21.0 percent from $1.43 in the prior year. The Company s operating income of $363.0 million increased from prior year operating income of $315.3 million by 15.1 percent.

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The table below shows the percentage of total operating income contributed by each segment for each of the last three fiscal years. Corporate and Unallocated includes corporate expenses determined to be non-allocable to the segments, interest income, and interest expense:

	2012	2011	2010
Engine Products	59.1%	64.1%	63.1%
Industrial Products	40.3%	38.7%	37.8%
Corporate and Unallocated	0.6%	(2.8)%	(0.9)%
Total Company	100.0%	100.0%	100.0%

International operating income, prior to corporate expense allocations, totaled 69.7 percent of consolidated operating income in Fiscal 2012 as compared to 80.2 percent in Fiscal 2011. Total international operating income increased 0.1 percent from the prior year. The table below shows the percentage of total operating income contributed by each major geographic region for each of the last three fiscal years:

	2012	2011	2010
United States	30.3%	19.8%	19.7%
Europe	29.9%	31.0%	24.6%
Asia - Pacific	31.1%	39.6%	45.3%
Other	8.7%	9.6%	10.4%
Total Company	100.0%	100.0%	100.0%

For more information regarding the Company s net sales by geographic region, see Note L to the Consolidated Financial Statements.

Gross margin for Fiscal 2012 was 35.0 percent, a decrease from 35.5 percent in the prior year. The decrease in gross margin is attributable to the combination of the higher level of first fit and project sales which generally carry a lower margin, the Company s planned ramp-up for its newest plant in Mexico, lower fixed cost absorption in Asia, and increased purchased commodity costs from higher prices during the first half of the year and unfavorable foreign exchange rates in the second half of the year. These decreases were partially offset by the benefits from the Company s ongoing Continuous Improvement initiatives. Within gross margin, the Company incurred minimal restructuring and asset impairment charges during Fiscal 2011.

The principal raw materials that the Company uses are steel, filter media, and petroleum based products. Purchased raw materials represents approximately 60 to 65 percent of the Company s cost of goods sold. Of that amount, steel, including fabricated parts, represents approximately 25 percent. Filter media represents approximately 15 to 20 percent and the remainder is primarily made up of petroleum based products and other components. The cost the Company paid for steel during Fiscal 2012, varied by grade, but in aggregate, it slightly decreased in the second half of Fiscal 2012. The Company s cost of filter media also varies by type but it moderated slightly during the fiscal year since reaching a historical high at the end of Fiscal 2011. Petroleum based products were generally flat. Commodity prices in aggregate generally decreased throughout Fiscal 2012 after strong increases in the last half of Fiscal 2011. The impact was moderated by certain long term supply arrangements. However, the full year impact of commodity prices was still unfavorable to Fiscal 2011. The Company anticipates a moderately favorable impact from commodity prices in fiscal 2013, as compared to Fiscal 2012, specifically for steel and media, as these supply arrangements were renewed at lower prices extending through the end of the calendar year. Based on recent market information for purchased commodities, the Company anticipates only modest increases when these purchase arrangements are renewed. The Company strives to recover or offset material cost through selective price increases to its Customers and through the Company s Continuous Improvement initiatives, which include material substitution, process improvement, and product redesigns.

Operating expenses for Fiscal 2012 were $510.7 million or 20.5 percent of sales, as compared to $498.5 million or 21.7 percent in the prior year. The decrease in operating expenses as a percentage of sales is driven by the higher volume of sales. In addition, the current year had reduced distribution and warranty costs as a percent of sales. The prior year included $0.7 million in restructuring and asset impairment charges.

Interest expense of $11.5 million decreased $1.0 million from $12.5 million in the prior year. Net other income totaled $19.3 million in Fiscal 2012, up from $9.5 million in the prior year. The increase of $9.8 million in other income was driven by an increase in foreign exchange gains of $6.3 million, an increase of $1.2 million in interest income, an increase of $0.6 million in income from unconsolidated affiliates, an increase of $0.4 million in royalty income, and an insurance recovery of $1.3 million.

The effective tax rate for Fiscal 2012 was 28.7 percent compared to 27.9 percent in Fiscal 2011. The increase in effective tax rate is primarily due to an unfavorable shift in the mix of earnings between tax jurisdictions, which increased the underlying average tax rate over the prior year to 30.8 percent from 29.7 percent. The increase in the underlying average tax rate was partially offset by incremental discrete benefits. Fiscal 2012 contained $7.7 million of discrete tax benefits from the favorable settlements of tax audits, the expiration of statutes in various jurisdictions, and other discrete items. Fiscal 2011 contained $5.8 million of discrete tax benefits, primarily from the release of reserves after the favorable conclusions of foreign tax audits, the expiration of statutes in various jurisdictions, and the positive impact of dividends from some foreign subsidiaries.

Total backlog at July 31, 2012, was $798.6 million, down 0.5 percent from the same period in the prior year. Backlog is one of many indicators of business conditions in the Company s markets. However, it is not always indicative of future results for a number of reasons, including short lead times in the Company s replacement parts businesses and the timing of the receipt of orders in many of the Company s Engine OEM and Industrial markets. In the Engine Products segment, total open order backlog decreased 5.9 percent from the prior year. In the Industrial Products segment, total open order backlog increased 13.9 percent from the prior year. Because some of the change in backlog can be attributed to a change in the ordering patterns of the Company s Customers and/or the impact of foreign exchange translation rates, it may not necessarily correspond to future sales.

Fiscal 2011 Compared to Fiscal 2010

Engine Products Segment The Engine Products segment sells to OEMs in the construction, mining, agriculture, aerospace, defense, and truck markets and to independent distributors, OEM dealer networks, private label accounts, and large equipment fleets. Products include air filtration systems, exhaust and emissions systems, liquid filtration systems including hydraulics, fuel and lube, and replacement filters.

Sales for the Engine Products segment were $1,440.5 million, an increase of 27.9 percent from $1,126.0 million in the prior year. Engine Products sales in the United States increased by 25.9 percent in Fiscal 2011 compared to Fiscal 2010. International Engine Products sales increased 29.8 percent from the prior year. The impact of foreign currency increased total sales by $31.5 million, or 2.8 percent. Earnings before income taxes as a percentage of Engine Products segment sales of 14.7 percent increased from 13.8 percent in the prior year. The earnings improvement for the current fiscal year was driven by better absorption of fixed costs due to improved volumes and the Company s ongoing Continuous Improvement initiatives, partially offset by increased commodity costs compared to the prior year. There were $1.9 million in restructuring expenses for the Engine Products segment in the prior year.

Worldwide sales of Off-Road Products were $327.6 million, an increase of 47.3 percent from $222.3 million in the prior year. Sales in the United States increased 35.8 percent over the prior fiscal year. Internationally, sales of Off-Road Products were up 56.0 percent from the prior year, with sales increasing in Asia and Europe by 58.2 percent and 55.6 percent, respectively. The Company s overall increase was driven by higher demand for agriculture, construction, and mining equipment due to continued strong commodity prices and improved sales of heavy construction equipment, which was due to increased global infrastructure spending, especially in developing economies. Off-Road Products sales in the U.S. also benefited from market share gains on new platforms that began production during calendar year 2011. These increases were slightly offset by U.S. residential and non-residential construction markets, which showed continued weakness, resulting in lower sales of the Company s products into those markets.

Worldwide sales of On-Road Products were $127.1 million, an increase of 55.2 percent from $81.9 million in the prior year. On-Road Products sales in the United States increased 86.0 percent from the prior year. Class 8 build rates increased 47.8 percent and medium duty truck build rates increased 37.1 percent over the prior year. International On-Road Products sales increased 27.4 percent from the prior year, driven by increased sales in Europe of 45.6 percent. This increase is consistent with the increase in European build rates. The overall sales increase was a result of an increase in Customer truck build rates, higher content per truck, and a slightly higher market share.

Worldwide Engine Aftermarket Products sales of $861.4 million increased 24.5 percent from $691.9 million in the prior year. Sales in the United States increased 26.3 percent over the prior year. International sales increased 23.1 percent from the prior year, primarily driven by sales increases in Asia, Latin America and Europe of 37.8 percent, 25.7 percent, and 13.5 percent, respectively. The sales increases in the U.S. and internationally were attributable to improved On-Road and Off-Road equipment utilization rates from a year ago, the Company s increased distribution and market share growth, and the continued increase in the percentage of equipment in the field that uses the Company s proprietary filtration systems.

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Worldwide sales of Retrofit Emissions Products were $19.6 million, an increase of 9.1 percent from $17.9 million in the prior year. The Company s Retrofit Emissions Products sales are solely in the United States. Sales of Retrofit Emissions Products increased overall, but challenges remained in the supply chain for certain components and delays in regulatory approval for certain of the Company s products have impacted the Company s sales.

Worldwide sales of Aerospace and Defense Products were $104.9 million, a 6.3 percent decrease from $112.0 million in the prior year. Sales in the United States decreased 8.7 percent over the prior year as a result of slowdowns in U.S. military activity, which is causing an associated slowdown in government procurement spending for major programs. Internationally, sales of Aerospace and Defense Products increased 3.0 percent over the prior year. The international sales increased primarily due to market share gains resulting from improving the Company s Aerospace distribution capabilities in Europe.

Industrial Products Segment The Industrial Products segment sells to various industrial end-users, OEMs of gas-fired turbines, and OEMs and end-users requiring clean air. Products include dust, fume, and mist collectors, compressed air purification systems, air filtration systems for gas turbines, PTFE membrane based products, specialized air and gas filtration systems for applications, including computer hard disk drives, and other electronic equipment.

Sales for the Industrial Products segment were $853.5 million, an increase of 13.6 percent from $751.1 million in the prior year. International Industrial Products sales increased 8.5 percent and sales in the United States increased 27.2 percent from the prior year. The impact of foreign currency increased sales by $18.3 million, or 2.4 percent. Earnings before income taxes as a percentage of Industrial Products segment sales of 14.5 percent increased from 12.1 percent in the prior year. The improvement in earnings as a percent of sales over the prior year was driven by better leverage of fixed operating costs and better plant utilization. Restructuring expenses in Fiscal 2011 were $0.7 million, a decrease from $8.3 million in Fiscal 2010.

Worldwide sales of Industrial Filtration Solutions Products of $507.6 million increased 20.0 percent from $423.1 million in the prior year. Sales in the United States, Europe and Asia increased 25.3 percent, 12.9 percent, and 26.2 percent, respectively. The increased sales were due to increased manufacturing activity, higher investment in capital equipment by manufacturers, and the continued strengthening of replacement filter sales due to utilization of existing equipment. North American general industrial activity remained strong as evidenced by a 110 percent increase in machine tool consumption in the United States during Fiscal 2011 as compared to Fiscal year 2010.

Worldwide sales of Gas Turbine Products were $154.7 million, an increase of 3.1 percent from $150.1 million in the prior year. Gas Turbine Products sales are typically large systems and, as a result, the Company s shipments and revenues fluctuate from period to period. Sales slightly improved due to additional demand for smaller systems used in the oil and gas industry as a result of higher average oil prices and an increase in Aftermarket sales for replacement filters. These increases were slightly offset by a decline in the sales of air filtration systems for large turbines used for power generation.

Worldwide sales of Special Applications Products were $191.2 million, a 7.5 percent increase from $177.9 million in the prior year. International sales of Special Application Products increased 6.1 percent over the prior year, primarily in Europe, which increased 47.0 percent. Domestic Special Application Products sales increased 17.1 percent. The global sales increases were driven by strong sales in some of the Company s product lines serving the membrane, semiconductor, imaging, and venting end markets, partially offset by a slight decline in the Company s disk drive filter sales due to soft demand in the global end market for hard disk drives. Overall, the decline in disk drive sales is comparable with published disk drive build rates.

Consolidated Results The Company reported net earnings for Fiscal 2011 of $225.3 million compared to $166.2 million in Fiscal 2010, an increase of 35.6 percent. Diluted net earnings per share were $1.43, up 36.2 percent from $1.05 in the prior year. The Company s operating income of $315.3 million increased from prior year operating income of $238.2 million by 32.3 percent.

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The table below shows the percentage of total operating income contributed by each segment for each of the last three fiscal years. Corporate and Unallocated includes corporate expenses determined to be non-allocable to the segments, interest income, and interest expense:

	2011	2010	2009
Engine Products	64.1%	63.1%	45.7%
Industrial Products	38.7%	37.8%	50.6%
Corporate and Unallocated	(2.8)%	(0.9)%	3.7%
Total Company	100.0%	100.0%	100.0%

International operating income, prior to corporate expense allocations, totaled 80.2 percent of consolidated operating income in Fiscal 2011 as compared to 80.3 percent in Fiscal 2010. Total international operating income increased 32.1 percent from the prior year. This increase is attributable to increased Customer sales and the leverage of fixed costs with the higher volume of sales. The table below shows the percentage of total operating income contributed by each major geographic region for each of the last three fiscal years:

	2011	2010	2009
United States	19.8%	19.7%	22.1%
Europe	31.0%	24.6%	23.3%
Asia - Pacific	39.6%	45.3%	43.5%
Other	9.6%	10.4%	11.1%
Total Company	100.0%	100.0%	100.0%

Gross margin for Fiscal 2011 was 35.5 percent, an increase from 35.1 percent in the prior year. The improved gross margin was the result of better fixed cost absorption and the Company s ongoing Continuous Improvement initiatives of approximately $27 million, which were partially offset by increases in purchased raw material (steel and petrochemical based raw materials) of approximately $19 million, net of selective price increases to Customers. Within gross margin, the Company incurred minimal restructuring and asset impairment charges during the fiscal year, compared to $7.5 million last year. The fiscal 2010 charges were primarily related to a downsizing at a plant in Germany and included severance and asset impairments for the building and inventory.

The principal raw materials that the Company uses are steel, filter media, and petroleum based products. Purchased raw materials represents approximately 60 to 65 percent of the Company s cost of goods sold. Of that amount, steel, including fabricated parts, represents approximately 25 percent. Filter media represents approximately 15 to 20 percent and the remainder is primarily made up of petroleum based products and other components.

Operating expenses for Fiscal 2011 were $498.5 million or 21.7 percent of sales, as compared to $420.5 million or 22.4 percent in the prior year. The decrease in operating expenses as a percentage of sales is driven by the higher volume of sales and benefits from the Company s Continuous Improvement initiatives. In addition, the current year included a $1.9 million reduction in restructuring expenses compared to Fiscal 2010. These benefits were partially offset by costs for our strategic operating investments totaling $13.9 million for the fiscal year and higher compensation related expenses such as incentive compensation of $9.2 million and pension expense of $5.1 million over the prior year.

Interest expense of $12.5 million increased $0.5 million from $12.0 million in the prior year. Net other income totaled $9.5 million in Fiscal 2011 up from $3.9 million in the prior year. The increase of $5.6 million over the prior year is primarily attributable to increased interest income of $2.0 million, increased earnings from non-consolidated joint ventures of $2.1 million, and increased royalty income of $1.4 million. Components of other income for Fiscal 2011 were as follows: interest income of $3.3 million, earnings from non-consolidated joint ventures of $4.1 million, royalty income of $8.7 million, partially offset by charitable donations of $1.1 million, foreign exchange losses of $4.5 million, and other miscellaneous income and expense items resulting in expenses of $1.0 million.

The effective tax rate for Fiscal 2011 was 27.9 percent compared to 27.8 percent in Fiscal 2010. The average underlying tax rate remained at 29.7 percent, while discrete items were also a consistent percentage of pre-tax profits. Fiscal 2010 contained $4.3 million of discrete tax benefits from the expiration of the statute of limitations at foreign subsidiaries. Fiscal 2011 contained $5.8 million of discrete tax benefits primarily from the release of reserves after the favorable conclusions of foreign tax audits, the expiration of statutes in various jurisdictions, and the positive impact of dividends from some foreign subsidiaries.

Total backlog at July 31, 2011, was $816.4 million, up 29.9 percent from the same period in the prior year. Backlog is one of many indicators of business conditions in the Company s markets. However, it is not always indicative of future results for a number of reasons, including short lead times in the Company s replacement parts businesses and the timing of the receipt of orders in many of the Company s Engine OEM and Industrial markets. In

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the Engine Products segment, total open order backlog increased 36.6 percent from the prior year. In the Industrial Products segment, total open order backlog increased 14.9 percent from the prior year. Because some of the change in backlog can be attributed to a change in the ordering patterns of the Company s Customers and/or the impact of foreign exchange translation rates, it may not necessarily correspond to future sales.

Liquidity and Capital Resources

Financial Condition At July 31, 2012, the Company s capital structure was comprised of $97.5 million of current debt, $203.5 million of long-term debt and $910.0 million of shareholders equity. The Company had cash and cash equivalents of $225.8 million at July 31, 2012. The ratio of long-term debt to total capital was 18.3 percent and 18.0 percent at July 31, 2012 and 2011, respectively.

Total debt outstanding increased $34.2 million during the year to $301.0 million outstanding at July 31, 2012. Short-term borrowings outstanding at the end of the year were $82.0 million more than the prior year, and long-term debt decreased $47.8 million (including current maturities) from the prior year.

The following table summarizes the Company s cash obligations as of July 31, 2012, for the years indicated (thousands of dollars):

			Payments Due by Period		
Contractual Obligations	**Total**	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Long-term debt obligations	$ 201,117	$	$ 101,117	$ 50,000	$ 50,000
Capital lease obligations	774	464	310		
Interest on long-term debt obligations	37,475	11,201	13,944	10,960	1,370
Operating lease obligations	26,583	11,793	11,819	2,510	461
Purchase obligations [1]	276,083	272,193	2,736	1,147	7
Pension and deferred compensation [2]	89,876	21,402	9,827	9,568	49,079
Total [3]	$ 631,908	$ 317,053	$ 139,753	$ 74,185	$ 100,917

(1) Purchase obligations consist primarily of inventory, tooling, contract employment services and capital expenditures. The Company s purchase orders for inventory are based on expected Customer demand, and quantities and dollar volumes are subject to change.

(2) Pension and deferred compensation consists of long-term pension liabilities and salary and bonus deferrals elected by certain executives under the Company s deferred compensation plan. Deferred compensation balances earn interest based on a treasury bond rate as defined by the plan (10 year treasury bond STRIP rate plus two percent for deferrals prior to January 1, 2011 and 10 year treasury bond rates for deferrals after December 31, 2010) and approved by the Human Resources Committee of the Board of Directors, and are payable at the election of the participants.

(3) In addition to the above contractual obligations, the Company may be obligated for additional cash outflows of $17.8 million of potential tax obligations, including accrued interest and penalties. The payment and timing of any such payments is affected by the ultimate resolution of the tax years that are under audit or remain subject to examination by the relevant taxing authorities, and are therefore not currently capable of estimation by period.

The Company s general funding policy for its pension plans is to make at least the minimum contributions as required by applicable regulations. Additionally, the Company may elect to make additional contributions up to the maximum tax deductible contribution. As such, the Company made contributions of $25.5 million to its U.S. pension plans in Fiscal 2012. The minimum funding requirement for the Company s U.S. pension plans for Fiscal 2013 is $13.5 million. Per the Pension Protection Act of 2006, this obligation could be met with existing credit balances. The Company is still considering whether a cash contribution will be made. The Company made contributions of $12.5 million to its non-U.S. pension plans in Fiscal 2012 and estimates that it will contribute approximately $7.0 million in Fiscal 2013 based upon the local government prescribed funding requirements. Future estimates of the Company s pension plan contributions may change significantly depending on the actual rate of return on plan assets, discount rates, and regulatory requirements.

The Company has a five-year, multi-currency revolving facility with a group of banks under which the Company may borrow up to $250 million. This facility matures on April 2, 2013. The agreement provides that loans may be made under a selection of currencies and rate formulas including Base Rate Advances or Off Shore Rate Advances. The interest rate on each advance is based on certain market interest rates and leverage ratios. Facility fees and other fees on the entire loan commitment are payable over the duration of this facility. There was $80.0 million outstanding

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at July 31, 2012 and nothing outstanding at July 31, 2011. At July 31, 2012 and 2011, $159.1 million and $238.6 million, respectively, were available for further borrowing under such facilities. The amount available for further borrowing reflects a reduction for issued standby letters of credit, as discussed below. The weighted average interest rate on short-term borrowings outstanding at July 31, 2012 was 0.4 percent. The Company s multi-currency revolving facility contains debt covenants specifically related to maintaining a certain interest coverage ratio and a certain leverage ratio as well as other covenants that under certain circumstances can restrict the Company s ability to incur additional indebtedness, make investments and other restricted payments, create liens, and sell assets. As of July 31, 2012, the Company was in compliance with all such covenants. The Company expects to remain in compliance with these covenants. The Company does anticipate refinancing this revolving credit facility during Fiscal 2013.

The Company has two uncommitted credit facilities in the United States, which provide unsecured borrowings for general corporate purposes. At July 31, 2012 and 2011, there was $41.3 million and $56.9 million available for use, respectively. There was $8.7 million outstanding at July 31, 2012 and $13.1 million outstanding at July 31, 2011.

The Company has a 100 million program for issuing treasury notes for raising short, medium, and long-term financing for its European operations. There was nothing outstanding on this program at July 31, 2012 or 2011. Additionally, the Company s European operations have lines of credit with an available limit of 43.6 million. There was nothing outstanding on these lines of credit as of July 31, 2012 or 2011.

Other international subsidiaries may borrow under various credit facilities. There was $6.4 million outstanding under these credit facilities as of July 31, 2012 and nothing outstanding as of July 31, 2011.

Also, at July 31, 2012 and 2011, the Company had outstanding standby letters of credit totaling $10.9 million and $11.4 million, respectively, upon which no amounts had been drawn. The letters of credit guarantee payment to third parties in the event the Company is in breach of insurance contract terms as detailed in each letter of credit.

During Fiscal 2012, credit in the global credit markets was accessible and market interest rates remained low. The Company believes that its current financial resources, together with cash generated by operations, are sufficient to continue financing its operations for the next twelve months. There can be no assurance, however, that the cost or availability of future borrowings will not be impacted by future capital market disruptions.

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329,397

(1) The options were granted under the Company's 1998 Equity Incentive Plan. These options become exercisable in four equal annual installments on each anniversary date of the date of grant. Options that have been issued may not be exercised beyond the earlier of (a) ten years from the date of grant, or (b) three months after the holder ceases to be employed by the Company, except in the event of termination by reason of death or permanent disability, in which event the option may be exercised for up to one year following termination.

(2) The assumed rates are compounded annually for the full term of the options.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

NAME	SHARES ACQUIRED ON EXERCISE (#)	VALUE REALIZED ($)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT 10/31/04 EXERCISABLE/ UNEXERCISABLE (#)	VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT 10/31/04 EXERCISABLE/ UNEXERCISABLE (1) ($)
Jerry D. Leitman	160,000	2,506,596	1,348,000 (2) 100,000 (3)	13,328,640 (2) -0- (3)
Christopher R. Bentley	4,900	80,262	193,000 (2) 58,000 (3)	1,436,560 (2) 51,600 (3)
R. Daniel Brdar	-0-	-0-	89,500 (2) 89,500 (3)	86,000 (2) 258,000 (3)
Joseph G. Mahler	63,150	897,216	212,800 (2) 58,000 (3)	1,726,754 (2) 51,600 (3)
Hansraj C. Maru	-0-	-0-	181,500 (2) 40,500 (3)	1,421,960 (2) 51,600 (3)
Herbert T. Nock	12,500	154,200	345,000 (2) 77,500 (3)	-0- (2) 258,000 (3)

(1) Based upon the closing price of $12.33 on October 29, 2004 of the Company s Common Stock on the Nasdaq National Market minus the respective option exercise price.
(2) Exercisable.
(3) Unexercisable.

EMPLOYMENT AGREEMENTS

In August 1997, the Company entered into an employment agreement with Mr. Leitman upon hiring him as its President and Chief Executive Officer. The employment agreement was subsequently modified in June 2002. Under the agreement, which is terminable by either party upon 30 days notice, Mr. Leitman is entitled to a minimum annual salary and a bonus based upon an incentive compensation plan to be developed by Mr. Leitman with the Compensation Committee. In addition, upon entering into the agreement, the Company granted Mr. Leitman options to purchase 1,500,000 shares of Common Stock. The agreement also provides Mr. Leitman with the opportunity to participate in insurance plans and other employment benefits as may be generally available to other employees of the Company. In certain circumstances, if Mr. Leitman s employment is terminated, including a termination by Mr. Leitman upon a change of control, Mr. Leitman will be entitled to a severance benefit equal to (i) two times his then base salary, plus (ii) an amount equal to Mr. Leitman s bonus from the Company for the immediately preceding year. The agreement also contains non-disclosure provisions and prohibits Mr. Leitman from competing with the Company during the term of his employment and for a period of two years thereafter. Under the Agreement, the Company has agreed to use its best efforts to cause Mr. Leitman to be elected to the Board of Directors and to appoint Mr. Leitman as a member of the Executive Committee of the Board of Directors.

In October 1998, the Company entered into an employment agreement with Mr. Mahler upon hiring him as its Chief Financial Officer, Treasurer and Corporate Secretary. Under the agreement, which is terminable by either party upon 30 days notice, Mr. Mahler is entitled to a minimum annual salary and a bonus based upon the Company incentive compensation plan. In addition, upon entering into the agreement, the Company granted Mr. Mahler options to purchase 300,000 shares of Common Stock. The agreement also provides Mr. Mahler with the opportunity to participate in insurance plans and other employment benefits as may be generally available to other employees of the Company. In certain circumstances, if Mr. Mahler s employment is terminated, Mr. Mahler will be entitled to a severance benefit equal to (i) his then base salary, plus (ii) an amount equal to Mr. Mahler s bonus from the Company for the immediately preceding year. The agreement also contains non-disclosure provisions and prohibits Mr. Mahler from competing with the Company during the term of his employment and for a period of two years thereafter.

In February 2005, the Company entered into an employment arrangement with Mr. Brdar upon his promotion to Executive Vice President and Chief Operating Officer. Under the at-will agreement, Mr. Brdar is entitled to an annual base salary of $250,000 and a bonus based upon the Company s incentive compensation plan. In addition, the Company granted Mr. Brdar options to purchase 250,000 shares of Common Stock. If Mr. Brdar s employment is terminated in the event of a change of control of the Company or without cause, Mr. Brdar will be entitled to a severance benefit equal to one year s salary.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Decisions regarding executive compensation are principally made by the Compensation Committee, which is composed of Messrs. Lawson, Casten, Rolls and Petty. The Compensation Committee reviews and recommends for approval by the independent members of the Board of Directors the compensation (salary, bonus and other long-term incentives) of the Chief Executive Officer of the Company and reviews and approves the compensation (salary, bonus and long-term incentives) of the other executive officers of the Company. The Company has both a short and long term incentive compensation plan. The Compensation Committee is responsible for the recommendation to the independent directors of the Company of incentive awards to the Chief Executive Officer of the Company under the plans and the approval of incentive awards to the other executive officers of the Company under the plans. No member of the Compensation Committee was an officer or employee of the Company during the fiscal year ended October 31, 2004.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The Compensation Committee reviews the Company's compensation plan on a regular basis. The Compensation Committee periodically retains independent consultants on an as needed basis to provide current market data with regard to base salary structure, short-term cash incentives and with the development of long-term incentive plans. The Compensation Committee regularly updates its assessment of various long-term incentive tools including stock options, restricted stock, performance-based equity, and other alternatives that might be available.

The Company's primary objective in developing executive compensation policies is to attract, motivate and retain highly qualified and effective leaders. The compensation policy includes various components of compensation that are intended to align management behaviors and priorities directly with the Company s strategic objectives and to encourage management to act in the best long-term interest of the Company and its shareholders. The Company's executive officer compensation policy generally consists of three elements: base compensation, annual cash bonus and long-term incentive compensation.

Cash Compensation

Annual compensation consists of two elements: base salary and an annual bonus payable in a combination of cash and Company common stock. Each officer is offered a base salary that is commensurate for the role that he or she is performing. In setting compensation, the Compensation Committee strives to maintain base compensation for the Company's executive officers at levels which the Compensation Committee, based on its experience, believes are competitive with the compensation of comparable executive officers in similarly situated companies.

Increases in base salary are based on a periodic review and evaluation of the performance of the operation or function for which the executive has responsibility, and is measured against defined performance criteria. The executive is also reviewed according to his or her competence as an effective leader in the Company, which includes an evaluation of the skills and experience required for the job, coupled with a comparison of these elements with similar elements for other executives both within and outside of the Company.

Executive officers are eligible to participate in a bonus plan. The Compensation Committee determines awards under the bonus plan. The Compensation Committee considers input of the Chief Executive Officer with respect to the bonus to be awarded to the other executive officers. The executive officers, as well as other key employees, may receive bonuses based upon meeting the performance objectives of the Company and their contributions to the Company.

The compensation paid by the Company to its Chief Executive Officer for fiscal 2004 was based upon an employment agreement negotiated with Mr. Leitman. The Compensation Committee has recently conducted a survey of compensation packages of Chief Executive Officers in comparable companies, and believes, based upon the individual experience of its members, that the compensation package for Mr. Leitman for fiscal 2004 was reasonable based upon Mr. Leitman s experience, his level of responsibility and the contributions made and expected to be made by him to the Company. See Employment Agreement for a description of Mr. Leitman s employment agreement.

Long-term incentive compensation

Each of the executive officers and all employees are eligible to receive awards under the 1998 Equity Incentive Plan. The 1998 Equity Incentive Plan will be used to align a portion of the officers compensation with the shareholders' interest and the long-term success of the Company by encouraging the executive officers and other employees to remain with the Company, and by enabling optionees to develop and maintain a significant, long-term stock ownership position in the Company's Common Stock. The value realizable from exercisable options is dependent upon the extent to which the Company's performance is reflected in the market price of the Company's Common Stock at any particular point in time.

In determining the number of options to be granted to each executive officer, the Compensation Committee considers input of the Chief Executive Officer with respect to the executive officers, other than the Chief Executive Officer. These determinations are based in part upon annual compensation surveys of executive officers and certain key employees in comparable companies along with following guidelines previously approved by the Compensation Committee.

The members of the Compensation Committee have submitted this report.

Compensation Committee

William Lawson
(Chairman)
Thomas Casten
John Rolls
George Petty

PERFORMANCE GRAPH

The following graph compares the annual change in the Company s cumulative total shareholder return on its Common Stock for the five fiscal years ended October 31, 2004 with the cumulative total return on the Russell 2000 and a peer group consisting of SIC Group Code 369 companies listed on The American Stock Exchange, Nasdaq National Market and New York Stock Exchange for that period.

FISCAL YEAR ENDED

COMPANY/INDEX/MARKET	10/31/1999	10/31/2000	10/31/2001	10/31/2002	10/31/2003	10/31/2004
FuelCell Energy, Inc.	100.00	895.89	365.79	135.03	357.59	288.67
Misc Electric Equip, Supplies	100.00	114.39	58.25	56.40	86.05	90.45
Russell 2000 Index	100.00	115.87	99.68	89.96	122.97	136.48

SECTION 16 (a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s officers, directors and persons who own more than ten percent of the issued and outstanding shares of Common Stock to file reports of beneficial ownership and changes in beneficial ownership with the SEC and to furnish copies of all Section 16(a) forms to the Company.

Based solely on the Company s review of the copies of such forms received by it, or written representations from certain reporting persons that no filings were required for those persons, the Company believes that during the last fiscal year all required filings were timely made as required by Section 16(a) except as follows: R. Daniel Brdar, and James Gerson were each delinquent in the filing of one Form 4 or 5 representing one transaction each and Jerry Leitman was delinquent in the filing of one Form 4 or 5 representing two transactions. Joseph Mahler and Hansraj Maru were each delinquent in the filing of two Forms 4 or 5 representing two transactions each and Herbert Nock and Christopher Bentley were delinquent in the filing of two Forms 4 or 5 representing an aggregate of three transactions each. All forms were subsequently filed. SEC rules require the Company to disclose all known delinquent Section 16(a) filings by its officers, directors and ten percent stockholders.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

MTU-Friedrichshafen GmbH

MTU-Friedrichshafen GmbH holds 2,746,548 shares of FuelCell Energy common stock. FuelCell Energy has certain business relationships with its subsidiary; MTU CFC Solutions (MTU).

In December of 1999, the Company entered into an agreement with Daimler Chrysler affiliate MTU-Friedrichshafen GmbH granting an exclusive license to use the Company's Direct Fuel Cell (DFC) patent rights and know how in Europe and the Middle East and a non-exclusive license in South America and Africa subject to certain rights of the Company and others. This license agreement was assigned to MTU in February 2003. MTU has agreed to make any improvements to the Company's DFC available to the Company. MTU plans to conduct further research, development, manufacturing and marketing programs in the area of carbonate fuel cell technology and has agreed to negotiate a license grant of the results to the Company. In addition, MTU has agreed to pay a royalty based on kilowatts of electrical generating capacity using the Company's DFC made or sold by MTU or its permitted licensees, including a minimum annual royalty commencing in 2000. Pursuant to this agreement, MTU paid the Company $300,000 in royalties in fiscal year 2004.

In July 1998, the Company entered into a Cross-Licensing and Cross-Selling Agreement with MTU-Friedrichshafen GmbH which was also assigned to MTU in February 2003. In this license MTU and the Company have granted to each other the right to manufacture and sell each other's stationary power fuel cell products in their respective regions. Each company will pay the other royalties based upon sales. Mr. Bode, a director of the Company, is an executive officer of an affiliate of MTU, and MTU is a significant shareholder of the Company. The Company believes that the terms of its transactions with MTU are no less favorable to the Company than it could have obtained from an unaffiliated third party.

During fiscal year 2004, the Company sold to MTU fuel cell components for approximately $1.6 million.

Strategic Alliance with Enbridge, Inc.

On November 4, 2003, the Company entered into a strategic alliance agreement with Enbridge to distribute FuelCell's products in Canada. As part of the agreement, Enbridge received warrants to purchase 500,000 shares of FuelCell Energy common stock. The agreement calls for the warrants to be exercisable on a graduated scale based on order flow generated by Enbridge. The full quantity of warrants will vest with order commitments for 20 megawatts of DFC power plants. The exercise prices of the warrants range from $14.65 to $19.04 per share and the warrants will expire in November 2006. Enbridge also holds shares of FuelCell Energy, Ltd. Series I Preferred Stock, a subsidiary of the Company, which are presently convertible into 225,286 shares of the Company s Common Stock. George K. Petty, a member of the Board of Directors of the Company, is a director of Enbridge.

EQUITY COMPENSATION PLAN AND WARRANT INFORMATION (1)

Plan Category	Number of Common Shares to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Plans approved by security holders:			
Stock option plans	5,353,791	$ 10.63	1,641,048
Employee stock purchase plan (2)	15,593	$ 10.49	431,738
Warrants issued to business partners not approved by security holders (3)	1,640,000	$ 35.51	
Total	7,009,384	$ 16.45	2,072,786

(1) As of the end of our fiscal year ended October 31, 2004.National Market minus the respective option exercise price.

(2) We offer a stock purchase plan that allows employees to purchase shares of our common stock at a discounted cost.

(3) We have issued warrants to certain of our business partners as sales incentives.

INDEPENDENT PUBLIC ACCOUNTANTS

Audit Fees

Audit fees include the aggregate fees billed for the audit of the Company's annual consolidated financial statements and the reviews of each of the quarterly consolidated financial statements included in the Company's Forms 10-Q. These fees also include statutory audit work performed with respect to the acquisition of Global on November 3, 2003. The aggregate audit fees billed to the Company by KPMG LLP for the fiscal year ended October 31, 2004 were $324,754. The aggregate audit fees billed to the Company by KPMG LLP for the fiscal year ended October 31, 2003 were $305,570. The audit fees for the year ended October 31, 2003 also included statutory audit work performed with respect to the acquisition of Global on November 3, 2003.

Audit-Related Fees

Audit-related fees include accounting advisory services related to the audit of the Company's employee benefit plans, the adoption of new accounting standards and special one-time events. The aggregate audit-related fees billed to the Company by KPMG for the fiscal year ended October 31, 2004 were $36,150. The aggregate audit-related fees billed to the Company by KPMG for the fiscal year ended October 31, 2003 were $35,350.

Tax Fees

Fees paid to KPMG LLP for tax services for 2004 were approximately $370,796. This included $65,900 for tax return and compliance work, $179,750 for acquisition costs and $125,146 for tax consulting, assistance and advice.

Fees paid to KPMG LLP for tax services for 2003 were approximately $244,585. This included $73,630 for tax return and compliance work, $65,075 for acquisition costs and $105,880 for tax consulting, assistance and advice.

Other Fees

Other than fees relating to the services described above under Audit Fees, Audit-Related Fees and Tax Fees, there were no additional fees billed by KPMG LLP for services rendered to the Company for the fiscal year ended October 31, 2004 or the fiscal year ended October 31, 2003.

As set forth in its charter, it is the policy of our Audit Committee to pre-approve all audit and non-audit services provided by KPMG. Our Audit Committee has considered whether the provision of KPMG LLP's services other than for the annual audit and quarterly reviews is compatible with their independence and has concluded that it is.

SHAREHOLDER PROPOSALS FOR THE 2005 ANNUAL MEETING

Shareholders who wish to present proposals for inclusion in the Company's proxy materials and for consideration at the 2005 Annual Meeting of Shareholders should submit the proposals in writing to the Secretary of the Company in accordance with all applicable rules and regulations of the SEC no later than October 27, 2005.

ANNUAL REPORT AND FORM 10-K

ADDITIONAL COPIES OF THE COMPANY'S ANNUAL REPORT TO SHAREHOLDERS FOR THE FISCAL YEAR ENDED OCTOBER 31, 2004 AND COPIES OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED OCTOBER 31, 2004 AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ARE AVAILABLE TO SHAREHOLDERS WITHOUT CHARGE UPON WRITTEN REQUEST ADDRESSED TO: FUELCELL ENERGY, INC., 3 GREAT PASTURE ROAD, DANBURY, CONNECTICUT 06813 ATTN: SHAREHOLDER RELATIONS OR IS ALSO AVAILABLE THROUGH THE COMPANY S WEBSITE AT WWW.FUELCELLENERGY.COM.

OTHER MATTERS

As of the date of this proxy statement, the Board of Directors knows of no matters which will be presented for consideration at the Annual Meeting other than the proposal set forth in this Proxy Statement. If any other matters properly come before the meeting, it is intended that the persons named in the proxy will act in respect thereof in accordance with their best judgment.

By Order of the Board of Directors
Joseph G. Mahler
Corporate Secretary

Danbury, CT
February 27, 2005

PROXY FUELCELL ENERGY, INC. PROXY

PROXY FOR ANNUAL MEETING OF STOCKHOLDERS MARCH 29, 2005
SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints Jerry D. Leitman and Joseph G. Mahler, and each of them, attorneys with full power of substitution, to vote as directed below all shares of Common Stock of FuelCell Energy, Inc. registered in the name of the undersigned, or which the undersigned may be entitled to vote, at the Annual Meeting of Stockholders to be held at the Sheraton Danbury Hotel located at 18 Old Ridgebury Road, Danbury, CT. at 10:00 a.m. and at any adjournment or postponement thereof.

1. Election of Directors

¨ **FOR** all nominees listed below (except as marked to the contrary below)	¨ **WITHHOLD AUTHORITY** to vote for all nominees listed below

(Instruction: To withhold authority to vote for any individual nominee strike a line through the nominee's name in the list below.)

Warren D. Bagatelle, Michael Bode, Thomas R. Casten, James D. Gerson, Thomas L. Kempner, William A. Lawson, Jerry D. Leitman, Charles J. Murphy, George K. Petty, John A. Rolls.

2. As such proxies may in their discretion determine in respect of any other business properly to come before said meeting (the Board of Directors knowing of no such other business).

The directors recommend a vote FOR item 1.

(Continued on reverse side)

(Continued from other side)

UNLESS THE STOCKHOLDER DIRECTS OTHERWISE, THIS PROXY WILL BE VOTED FOR ITEM 1 AS PROPOSED.

PLEASE DATE, SIGN AND RETURN IN THE ENVELOPE PROVIDED.

Dated ______________________, 2005

____

Signature of Stockholder(s)

(Please sign in the same form as name appears hereon. Executors and other fiduciaries should indicate their titles. If signed on behalf of a corporation, give title of officer signing).

THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD MARCH 29, 2005.