TIME WARNER INC.
Form DEF 14A
April 24, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to § 240.14a-12

Time Warner Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(3) Filing Party:

(4) Date Filed:

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April 24, 2015

Dear Fellow Shareholder:

2014 was a milestone year for Time Warner.

We completed the strategic transition of the company from a traditional media conglomerate to a global media company focused on high-quality video content. It s a process that began several years ago and culminated with the separation of Time Inc. in 2014.

As a result, Time Warner is uniquely well positioned for today s media environment. We have the scale that comes with industry-leading positions in cable networks at Turner and Home Box Office and with the world s preeminent television and film studio at Warner Bros. And we have the focus that comes with a naturally aligned set of businesses. This combination allows us to move swiftly to take advantage of the growing worldwide consumer demand for high-quality video content, while leading the industry in developing new products and services that capitalize on technology and address consumers ever-evolving expectations.

Sustained Performance. Last year, we made great progress in executing our strategy to drive superior and sustained operating and financial performance. The core of our strategy is to use our industry-leading scale to produce high-quality, branded video content and distribute that content on traditional and emerging platforms worldwide, and to manage our businesses and capital resources with a high degree of discipline to provide for ongoing earnings growth and direct returns of capital to our shareholders.

As a result, we grew Adjusted EPS by 18% and Free Cash Flow by 12% in 2014. Our Total Shareholder Return (TSR) for the year was 30%, the highest among all our media peers and double the S&P 500 average. This represents a continuation of our strong performance, with Adjusted EPS growth of at least high teens for the sixth consecutive year and a TSR of 244% over the last five years. We demonstrated our commitment to providing direct returns to our shareholders, with $6.6 billion in share repurchases and dividends in 2014 and a cumulative $26 billion since 2008. In early 2015, we reinforced this commitment by raising our dividend by 10%, the sixth straight year of double-digit increases.

Plans for Future Growth. In addition to delivering strong performance in 2014, we adopted an aggressive plan for Time Warner as a video-focused company. At our investor event on October 15th following the spin-off of Time Inc. and the withdrawal of an unsolicited takeover offer by Twenty-First Century Fox our management team presented specific strategic, operating, and financial goals for the company through 2018, reflecting the long-range plan for 2014-2018 approved by the Board of Directors. While acknowledging the challenges facing the media industry, we also identified key upside opportunities including HBO NOW, a stand-alone HBO streaming service (which launched in April of this year), a global initiative by Turner and Warner Bros. to expand our kids businesses, and an ambitious plan to use DC Comics rich trove of characters and stories across Warner Bros. businesses, including consumer products and videogames.

Next Generation of Management. 2014 was also the first full year with a new senior management team in place at our three operating divisions John Martin at Turner, Richard Plepler at Home Box Office and Kevin Tsujihara at Warner Bros. and a new CFO at Time Warner Howard Averill. Reflecting the deep management strength we have at Time Warner, these executives bring decades of company and industry experience to their new positions. They also exemplify a renewed energy, drive, and natural ability to work together to create shareholder value.

Effective Governance. In the following proxy statement, you can read a great deal more about our Board, strong governance policies and practices, and compensation programs. Our governance policies and practices and compensation programs are based on a few key pillars, including:

- A thoughtful approach to governance, with the overriding goal of having effective structures, policies and practices that serve the best interests of our shareholders over the long-term.
- A strong, independent and informed board, whose members bring a diversity of perspectives, backgrounds, skills and tenure to help oversee a global media company, including experience in the media, technology, and consumer-facing industries, as well as success in building and managing large and successful global enterprises.

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A robust shareholder engagement program, which allows for a constructive dialogue on variety of topics with our shareholders that helps to inform our Board s decisions.

An approach to compensation that is designed to attract and retain a strong management team in a competitive environment, and that provides appropriate incentives to drive exceptional long-term performance.

On behalf of the entire Board of Directors, we want to express our appreciation for your investment in Time Warner. As the company executes the plans we ve shared with you, the Board of Directors and management will continue to look for additional opportunities to drive sustained and superior performance for you, our shareholders.

We look forward to seeing those of you who are planning to attend the Annual Meeting in person. If you are unable to attend the meeting in person, you may listen to the webcast of the Annual Meeting live at *www.timewarner.com/annualmeetingmaterials.*

Sincerely,

Jeffrey L. Bewkes
Chairman of the Board

and Chief Executive Officer

Stephen F. Bollenbach
Lead Independent Director

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NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

Annual Meeting Date: Friday, June 19, 2015

Time: 10:00 a.m. (local time)

Location: Georgia World Congress Center, Georgia Ballroom, Building C, Level 3,

235 Northside Drive, Atlanta, Georgia

(see directions on the last page of the Proxy Statement)

Record Date: Close of business on April 20, 2015

You are cordially invited to attend Time Warner Inc. s 2015 Annual Meeting of Shareholders (the Annual Meeting or the 2015 Annual Meeting).

Meeting Agenda:

1. Elect the 12 directors named in the Proxy Statement;
2. Ratify the appointment of Ernst & Young LLP as the Company s independent auditor for 2015;
3. Hold an annual advisory vote to approve named executive officer compensation;
4. Consider and vote on the shareholder proposals included in the Proxy Statement, if properly presented at the Annual Meeting; and
5. Transact such other business as may properly come before the Annual Meeting.

Who Can Vote at the Annual Meeting: Only holders of Time Warner s common stock as of the record date are entitled to vote on the proposals described above at the Annual Meeting or any adjournments or postponements of the meeting.

Voting: Whether or not you plan to attend the Annual Meeting in person, your vote is important. After reading the Proxy Statement, please promptly submit your proxy or voting instructions by Internet, telephone or mail by following the instructions in your Notice of Internet Availability of Proxy Materials, proxy card or voting instruction form. Any holder of record who is present at the Annual Meeting may vote in person, which will revoke any previously submitted proxy. If your shares are held through a bank or brokerage account and you want to vote in person at the Annual Meeting, you will need to contact your bank or broker to obtain a written legal proxy from the record holder of your shares.

Attending the Annual Meeting: If you are attending the Annual Meeting in person, you can register in advance by calling (855) 883-3141 by 5:00 p.m. EST, Monday, June 15, 2015. A map with directions to the Annual Meeting is provided on the last page of the Proxy Statement. You will be required to present government-issued photo identification (*e.g.*, driver s license or passport) to be admitted to the Annual Meeting. Inspection of packages and bags, among other measures, may be employed to enhance the security of those attending the Annual Meeting. These procedures may require additional time, so please plan accordingly. To avoid disruption, admission may be limited once the Annual Meeting begins. If you are unable to attend the meeting in person, you may listen to the webcast of the Annual Meeting live at *www.timewarner.com/annualmeetingmaterials.*

TIME WARNER INC.

Paul F. Washington

Corporate Secretary

April 24, 2015

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on Friday, June 19, 2015:

This Proxy Statement and the Company s 2014 Annual Report to Shareholders are available electronically at *www.timewarner.com/annualmeetingmaterials*.

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2015 PROXY STATEMENT SUMMARY

This summary highlights information contained in this Proxy Statement. We encourage you to read the entire Proxy Statement carefully before voting.

Matters to Be Voted on at the Annual Meeting

Matter		Board Recommendation	Page Reference For More Information
Proposal 1: Election of Directors Election of 12 directors for a term of one year and until their successors are duly elected and qualified:		**FOR each nominee**	Pages 4 to 15
James L. Barksdale	Jessica P. Einhorn		
William P. Barr	Carlos M. Gutierrez		
Jeffrey L. Bewkes	Fred Hassan		
Stephen F. Bollenbach	Kenneth J. Novack		
Robert C. Clark	Paul D. Wachter		
Mathias Döpfner	Deborah C. Wright		
Proposal 2: Ratification of the appointment of Ernst & Young LLP as independent auditor for 2015		**FOR**	Page 16
Proposal 3: Advisory vote to approve named executive officer compensation		**FOR**	Page 17
Proposal 4: Shareholder proposal on right to act by written consent		**AGAINST**	Pages 18 to 20
Proposal 5: Shareholder proposal on tobacco depictions in films		**AGAINST**	Pages 21 to 23
Proposal 6: Shareholder proposal regarding greenhouse gas emission targets		**AGAINST**	Pages 24 to 26

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Business and Governance

Focused Business Model	With the spin-off of Time Inc. in June 2014 (the Time Separation), Time Warner Inc. (Time Warner or the Company) completed multi-year transition under the leadership of Jeff Bewkes to a global media company focused on high-quality video content with an unmatched collection of television and film businesses ¡ Biggest cable network group (Turner Broadcasting System, Inc. (Turner) and Home Box Office, Inc. (Home Box Office)) ¡ Largest television and feature film studio in the world (Warner Bros. Entertainment Inc. (Warner Bros.)) Also completed transition in senior leadership, with new CEOs assuming responsibility at Turner, Home Box Office and Warner Bros. and a new CFO at Time Warner these executives bring deep industry experience to their new roles, and their appointments reflect the Company s strong succession processes
Clear Operating Strategy	Use leading scale and brands to create the best content Use technology to enhance consumer experience, drive usage and improve Company economics Expand internationally with a focus on faster-growing territories Focus on operating and capital efficiency
Sustained Strong Financial Performance	Increased Adjusted EPS 18% to $4.15, the 6th consecutive year of at least high teens growth Posted Adjusted Operating Income of $5.8 billion in 2014 and grew Adjusted Operating Income at a 6% compound annual growth rate (CAGR) over the

past five years

Grew Free Cash Flow 12% to $3.5 billion

Delivered shareholder returns of 30.0%, 162.5% and 244.3% over the one, three and five-year periods, respectively, in each case at or near the top of the Company s entertainment and media peer group

Compensation Program Closely Aligned with Performance

Compensation program supported strong financial and operating performance by the Company in 2014

- Substantial emphasis on variable performance-based compensation (93% for CEO)
- Mix of performance measures tied to underlying business and stock performance, with focus on long-term sustainable growth
- Challenging financial and strategic goals set at the beginning of each performance period
- Compensation decisions informed by shareholder perspectives

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Donaldson Co., Inc.	$ 100.00	$ 181.43	$ 210.15	$ 275.35	$ 341.93	$ 456.67	$ 504.55	$ 469.91	$ 786.11
S&P 500	100.00	106.50	120.09	135.45	147.27	154.87	195.31	227.67	346.37
S&P Industrial Machinery	100.00	103.72	112.35	131.16	157.35	178.76	244.07	253.61	397.03

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Donaldson Co., Inc.	$ 722.40	$ 976.72	$ 764.63	$ 1,241.46	$ 1,362.95	$ 2,001.35	$ 2,203.27	$ 2,716.05	$ 2,768.89
S&P 500	413.16	496.64	541.21	463.66	354.10	391.79	443.40	505.71	532.93
S&P Industrial Machinery	389.55	526.66	434.40	480.87	483.91	568.26	738.57	800.97	846.76

* $100 invested on 7/31/89 in stock or index including reinvestment of dividends. Fiscal year ending July 31.

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EXECUTIVE COMPENSATION

The following table includes information for each person who was, at the end of fiscal 2006, the Chief Executive Officer or one of the other four most highly compensated executive officers of the Company (the Named Officers) on the basis of total annual salary and bonus for the last completed fiscal year. The table includes compensation information for each of the last three fiscal years.

Summary Compensation Table

				Long Term Compensation			
		Annual Compensation (1)		Awards		Payouts	
Name and Principal Position	**Fiscal Year**	**Salary ($)**	**Bonus ($)**	**Restricted Stock**	**Securities Underlying**	**LTIP Payouts**	**All Other Compensation**

				Long Term Compensation			
				Award(s) ($) (2)	Options (#) (3)	($) (4)	($) (5)
William M. Cook	2006	593,270	1,000,000	0	53,000	692,925	63,941
Chairman, Chief Executive	2005	525,135	586,520	0	75,514	522,132	44,700
Officer and President	2004	302,596	233,750	0	113,416	507,238	23,480
James R. Giertz (6)	2006	314,059	325,080	0	20,000	397,967	22,224
Former Senior	2005	304,192	203,834	0	21,500	222,152	22,025
Vice President, Commercial and Industrial	2004	295,020	192,676	400,350	38,000	158,760	16,826
Lowell F. Schwab	2006	314,059	324,467	0	20,000	548,657	16,074
Senior Vice President,	2005	300,385	240,979	0	83,603	431,961	22,569
Engine Systems and Parts	2004	286,039	220,806	0	96,148	305,760	19,039
Thomas R. VerHage (7)	2006	295,820	283,746	0	9,000	0	28,149
Vice President and Chief	2005	273,077	213,498	0	9,000	0	17,914
Financial Officer	2004	95,192	62,816	507,690	25,000	0	3,503
Geert Henk Touw	2006	254,905	207,467	0	16,000	457,523	16,781
Senior Vice President,	2005	236,500	151,000	0	18,000	343,966	15,197
Asia Pacific	2004	220,039	134,168	0	15,000	393,680	12,695

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(1) Includes any portion of salary and bonus deferred under the Deferred Compensation and 401(k) Excess Plan.

(2) Amounts in the Restricted Stock Award column represent the dollar value on the grant date of grants of restricted stock under the Company s 2001 Master Stock Incentive Plan. Regular dividends are paid on the restricted shares. At the end of fiscal 2006, the number and value of the aggregate restricted stock holdings for the Named Officers that vest in less than three years were: Cook, 0 shares, $0; Giertz, 15,000 shares, $488,550; Schwab, 0 shares, $0; VerHage, 18,000 shares, $586,260; and Touw, 0 shares, $0. Giertz surrendered 50,000 shares of restricted stock in 2001 and received 49,275 deferred restricted share units. The balance of Giertz s deferred restricted share units at the end of fiscal 2006, including dividend equivalent rights earned, was 51,439 shares valued at $1,675,360. Cook surrendered 25,000 shares of restricted stock in 2005 and received 24,638 deferred restricted share units. The balance of Cook s deferred restricted share units at the end of fiscal 2006, including dividend equivalent rights earned, was 24,883 shares valued at $810,437. One additional restricted stock award of 3,000 shares was made in fiscal 2006 to Sandra Joppa, and is subject to a five-year vesting schedule.

(3) The stock option grants include new fiscal 2006 annual grants. No reload grants resulting from the exercise in fiscal 2006 of option awards granted in prior years were awarded in fiscal 2006.

(4) Earned under the Company s 2001 Master Stock Incentive Plan during the three-year period ending in the fiscal year in which the payout is listed. Payout is made in the form of the Company s Common Stock and delivered or deferred into the Company s Deferred Compensation and 401(k) Excess Plan during the following fiscal year.

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(5) Amounts in this column represent the dollar value of share allocations (i) under the Company s match for bonus and salary under the Company s ESOP and 401(k) benefit plans; and (ii) under the Company s match (both the fixed match and the discretionary variable match) for deferred bonus and salary and salary in excess of the limits established by Section 415 of the Internal Revenue Code contributed by the Company to an unqualified supplemental plan; and (iii) also includes amounts for the dollar value of the interest accrued that is above the market interest rates determined under SEC rules for compensation deferred under the Company s Deferred Compensation and 401(k) Excess Plan. The interest rate for the Company s deferred compensation plans is set by the Human Resources Committee at the ten-year Treasury Bond rate plus 2%.

Name	Salary and Bonus Match	Deferred Salary and Bonus Match	Excess Match	Discretionary Match	Above Market Interest
William M. Cook	$ 7,712	$ 11,730	$ 26,661	$ 4,633	$ 13,205
James R. Giertz	8,642	0	12,073	1,509	0
Lowell F. Schwab	8,800	441	5,212	1,594	27
Thomas R. VerHage	2,914	16,770	0	2,155	6,310
Geert Henk Touw	8,279	0	7,557	945	0

(6) James Giertz resigned as an officer of the Company effective September 15, 2006, resulting in the forfeiture of the 15,000 shares of restricted stock granted in fiscal 2004.

(7) Thomas VerHage was appointed as an officer of the Company effective March 1, 2004.

Option Grants in Last Fiscal Year

Name	Individual Grants (1)				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (3)	
	Number of Securities Underlying Options/SARs	% of Total Options/SARs Granted to Employees in Fiscal	Exercise Price ($/sh)	Expiration Date	5% ($)	10% ($)

	Granted	Year				
William M. Cook	53,000 (2)	~~15.5~~	32.80		1,093,270	2,770,562
James R. Giertz	~~20,000~~	5.9	32.80	12/16/15	412,555	1,045,495
Lowell F. Schwab	20,000	5.9	32.80	12/16/15	412,555	1,045,495
Thomas R. VerHage	9,000	2.6	32.80	12/16/15	185,650	470,473
Geert Henk Touw	16,000	4.7	32.80	12/16/15	330,044	836,396

(1) No stock appreciation rights (SARs) have been granted. Total shares used to calculate the total options percentages do not include options to purchase 57,600 shares of Common Stock granted to the Company s non-employee directors.

(2) All officer grants (other than the option granted to Sandra Joppa noted in the following sentence) during the period were non-qualified stock options granted at the market value on date of grant for a term of ten years, vesting immediately and were granted with the right to use shares in lieu of cash to pay the exercise price and to satisfy any tax withholding obligations. Ms. Joppa received an option grant of 10,000 shares on November 1, 2005, that is the same in its terms as the officer grants described above, except that it vests in equal annual one-third increments starting on November 1, 2006.

(3) These amounts represent certain assumed rates of appreciation over the full term of the option. The value ultimately realized, if any, will depend on the amount by which the market price of the Company s Common Stock exceeds the exercise price on date of sale.

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

Name	Shares Acquired on Exercise (#) (1) (2)	Value Realized ($)	Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($)(3)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
William M. Cook	22,014	30,379	555,706	0	7,393,430	0
James R. Giertz	51,488	1,076,872	269,350	0	3,258,937	0
Lowell F. Schwab	39,360	645,110	232,615	0	812,731	0
Thomas R. VerHage	0	0	34,667	8,333	89,671	36,374
Geert Henk Touw	0	0	49,000	0	66,690	0

(1) The number of shares shown in this column is larger than the number of shares actually acquired on exercise. The actual number of shares received is reduced by the number of shares delivered in payment of the exercise price and shares withheld to cover withholding taxes.

(2) No SARs were exercised in fiscal 2006.

(3) This value is based on the difference between the exercise price of such options and the closing price of Company Common Stock as of fiscal year-end 2006.

LONG-TERM INCENTIVE PLANS AWARDS IN LAST FISCAL YEAR

Name	Number of Shares, Units or Other Rights (#)(1)	Performance or Other Period Until Maturation or Payout	Estimated Future Payouts Under Non-Stock Price-Based Plan Threshold (#)	Target (#)	Maximum (#)
William M. Cook	14,800	8/1/05 7/31/08	3,700	14,800	40,700
James R. Giertz	6,200	8/1/05 7/31/08	1,550	6,200	17,050
Lowell F. Schwab	6,200	8/1/05 7/31/08	1,550	6,200	17,050
Thomas R. VerHage	5,800	8/1/05 7/31/08	1,450	5,800	15,950
Geert Henk Touw	4,200	8/1/05 7/31/08	1,050	4,200	11,550

(1) Awards are of performance shares of the Company s Common Stock. Awards are earned only if the Company achieves the minimum performance objectives and the award value will be based on a weighting of compound corporate net sales growth and after-tax return on investment over the three year-period. The amounts shown in the table under the headings Threshold, Target and Maximum are amounts awarded at 25%, 100% and 275% of the targeted award. The award will also be adjusted upward by 25% if earnings per share increase in each of the three years in the period by at least 5%.

HUMAN RESOURCES COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The Human Resources Committee of the Board of Directors, consisting of four independent, non-employee directors (the Committee), is responsible for establishing the compensation programs for the Company s key executives. The Company s executive compensation program comprises base salary, annual incentive and long term incentive compensation. The objectives of the Company s executive compensation program are to:

- emphasize a pay-for-performance philosophy by placing significant portions of pay at risk and requiring outstanding results for payment at the threshold level;
- attract, reward and retain the best executives available in our industry taking into consideration all aspects of performance and ethical leadership, with their compensation levels keyed to a peer group of companies;
- motivate and reward executives responsible for attaining the financial and strategic objectives essential to the Company s long-term success focusing on earnings per share growth and continued growth in stockholder value; and

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align the interests of executives with those of the Company s stockholders by providing a significant portion of compensation in the form of Company Common Stock. Common Stock ownership objectives have been established for all executive officers at a high level, ranging from five times base salary for Vice Presidents, seven times base salary for Senior Vice Presidents and ten times base salary for the Chief Executive Officer.

Base Salaries. Base salaries for all executives are reviewed annually based on performance and market conditions. A performance appraisal taking into consideration predetermined performance objectives is required for all executives of the Company. The Committee approves and/or determines the annual base salary increases for all senior executive officers based on performance of the executive and external market data. The Company s objective is that base salaries should approximate the mid-point (average) of senior executives of manufacturing companies of similar size in the United States. The Company uses surveys by national consultants for external market data. Executives are eligible to defer up to 75% of their base compensation under the Company s Deferred Compensation and 401(k) Excess Plan.

Annual Cash Incentive. Executive officers are eligible for target awards under the annual cash incentive plan that range from 40% to 80% of base salary. The size of the target award is determined by the executive officer s position and competitive data for similar positions within the peer group and cross-industry companies as presented in the same nationally recognized surveys as are used for the base salary. The Company sets performance goals in keeping with the strong performance-based philosophy, the resulting awards increase or decrease substantially if actual Company performance exceeds or fails to meet targeted levels. Payments can range from 0% to 200% of the target award amounts. Executive officers annual cash incentive opportunity is linked to achieving record earnings per share and to achieving sales, profits and return on investment targets for the Company and for their respective business units. Executives are eligible to defer up to 100% of their incentive compensation under the Company s Deferred Compensation and 401(k) Excess Plan.

Long Term Incentive Stock Compensation Awards and Stock Option Grants. There were payouts under the Long Term Compensation Plan in 2006, 2005 and 2004 as shown in the summary compensation table on page 16 because the Company achieved the performance objectives for three-year compounded growth in net sales and after-tax return on investment. The variance in the Long Term Compensation Plan award payouts are consistent with the at risk and pay for performance compensation philosophy. The Long Term Compensation Plan Award targets are based on three-year compounded growth in net sales and an after-tax return on investment that exceeds the Company s weighted average cost of capital. Under this program, the Committee annually selects and approves eligible executives and establishes incentive opportunities as a percentage of base salary. In order for a participant to receive a payout, threshold performance must be achieved.

The Committee also occasionally grants restricted stock with a fixed restriction period, usually three to five years, to ensure retention of key executives. The Committee also believes that stock option grants encourage the key executives to own and hold Donaldson stock and tie their long-term economic interests directly to those of the stockholders. Stock options are typically granted annually. In determining the number of shares covered by such options, the Committee takes into account position level, base salary, and other factors relevant to individual performance.

Target awards for the incentive compensation are designed based on financial performance in the 60^{th} to 65^{th} percentile of the peer group. Executives are eligible to make elections in advance to defer up to 100% of their long term incentive stock compensation awards, stock option grants upon exercise and restricted stock awards upon vesting under the Company s Deferred Compensation and 401(k) Excess Plan and the Deferred Stock Option Gain Plan.

Stock Option Bonus Replacement Program. To encourage stock ownership by executives, the Company allows executives to elect in advance to receive stock options under the 2001 Master Stock Incentive Plan in lieu of a portion of all of the cash compensation earned under the Officer Annual Cash Incentive Plan. Currently under the program, participants receive an option to acquire $4 of stock at market value for every $1 of compensation exchanged. In fiscal 2006, no executives participated in the program.

Stock Ownership. Ownership of Donaldson stock is expected of Donaldson executives. The Committee believes that linking a significant portion of the executive s current and potential net worth to the Company s

success, as reflected in the stock price, gives the executive a stake similar to the stockholders. The Committee has established stock ownership guidelines for the Named Officers and certain other executive officers, which encourage retention of shares. The guidelines range from five to ten times base salary and, in addition, require officers to retain one-quarter of the net shares acquired in excess of their initial target. The goal of the Chief Executive Officer is ten times annual base salary. Mr. Cook exceeded this ownership goal in fiscal 2006.

Compensation of the Chief Executive Officer. Mr. Cook s fiscal 2006 base salary and incentive award opportunity were determined by the Committee in accordance with the evaluation process and the methodology described above. The Committee considered Mr. Cook s performance against pre-established objectives and met both in private and with Mr. Cook in completing his performance appraisal and setting his compensation and objectives.

Base Salary. Mr. Cook s base salary earnings for fiscal 2006 were $593,270, which is at the lower end of the range of the market mid-point for manufacturing companies of similar size. Mr. Cook s base salary was increased by the Committee following its annual performance evaluation to $625,000 effective January 1, 2006.

Annual Incentive. Mr. Cook s incentive award for fiscal 2006 was $1,000,000. This annual incentive was earned under the annual cash incentive plan based on the Company achieving performance objectives for earning per share growth over the previous record earned in fiscal 2005.

Stock Options. Mr. Cook received an annual stock option grant in December 2005 to purchase 53,000 shares of stock.

Long Term Compensation Plan Payout. Mr. Cook received a payout of 18,770 shares of stock under the Long Term Compensation Plan in 2006 based on the Company s achieving the performance objectives for three-year compounded growth in net sales and after-tax return on investment.

Policy on Qualifying Compensation. The Company s policy is to preserve the tax deduction for compensation paid to its Chief Executive Officer and other senior executive officers. In accordance with this policy, in November 2005, the stockholders approved the Company s Qualified Performance-Based Compensation Plan established under the 2001 Master Stock Incentive Plan. The Committee approves the performance goals for payment of the cash incentive and share awards under The Long Term Compensation Plan annually. The 1991 Master Stock Compensation Plan, now expired, and the 2001 Master Stock Incentive Plan were approved by stockholders in 1991 and 2001, respectively, and limit the number of shares that can be granted in any one year to any one individual to further the policy of preserving the tax deduction for compensation paid to executives. The Company s policy is to preserve the tax deductibility of such performance-based compensation.

Conclusion. The executive officer compensation program administered by the Committee provides incentives to attain strong financial performance and to ensure alignment with stockholder interests. The Committee believes that the Company s total executive compensation program focuses the efforts of Company executives on the continued achievement of growth and profitability for the long-term and for the benefit of the Company s stockholders.

Members of the Human Resources Committee
Jeffrey Noddle, Chair
F. Guillaume Bastiaens
Jack W. Eugster
John F. Grundhofer

PENSION BENEFITS

The Company maintains the Donaldson Company, Inc. Salaried Employees Pension Plan (the Retirement Plan), a defined benefit pension plan that provides retirement benefits to eligible employees through a cash balance plan structure. The Company also maintains the Donaldson Company, Inc. Excess Retirement Plan (the Excess Retirement Plan). The Excess Retirement Plan is an unfunded, non-qualified deferred compensation arrangement that primarily provides retirement benefits that cannot be paid under the Retirement Plan because of the limitations imposed by the Internal Revenue Code on qualified plans in regards to compensation and benefits.

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Participants in the Retirement Plan and Excess Retirement Plan accumulate benefits in a hypothetical account balance through interest credits, and company credits that vary with age, service and pay. At retirement or termination of employment, the vested account balance is payable to the participant in the form of an immediate or deferred lump sum, or an actuarially equivalent annuity.

Under the cash balance benefit structure, account balances receive an interest credit annually. The interest credit is defined as the current plan year s interest crediting rate times the account balance as of the beginning of the plan year. The interest crediting rate for a particular plan year is the greater of the yield on one-year U.S. Treasury Constant Maturities during the month of June preceding the plan year, plus one percent, and 4.83%. The interest crediting rate is 6.16% for the 2006 plan year.

Company credits are credited to the account balances at the end of each plan year. The participant s Company Credit Percentages are based on the participant s years of age and service with the Company and its affiliates as of the end of each plan year. As of August 1, 2006, the sum of years of age plus service for Messrs. Cook, Giertz, Schwab, VerHage and Touw were 78, 61, 83, 55 and 80, respectively. The participant s Base Company Credit is equal to the Base Company Credit Percentage times total covered compensation during the plan year (Pensionable Earnings). The participant s Excess Company Credit is equal to the Excess Company Credit Percentage times Pensionable Earnings in excess of the Social Security taxable wage base. The following table displays the Company Credit Percentages for the sum of years of age and service shown:

	Company Credit Percentages	
Sum of Years of Age Plus Service	**Base**	**Excess**
Less than 40	3.0%	3.0%

	Company Credit Percentages	
40 49	4.0	4.0
50 59	5.0	5.0
60 69	6.5	5.0
70 or more	8.5	5.0

Special Career Credits are credited at the end of the plan year to the account balances of participants who were born prior to August 1, 1957 and continuously employed since August 1, 1992. The Special Career Credits are equal to 3.0% of the participant s Pensionable Earnings and will continue through the end of the 2006 plan year, or if earlier, through the plan year in which the participant attains 35 years of benefit service. Messrs. Cook, Schwab and Touw are all currently eligible to receive Special Career Credits.

The individuals named in the Summary Compensation Table are also eligible for retirement benefits under the Donaldson Company, Inc. Supplemental Executive Retirement Plan (the SERP). The SERP assures participants a lump sum retirement benefit from all company funded retirement programs equal to six times their average compensation (three highest consecutive years) upon reaching age 62 with 20 years of service. This target benefit is reduced by 2% for each year the participant s retirement precedes age 62, and it is also reduced on a prorated basis for less than 20 years of service. In determining whether the SERP must supplement the other company funded retirement programs, the Company will consider the lump sum benefits described in the previous paragraph and footnote (5) to the Summary Compensation Table, as well as, any vested pension benefits available from prior employers, if any.

The projections below set forth the estimated annual benefit payable to each of the individuals named in the Summary Compensation Table as a single life annuity, beginning at age 65, under the Retirement, Excess Retirement and SERP Plans: Mr. Cook, $427,893; Mr. Giertz, $246,424; Mr. Schwab, $183,735; Mr. VerHage, $124,796; and Mr. Touw, $113,542. Mr. VerHage is the only participant who is expected to receive a benefit from the SERP Plan. These projections are based on the following assumptions: (1) employment until age 65; (2) base pay plus target bonus with no future increase in pensionable earnings; (3) interest credits at the actual rate of 6.16% during the 2006 plan year, and thereafter; and (4) conversion to a single life annuity at normal retirement age based on a discount rate of 6.00% and the Unisex 1994 Group Annuity Mortality Table.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s directors and executive officers to file initial reports of ownership and reports of changes in ownership with the SEC and the NYSE. To the Company s knowledge, based on a review of copies of such forms and representations furnished to the Company during fiscal 2006, all Section 16(a) filing requirements applicable to the Company s directors and executive officers were satisfied, except that one Form 4 reporting a company matching contribution of two shares into one reporting person s employee benefit account was filed late.

CHANGE-IN-CONTROL ARRANGEMENTS

Each of the Named Officers has a severance agreement with the Company designed to retain the executive and provide for continuity of management in the event of an actual or threatened change of control in the Company (as defined in the agreements). The agreements provide that in the event of a change of control, each key employee would have specific rights and receive certain benefits if, within three years after a change in control, the employee is terminated without cause or the employee terminates voluntarily under constructive involuntary circumstances as defined in the agreement. In such circumstance the employee will receive a severance payment equal to three times the employee s annual average compensation calculated over the five years preceding such termination as well as continued health, disability and life insurance for three years after termination. The awards issued under the stock compensation plans, the supplementary retirement benefit plan and the deferred compensation plan also provide for immediate vesting or payment in the event of termination under circumstances of a change in control.

By Order of the Board of Directors

Norman C. Linnell
Secretary

October 9, 2006

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APPENDIX A

DONALDSON COMPANY, INC.
AUDIT COMMITTEE CHARTER

Mission Statement

The Audit Committee will assist the Board of Directors in fulfilling its oversight of (1) the integrity of the Company s financial statements, (2) the Company s compliance with legal and regulatory requirements, (3) the independent auditor s qualifications and independence, and (4) the performance of the Company s internal audit function and independent auditors; and will prepare the report that SEC rules require be included in the Company s annual proxy statement. The Committee also will carry out its duties and responsibilities to retain and terminate the Company s independent auditors and to conduct an annual performance evaluation of the Audit Committee.

While the Audit Committee has the oversight responsibilities and powers set forth in this charter, the Committee does not itself prepare financial statements or perform audits, and its members are not auditors or certifiers of the Company s financial statements. This is the responsibility of management and the Company s independent auditor.

Organization

The Committee will be organized consistent with the following significant parameters:

Size of the committee: The Committee will have no less than three members.

Qualifications: Committee members must be Non-employee Directors who meet the independence and experience requirements of the Securities and Exchange Commission, the New York Stock Exchange and applicable law.

Frequency of Meetings: The Committee will have no less than four regularly scheduled meetings each fiscal year. In addition, the Committee will meet at other times if deemed necessary to discharge completely its duties and responsibilities as outlined in this charter.

Appointment of Members and Chairperson: Each Committee member and the Chairperson will be recommended by the Corporate Governance Committee and shall be elected by vote of the Board of Directors to serve a term of one year. Committee members and the Chairperson may serve successive one-year terms without limitation.

Oversight

Internal Controls and Disclosure Controls:

1. Review the appointment, performance and replacement of the senior internal audit executive.
2. Review the internal auditor s reports and findings on internal audit activities and the major issues as to the adequacy of the Company s internal controls.
3. Review the Company s disclosure controls and procedures for its filings with the Securities and Exchange Commission.

Financial Reporting:

1. Review the Company s policies with respect to risk assessment and risk management.
2. Review major issues regarding accounting principles and financial statement presentations, including any significant change in the Company s selection or application of accounting principles.
3. Review analyses prepared by management and/or the independent auditor setting forth the Company s critical accounting policies and estimates, and significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements.

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4. Review the effect on the financial statements of regulatory and accounting initiatives and off-balance sheet structures.

5. Review the annual financial statements, including the Company s disclosures under Management s Discussion and Analysis of Financial Condition and Results of Operations, with management and the independent auditors prior to the filing or release of such financial statements, including confirmation that the Committee (i) discussed with the external auditors the matters requiring discussion by Statement on Auditing Standards No. 61, and (ii) received the written report from the external auditors required by Independence Standards Board Statement No. 1. Based on these reviews and discussions, recommend to the Board of Directors that the audited financial statements be included in the Annual Report on Form 10-K filed with the SEC.

6. Review and approve the process for reviewing and discussing with management and the independent auditors the quarterly financial statements, including the Company s disclosures under Management s Discussion and Analysis of Financial Condition and Results of Operations, either through the Committee as a whole or through the Chairperson.

Compliance with Laws, Regulations and Company Policies:

1. Review the Company s compliance system (including, but not limited to, a code of ethics for senior financial officers).

2. Review the Committee s charter on an annual basis and recommend any proposed changes to the Board of Directors for approval.

3. Affirmatively determine that the Committee members are independent as required by the Qualifications section of this charter.

Relationship with Independent Auditor:

1. The Committee has the ultimate authority and responsibility to select and evaluate the independent auditor, approve all audit engagement terms and fees to be paid to such firm, and terminate such firm when circumstances warrant, and the independent auditor shall be accountable to and report to the Committee.

2. Evaluate the independent auditor s qualifications, performance and independence on an ongoing basis, but no less frequently than once per year.

3. Review and approve the scope of the external audit to be performed each fiscal year.

4. Set policies and procedures for, and, as appropriate, approve the engagement of, the independent auditor for any non-audit service (to the extent such service is not prohibited) and the fee for such service, and consider whether the independent auditor s performance of any non-audit services is compatible with its independence.

5. Review with the independent auditor any audit problems or difficulties the independent auditor may have encountered in the course of the audit work and any management letter provided by the independent auditor, and management s response (including any restrictions on the scope of the independent auditor s activities or on access to requested information and any significant disagreements with management).

6. At least annually, obtain and review a report by the independent auditor describing:

    the independent auditor s internal quality-control procedures;

    any material issues raised by the most recent internal quality-control review, or peer review, of the independent auditor s firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with such issues; and (to assess the auditor s independence)

all relationships between the independent auditor and the Company.

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Other Responsibilities:

1. Set clear hiring policies for employees or former employees of the independent auditor.
2. Review procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal controls or auditing matters, and the confidential, anonymous submissions by employees of concerns regarding questionable accounting or auditing matters.
3. Meet separately, periodically, with management, with internal auditors and with the independent auditor in executive sessions.
4. Discuss generally with management earnings press releases and financial information and earnings guidance provided through public disclosures under the New York Stock Exchange requirements and applicable law.
5. Prepare the Committee report for inclusion in the Company s annual proxy statement.
6. Conduct an annual performance evaluation of the Committee.
7. As appropriate, obtain advice and assistance from outside legal, accounting or other advisors. In this regard, the Committee will have authority to:

    conduct or authorize investigations into any matters within its scope of responsibilities;

    engage outside auditors for special audits, reviews and other procedures;

    retain special counsel and other experts and consultants to advise the Committee and meet with any representative of the Company; and

    approve the fees and other retention terms for such parties.
8. Report regularly to the full Board of Directors regarding the significant items of discussion at each Committee meeting.

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Donaldson Company, Inc. Annual Meeting of Stockholders
Friday, November 17, 2006, at 1:00 p.m.
Held at the Corporate Offices of
Donaldson Company, Inc.
1400 West 94th Street
Minneapolis, Minnesota

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DONALDSON COMPANY, INC.

ANNUAL MEETING OF STOCKHOLDERS

November 17, 2006

1:00 p.m., Central Time

Donaldson Company, Inc.

1400 West 94th Street

Minneapolis, Minnesota

Your telephone or Internet vote authorizes the Named Proxies to vote your shares

in the same manner as if you marked, signed and returned your proxy card.

Donaldson Company, Inc.

Proxy

The undersigned appoints WILLIAM M. COOK, NORMAN C. LINNELL and AMY C. BECKER, and each of them, as Proxies, each with the power to appoint a substitute, to represent and vote, as designated on the reverse side, all shares of the undersigned at the 2006 Annual Meeting of Stockholders of Donaldson Company, Inc. at Donaldson Company, Inc., 1400 West 94th Street, Minneapolis, Minnesota, at 1:00 p.m., Central Time, on Friday, November 17, 2006, and at any adjournment thereof.

In their discretion, the Proxies are authorized to vote upon such other business as may properly come before the Meeting or any adjournment thereof.

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED AS DIRECTED OR, IF NO DIRECTION IS GIVEN, WILL BE VOTED FOR EACH PROPOSAL. THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS, DONALDSON COMPANY, INC.

Address Changes/Comments: ____

____

(If you noted any Address Changes/Comments above, please mark corresponding box on the reverse side.)

(Continued, and to be signed and dated on other side)

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P.O. BOX 1299

MINNEAPOLIS, MN 55440-1299

PLEASE VOTE PROMPTLY

If you vote by Phone or Internet, please do not mail your Proxy Card

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. (Central time) on November 16, 2006. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS

If you would like to reduce the costs incurred by Donaldson Company, Inc. in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access shareholder communications electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. (Central time) on November 16, 2006. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Donaldson Company, Inc., c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: DONCO1 KEEP THIS PORTION FOR YOUR RECORDS

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED. DETACH AND RETURN THIS PORTION ONLY

DONALDSON COMPANY, INC.

The Board of Directors recommends votes FOR:

To withhold authority to vote for any individual nominee(s), mark For All Except and write the name(s) of the nominee(s) on the line below.

Vote on Directors	**For All**	**Withhold All**	**For All Except**
1. Election of directors: 01 **Jack W. Eugster**			
02 **John F. Grundhofer**			
03 **Paul David Miller**	o	o	o

Vote on Proposal	**For**	**Against**	**Abstain**
2. Ratify appointment of PricewaterhouseCoopers LLP as Donaldson Company, Inc s independent registered accounting firm.	o	o	o

PLEASE DATE AND SIGN BELOW exactly as name appears, indicating, if appropriate, official position or representative capacity. If stock is held in joint tenancy, each joint owner should sign.

For address changes and/or comments, please check this box and write them on the back where indicated. o

Please indicate if you plan to attend this meeting. o o

Yes **No**

Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date