

TORO CO
Form 10-Q
September 01, 2011
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended July 29, 2011

THE TORO COMPANY

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

1-8649
(Commission File Number)

41-0580470
(I.R.S. Employer Identification Number)

8111 Lyndale Avenue South
Bloomington, Minnesota 55420
Telephone number: (952) 888-8801

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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

Edgar Filing: TORO CO - Form 10-Q

to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐
(Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares of Common Stock outstanding as of August 26, 2011 was 30,662,565.

Table of Contents

THE TORO COMPANY

INDEX TO FORM 10-Q

	Page Number
<u>PART I.</u>	
<u>FINANCIAL INFORMATION:</u>	
<u>Item 1.</u>	
Financial Statements (Unaudited)	
Condensed Consolidated Statements of Earnings Three and Nine Months Ended July 29, 2011 and July 30, 2010	3
Condensed Consolidated Balance Sheets July 29, 2011, July 30, 2010, and October 31, 2010	4
Condensed Consolidated Statements of Cash Flows Nine Months Ended July 29, 2011 and July 30, 2010	5
Notes to Condensed Consolidated Financial Statements	6-15
<u>Item 2.</u>	
Management's Discussion and Analysis of Financial Condition and Results of Operations	16-25
<u>Item 3.</u>	
Quantitative and Qualitative Disclosures about Market Risk	25-26
<u>Item 4.</u>	
Controls and Procedures	27
<u>PART II.</u>	
<u>OTHER INFORMATION:</u>	
<u>Item 1.</u>	
Legal Proceedings	27
<u>Item 1A.</u>	
Risk Factors	27
<u>Item 2.</u>	
Unregistered Sales of Equity Securities and Use of Proceeds	28
<u>Item 6.</u>	
Exhibits	28-29
Signatures	30

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****THE TORO COMPANY AND SUBSIDIARIES****Condensed Consolidated Statements of Earnings (Unaudited)****(Dollars and shares in thousands, except per share data)**

	Three Months Ended		Nine Months Ended	
	July 29, 2011	July 30, 2010	July 29, 2011	July 30, 2010
Net sales	\$ 501,045	\$ 458,890	\$ 1,515,858	\$ 1,353,067
Cost of sales	333,384	297,257	997,998	887,631
Gross profit	167,661	161,633	517,860	465,436
Selling, general, and administrative expense	112,937	107,824	342,580	319,712
Operating earnings	54,724	53,809	175,280	145,724
Interest expense	(4,294)	(4,243)	(12,596)	(12,759)
Other income, net	1,861	2,399	4,560	4,205
Earnings before income taxes	52,291	51,965	167,244	137,170
Provision for income taxes	17,200	18,551	54,621	47,177
Net earnings	\$ 35,091	\$ 33,414	\$ 112,623	\$ 89,993
Basic net earnings per share of common stock	\$ 1.13	\$ 1.03	\$ 3.58	\$ 2.69
Diluted net earnings per share of common stock	\$ 1.11	\$ 1.01	\$ 3.51	\$ 2.66
Weighted-average number of shares of common stock outstanding Basic	31,176	32,464	31,491	33,400
Weighted-average number of shares of common stock outstanding Diluted	31,739	32,972	32,062	33,819

See accompanying notes to condensed consolidated financial statements.

Table of Contents**THE TORO COMPANY AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (Unaudited)**

(Dollars in thousands)

	July 29, 2011	July 30, 2010	October 31, 2010
ASSETS			
Cash and cash equivalents	\$ 118,113	\$ 163,379	\$ 177,366
Receivables, net	199,012	170,096	142,901
Inventories, net	232,362	177,195	194,402
Prepaid expenses and other current assets	20,256	12,302	10,766
Deferred income taxes	59,908	56,847	59,538
Total current assets	629,651	579,819	584,973
Property, plant, and equipment	642,642	576,645	594,070
Less accumulated depreciation	454,994	408,642	420,663
	187,648	168,003	173,407
Deferred income taxes	965	3,679	842
Other assets	20,424	18,001	17,038
Goodwill	92,046	86,484	86,400
Other intangible assets, net	36,813	23,666	22,962
Total assets	\$ 967,547	\$ 879,652	\$ 885,622
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current portion of long-term debt	\$ 2,728	\$ 3,205	\$ 1,970
Short-term debt	53	737	1,034
Accounts payable	126,688	118,009	125,138
Accrued liabilities	268,200	243,743	240,141
Total current liabilities	397,669	365,694	368,283
Long-term debt, less current portion	225,162	224,313	223,578
Deferred revenue	10,776	10,332	10,944
Other long-term liabilities	7,560	7,680	7,007
Stockholders' equity:			
Preferred stock, par value \$1.00 per share, authorized 1,000,000 voting and 850,000 non-voting shares, none issued and outstanding			
Common stock, par value \$1.00 per share, authorized 100,000,000 shares, issued and outstanding 30,641,707 shares as of July 29, 2011, 31,310,103 shares as of July 30, 2010, and 31,394,942 shares as of October 31, 2010	30,642	31,310	31,395
Retained earnings	297,590	251,812	253,477
Accumulated other comprehensive loss	(1,852)	(11,489)	(9,062)
Total stockholders' equity	326,380	271,633	275,810
Total liabilities and stockholders' equity	\$ 967,547	\$ 879,652	\$ 885,622

See accompanying notes to condensed consolidated financial statements.

Table of Contents**THE TORO COMPANY AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows (Unaudited)****(Dollars in thousands)**

	Nine Months Ended	
	July 29, 2011	July 30, 2010
Cash flows from operating activities:		
Net earnings	\$ 112,623	\$ 89,993
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Equity income from affiliates	(4,433)	(1,760)
Depreciation, amortization, and impairment losses	34,251	32,454
Gain on disposal of property, plant, and equipment	(22)	(107)
Stock-based compensation expense	6,094	5,370
(Increase) decrease in deferred income taxes	(930)	460
Changes in operating assets and liabilities, net of effect of acquisitions:		
Receivables, net	(53,335)	(33,918)
Inventories, net	(33,975)	(398)
Prepaid expenses and other assets	(8,994)	1,259
Accounts payable, accrued liabilities, deferred revenue, and other long-term liabilities	21,190	64,042
Net cash provided by operating activities	72,469	157,395
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(43,269)	(32,689)
Proceeds from asset disposals	109	312
Distributions from (investments in) finance affiliate, net	959	(5,354)
(Increase) decrease in other assets	(631)	464
Acquisitions, net of cash acquired	(14,060)	(3,572)
Net cash used for investing activities	(56,892)	(40,839)
Cash flows from financing activities:		
Decrease in short-term debt	(776)	
Repayments of long-term debt, net of costs	(1,134)	(1,690)
Excess tax benefits from stock-based awards	2,444	3,093
Proceeds from exercise of stock options	12,309	13,318
Purchases of Toro common stock	(71,216)	(135,269)
Dividends paid on Toro common stock	(18,894)	(17,997)
Net cash used for financing activities	(77,267)	(138,545)
Effect of exchange rates changes on cash	2,437	(2,405)
Net decrease in cash and cash equivalents	(59,253)	(24,394)
Cash and cash equivalents as of the beginning of the fiscal period	177,366	187,773
Cash and cash equivalents as of the end of the fiscal period	\$ 118,113	\$ 163,379
Long-term debt issued in connection with acquisitions	\$ 3,515	\$ 440

See accompanying notes to condensed consolidated financial statements.

Table of Contents

THE TORO COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

July 29, 2011

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all the information and notes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. Unless the context indicates otherwise, the terms company and Toro refer to The Toro Company and its consolidated subsidiaries. In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting primarily of recurring accruals, considered necessary for a fair presentation of the financial position and results of operations. Since the company's business is seasonal, operating results for the nine months ended July 29, 2011 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2011. Additional factors that could cause the company's actual results to differ materially from its expected results, including any forward-looking statements made in this report, are described in the company's most recently filed Annual Report on Form 10-K (Item 1A. Risk Factors) and later in this report under Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Information.

The company's fiscal year ends on October 31, and quarterly results are reported based on three month periods that generally end on the Friday closest to the quarter end. For comparative purposes, however, the company's second and third quarters always include exactly 13 weeks of results so that the quarter end date for these two quarters is not necessarily the Friday closest to the quarter end.

For further information, refer to the consolidated financial statements and notes included in the company's Annual Report on Form 10-K for the fiscal year ended October 31, 2010. The policies described in that report are used for preparing quarterly reports.

Accounting Policies

In preparing the consolidated financial statements in conformity with U.S. GAAP, management must make decisions that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures, including disclosures of contingent assets and liabilities. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. Estimates are used in determining, among other items, sales promotions and incentives accruals, inventory valuation, warranty reserves, earnout liabilities, allowance for doubtful accounts, pension and postretirement accruals, self-insurance accruals, useful lives for tangible and intangible assets, and future cash flows associated with impairment testing for goodwill and other long-lived assets. These estimates and assumptions are based on management's best estimates and judgments. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances, including the current economic environment. Management adjusts such estimates and assumptions when facts and circumstances dictate. A number of these factors are discussed in the company's Annual Report on Form 10-K (Item 1A. Risk Factors) for the fiscal year ended October 31, 2010, which include, among others, economic conditions, including consumer spending and confidence levels; foreign currency exchange rate impact; commodity costs; and credit conditions, all of which may increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual amounts could differ significantly from those estimated at the time the consolidated financial statements are

prepared. Changes in those estimates will be reflected in the consolidated financial statements in future periods.

Acquisitions

On June 24, 2011, during the third quarter of fiscal 2011, the company completed the acquisition of certain assets of, and assumed certain liabilities from, Lawn Solutions Commercial Products, Inc. ("Lawn Solutions"), a leading manufacturer of turf renovation equipment, such as aerators, seeders, power rakes, and brush cutters, for the landscape, rental, municipal and golf markets. The purchase price included a cash payment, the issuance of a long-term note, and an estimated earnout consideration. The earnout consideration is based on annual financial results over certain thresholds as defined in the acquisition agreement from fiscal 2011 through fiscal 2015.

On January 17, 2011, during the first quarter of fiscal 2011, the company completed the acquisition of a majority of the assets of, and assumed certain liabilities from, Unique Lighting Systems, Inc. ("Unique Lighting"), a leading manufacturer of professionally installed landscape lighting fixtures and transformers for residential and commercial use. The purchase price was \$19.1 million, which included a cash payment, the issuance of a long-term note, and an estimated earnout consideration. The

Table of Contents

earnout is based on annual financial results over certain thresholds as defined in the acquisition agreement from fiscal 2011 through fiscal 2016.

Additional purchase accounting disclosures have been omitted given the immateriality of these acquisitions as compared to the company's consolidated financial condition and results of operations.

Comprehensive Income

Comprehensive income and the components of other comprehensive income (loss) were as follows:

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 29, 2011	July 30, 2010	July 29, 2011	July 30, 2010
Net earnings	\$ 35,091	\$ 33,414	\$ 112,623	\$ 89,993
Other comprehensive income (loss):				
Cumulative translation adjustments	(1,472)	(1,655)	5,485	(5,520)
Pension liability adjustment, net of tax			(257)	671
Unrealized gain on derivative instruments, net of tax	1,652	251	1,982	2,762
Comprehensive income	\$ 35,271	\$ 32,010	\$ 119,833	\$ 87,906

Stock-Based Compensation***Stock Option Awards***

Under the company's equity-based compensation plan, option awards are granted with an exercise price equal to the closing price of the company's common stock on the date of grant, as reported by the New York Stock Exchange. Options are generally granted to non-employee directors, officers, and other key employees on an annual basis in the first quarter of the company's fiscal year. Option awards generally vest one-third each year over a three-year period and have a ten-year term. Other option awards granted to certain key employees vest in full on the three-year anniversary of the date of grant and have a ten-year term. Compensation expense equal to the grant date fair value is generally recognized for these awards over the vesting period. However, if a non-employee director has served on the company's Board of Directors for ten full fiscal years or longer, the fair value of the options granted is fully expensed on the date of the grant. Similarly, options granted to officers and other key employees are also subject to accelerated expensing if the option holder meets the retirement definition set forth in the plan. In that case, the fair value of the options is expensed in the fiscal year of grant because the option holder must be employed as of the end of the fiscal year in which the options are granted in order for the option to continue to vest following retirement.

The fair value of each share-based option is estimated on the date of grant using a Black-Scholes valuation method that uses the assumptions noted in the table below. The expected life is a significant assumption as it determines the period for which the risk-free interest rate, volatility, and dividend yield must be applied. The expected life is the average length of time over which the employee groups are expected to exercise

Edgar Filing: TORO CO - Form 10-Q

their options, which is based on historical experience with similar grants. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. Expected volatilities are based on the movement of the company's common stock over the most recent historical period equivalent to the expected life of the option. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate over the expected life at the time of grant. Dividend yield is estimated over the expected life based on the company's dividend policy, historical dividends paid, expected future cash dividends, and expected changes in the company's stock price. The following table illustrates the assumptions for options granted in the following fiscal periods.

	Fiscal 2011	Fiscal 2010
Expected life of option in years	6	6
Expected volatility	33.34% - 33.43%	33.00% - 33.07%
Weighted-average volatility	33.42%	33.00%
Risk-free interest rate	1.72% - 2.36%	2.51% - 2.87%
Expected dividend yield	1.04% - 1.16%	1.52% - 1.68%
Weighted-average dividend yield	1.05%	1.54%
Grant date weighted-average fair value	\$20.30	\$12.33

Table of Contents***Performance Share Awards***

The company grants to officers and other key employees long-term performance share awards pursuant to which they are entitled to the right to receive shares of common stock or performance share units contingent on the achievement of performance goals of the company, which are generally measured over a three-year period. The number of shares of common stock or performance share units a participant receives will be increased (up to 200 percent of target levels) or reduced (down to zero) based on the level of achievement of performance goals and vest over a three-year period. Performance share awards are granted on an annual basis in the first quarter of the company's fiscal year. Compensation expense is recognized for these awards on a straight-line basis over the vesting period based on the fair value as of the date of grant and the probability of achieving performance goals. The fair value of performance share awards granted during the first quarter of each of fiscal 2011 and 2010 was \$63.52 per share and \$40.73 per share, respectively.

Restricted Stock Awards

In the first quarter of fiscal 2011, the company began granting restricted stock awards to certain non-officer employees. In the second quarter of fiscal 2011, the company granted restricted stock awards to two officer employees to help ensure a smooth transition in connection with the retirement of the company's then chief financial officer. In the third quarter of fiscal 2011, the company granted restricted stock awards to certain non-officer employees as part of their annual merit increase. On August 22, 2011, the company also granted restricted stock awards as part of the offer to the new Vice President, Finance and Chief Financial Officer. Restricted stock awards generally vest one-third each year over a three-year period or vest in full on the three-year anniversary of the date of grant. Previously, the company granted limited restricted stock awards with varying vesting schedules. Compensation expense equal to the grant date fair value, which is equal to the closing price of the company's common stock on the date of grant, is recognized for these awards over the vesting period. The weighted average fair value of restricted stock awards granted during the first nine months of fiscal 2011 was \$61.23 per share.

Per Share Data

Reconciliations of basic and diluted weighted-average shares of common stock outstanding are as follows:

(Shares in thousands)	Three Months Ended		Nine Months Ended	
	July 29, 2011	July 30, 2010	July 29, 2011	July 30, 2010
<i>Basic</i>				
Weighted-average number of shares of common stock	31,176	32,464	31,488	33,397
Assumed issuance of contingent shares			3	3
Weighted-average number of shares of common stock and assumed issuance of contingent shares	31,176	32,464	31,491	33,400
<i>Diluted</i>				
Weighted-average number of shares of common stock and assumed issuance of contingent shares	31,176	32,464	31,491	33,400
Effect of dilutive securities	563	508	571	419
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	31,739	32,972	32,062	33,819

Options to purchase an aggregate of 221,306 and 320,490 shares of common stock outstanding during the third quarter of fiscal 2011 and 2010, respectively, were excluded from the diluted net earnings per share calculation because their exercise prices were greater than the average market price of the company's common stock during the same respective periods. Options to purchase an aggregate of 191,841 and 331,730 shares of common stock outstanding during the year-to-date periods through the third quarter of fiscal 2011 and 2010, respectively, were excluded from the diluted net earnings per share calculations because their exercise prices were greater than the average market price of the company's common stock during the same respective periods.

Inventories

Inventories are valued at the lower of cost or net realizable value, with cost determined by the last-in, first-out (LIFO) method for most inventories and first-in, first-out (FIFO) method for all other inventories. The company establishes a reserve for excess, slow-moving, and obsolete inventory that is equal to the difference between the cost and estimated net realizable value

Table of Contents

for that inventory. These reserves are based on a review and comparison of current inventory levels to the planned production, as well as planned and historical sales of the inventory.

Inventories were as follows:

(Dollars in thousands)	July 29, 2011	July 30, 2010	October 31, 2010
Raw materials and work in process	\$ 70,510	\$ 59,612	\$ 66,152
Finished goods and service parts	217,594	167,727	183,992
Total FIFO value	288,104	227,339	250,144
Less: adjustment to LIFO value	55,742	50,144	55,742
Total	\$ 232,362	\$ 177,195	\$ 194,402

Goodwill

The changes in the net carrying amount of goodwill for the first nine months of fiscal 2011 were as follows:

(Dollars in thousands)	Professional Segment	Residential Segment	Total
Balance as of October 31, 2010	\$ 75,422	\$ 10,978	\$ 86,400
Addition from acquisitions	5,765		5,765
Translation and other adjustments	(192)	73	(119)
Balance as of July 29, 2011	\$ 80,995	\$ 11,051	\$ 92,046

Other Intangible Assets

The components of other amortizable intangible assets were as follows:

(Dollars in thousands) July 29, 2011	Estimated Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Trade name	15	\$ 1,500	\$ (175)	\$ 1,325
Patents	5-13	9,403	(7,382)	2,021
Non-compete agreements	2-10	6,139	(2,452)	3,687
Customer related	5-13	8,207	(2,659)	5,548
Developed technology	2-10	25,245	(6,294)	18,951
Other		800	(800)	
Total amortizable		51,294	(19,762)	31,532
Non-amortizable - Trade name		5,281		5,281
Total other intangible assets, net		\$ 56,575	\$ (19,762)	\$ 36,813

Edgar Filing: TORO CO - Form 10-Q

(Dollars in thousands) October 31, 2010	Estimated Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	5-13	\$ 8,703	\$ (7,034)	\$ 1,669
Non-compete agreements	2-10	3,039	(1,910)	1,129
Customer related	10-13	7,471	(2,061)	5,410
Developed technology	2-10	13,984	(4,511)	9,473
Other		800	(800)	
Total amortizable		33,997	(16,316)	17,681
Non-amortizable - Trade name		5,281		5,281
Total other intangible assets, net		\$ 39,278	\$ (16,316)	\$ 22,962

Amortization expense for intangible assets during the first nine months of fiscal 2011 was \$3.4 million. Estimated amortization expense for the remainder of fiscal 2011 and succeeding fiscal years is as follows: fiscal 2011 (remainder), \$1.3 million; fiscal 2012, \$5.5 million; fiscal 2013, \$5.3 million; fiscal 2014, \$4.9 million; fiscal 2015, \$4.8 million; fiscal 2016, \$4.1 million; and after fiscal 2016, \$5.6 million.

Table of Contents

Investment in Joint Venture

On August 12, 2009, the company and TCF Inventory Finance, Inc. ("TCFIF"), a subsidiary of TCF National Bank, established Red Iron Acceptance, LLC, ("Red Iron"), a joint venture in the form of a Delaware limited liability company that provides inventory financing, including floor plan and open account receivable financing, to distributors and dealers of the company's products in the U.S. and to select distributors of the company's products in Canada. The initial term of Red Iron will continue until October 31, 2014, subject to unlimited automatic two-year extensions thereafter. Either the company or TCFIF may elect not to extend the initial term or any subsequent term by giving one-year notice to the other party of its intention not to extend the term. Additionally, in connection with the joint venture, the company and an affiliate of TCFIF entered into an arrangement to provide inventory financing to dealers of the company's products in Canada. In connection with the establishment of Red Iron, the company terminated its agreement with a third party financing company that previously provided floor plan financing to dealers of the company's products in the U.S. and Canada. During the first quarter of fiscal 2010, Red Iron began financing open account receivables, as well as floor plan receivables previously financed by such third party financing company. Red Iron also began financing floor plan receivables during the company's fourth quarter of fiscal 2009.

The company owns 45 percent of Red Iron and TCFIF owns 55 percent of Red Iron. The company accounts for its investment in Red Iron under the equity method of accounting. Each of the company and TCFIF contributed a specified amount of the estimated cash required to enable Red Iron to purchase the company's inventory financing receivables and to provide financial support for Red Iron's inventory financing programs. Red Iron borrows the remaining requisite estimated cash utilizing a \$450 million secured revolving credit facility established under a credit agreement between Red Iron and TCFIF. The company's total investment in Red Iron as of July 29, 2011 was \$12.5 million. The company has not guaranteed the outstanding indebtedness of Red Iron. The company has agreed to repurchase products repossessed by Red Iron and the TCFIF Canadian affiliate, up to a maximum aggregate amount of \$7.5 million in a calendar year. In addition, the company has provided recourse to Red Iron for certain outstanding receivables, which amounted to a maximum amount of \$0.5 million as of July 29, 2011.

On October 29, 2010, the company and Red Iron amended their repurchase agreement under which Red Iron provides financing for certain dealers and distributors. Instead of transactions under the agreements being characterized as a sale of receivables from the company to Red Iron, the transactions are structured as an advance in the form of a payment by Red Iron to the company on behalf of a distributor or dealer with respect to invoices financed by Red Iron that extinguishes the obligation of the dealer or distributor to make payment to the company under the terms of the invoice. Under separate agreements between Red Iron and the dealers and distributors, Red Iron provides loans to the dealers and distributors for the advances paid by Red Iron to the company. The net amount of new receivables financed for dealers and distributors under this arrangement for the nine months ended July 29, 2011 was \$890.9 million.

Red Iron's year end is December 31. As of June 30, 2011, Red Iron's total assets were \$267.8 million and total liabilities were \$238.0 million.

Warranty Guarantees

The company's products are warranted to ensure customer confidence in design, workmanship, and overall quality. Warranty coverage is for specified periods of time and on select products' hours of usage, and generally covers parts, labor, and other expenses for non-maintenance repairs. Warranty coverage generally does not cover operator abuse or improper use. An authorized company distributor or dealer must perform warranty work. Distributors and dealers submit claims for warranty reimbursement and are credited for the cost of repairs, labor, and other expenses as long as the repairs meet prescribed standards. Warranty expense is accrued at the time of sale based on the estimated number of products under warranty, historical average costs incurred to service warranty claims, the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, and other minor factors. Special warranty reserves are also accrued for

Edgar Filing: TORO CO - Form 10-Q

major rework campaigns. The company also sells extended warranty coverage on select products for a prescribed period after the factory warranty period expires.

Warranty provisions, claims, and changes in estimates for the first nine-month periods in fiscal 2011 and 2010 were as follows:

(Dollars in thousands) Nine Months Ended	Beginning Balance	Warranty Provisions	Warranty Claims	Changes in Estimates	Ending Balance
July 29, 2011	\$ 56,934	\$ 32,739	\$ (21,538)	\$ 2,179	\$ 70,314
July 30, 2010	54,273	29,374	(22,135)	1,164	62,676

Table of Contents

Segment Data

The presentation of segment information reflects the manner in which management organizes segments for making operating decisions and assessing performance. On this basis, the company has determined it has three reportable business segments: Professional, Residential, and Distribution. The Distribution segment, which consists of company-owned domestic distributorships, has been combined with the company's corporate activities and elimination of intersegment revenues and expenses that is shown as Other in the following tables due to the insignificance of the segment.

The following table shows the summarized financial information concerning the company's reportable segments:

(Dollars in thousands)

Three months ended July 29, 2011	Professional	Residential	Other	Total
Net sales	\$ 345,972	\$ 147,479	\$ 7,594	\$ 501,045
Intersegment gross sales	10,678	842	(11,520)	
Earnings (loss) before income taxes	64,344	4,638	(16,691)	52,291

Three months ended July 30, 2010	Professional	Residential	Other	Total
Net sales	\$ 317,876	\$ 135,759	\$ 5,255	\$ 458,890
Intersegment gross sales	4,471	101	(4,572)	
Earnings (loss) before income taxes	62,681	10,650	(21,366)	51,965

Nine months ended July 29, 2011	Professional	Residential	Other	Total
Net sales	\$ 1,022,536	\$ 480,404	\$ 12,918	\$ 1,515,858
Intersegment gross sales	30,245	3,006	(33,251)	
Earnings (loss) before income taxes	187,869	42,545	(63,170)	167,244
Total assets	540,977	210,479	216,091	967,547

Nine months ended July 30, 2010	Professional	Residential	Other	Total
Net sales	\$ 880,252	\$ 462,613	\$ 10,202	\$ 1,353,067
Intersegment gross sales	12,841	422	(13,263)	
Earnings (loss) before income taxes	156,094	49,190	(68,114)	137,170
Total assets	459,712	153,840	266,100	879,652

The following table summarizes the components of the loss before income taxes included in Other shown above:

(Dollars in thousands)	Three Months Ended July 29, 2011	July 30, 2010	Nine Months Ended July 29, 2011	July 30, 2010
Corporate expenses	\$ (15,462)	\$ (19,523)	\$ (53,227)	\$ (57,919)
Interest expense, net	(4,294)	(4,243)	(12,596)	(12,759)
Other	3,065	2,400	2,653	2,564
Total	\$ (16,691)	\$ (21,366)	\$ (63,170)	\$ (68,114)

Derivative Instruments and Hedging Activities

The company is exposed to foreign currency exchange rate risk arising from transactions in the normal course of business, such as sales to third party customers, sales and loans to wholly owned foreign subsidiaries, foreign plant operations, and purchases from suppliers. The company actively manages the exposure of its foreign currency market risk by entering into various hedging instruments, authorized under company policies that place controls on these activities, with counterparties that are highly rated financial institutions. The company's hedging activities involve the primary use of forward currency contracts. The company uses derivative instruments only in an attempt to limit underlying exposure from foreign currency exchange rate fluctuations and to minimize earnings and cash flow volatility associated with foreign currency exchange rate changes. Decisions on whether to use such contracts are made based on the amount of exposure to the currency involved, and an assessment of the near-term market value for each currency. The company's policy does not allow the use of derivatives for trading or speculative purposes. The company's primary foreign currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the

Table of Contents

British pound, the Mexican peso, and the Japanese yen against the U.S. dollar. The company also has exposure with the Romanian New Lei against the Euro and U.S. dollar as a result of its new manufacturing facility in Romania.

Cash flow hedges. The company recognizes all derivative instruments as either assets or liabilities at fair value on its consolidated balance sheet and formally documents relationships between cash flow hedging instruments and hedged items, as well as its risk-management objectives and strategy for undertaking hedge transactions. This process includes linking all derivatives to the forecasted transactions, such as sales to third parties and foreign plant operations. Changes in the fair value of outstanding derivative instruments that are designated and qualify as a cash flow hedge are recorded in other comprehensive income (OCI), except for the ineffective portion, until net earnings is affected by the variability of cash flows of the hedged transaction. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in net earnings. The consolidated statement of earnings classification of effective hedge results is the same as that of the underlying exposure. Results of hedges of sales and foreign plant operations are recorded in net sales and cost of sales, respectively, when the underlying hedged transaction affects net earnings. The maximum amount of time the company hedges its exposure to the variability in future cash flows for forecasted trade sales and purchases is two years.

The company formally assesses at a hedge's inception and on an ongoing basis whether the derivatives that are used in the hedging transaction have been highly effective in offsetting changes in the cash flows of the hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not, or has ceased to be, highly effective as a hedge, the company discontinues hedge accounting prospectively. When the company discontinues hedge accounting because it is no longer probable, but it is still reasonably possible that the forecasted transaction will occur by the end of the originally expected period or within an additional two-month period of time thereafter, the gain or loss on the derivative remains in accumulated other comprehensive loss (AOCL) and is reclassified to net earnings when the forecasted transaction affects net earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in OCI are recognized immediately in net earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the company carries the derivative at its fair value on the balance sheet, recognizing future changes in the fair value in other income, net. For the third quarter of fiscal 2011, there were no gains or losses on contracts reclassified into earnings as a result of the discontinuance of cash flow hedges. As of July 29, 2011, the notional amount outstanding of forward contracts designated as cash flow hedges was \$89.4 million.

Derivatives not designated as hedging instruments. The company also enters into forward currency contracts to mitigate the change in fair value of specific assets and liabilities on the consolidated balance sheet. These contracts are not designated as hedging instruments. Accordingly, changes in the fair value of hedges of recorded balance sheet positions, such as cash, receivables, payables, intercompany notes, and other various contractual claims to pay or receive foreign currencies other than the functional currency, are recognized immediately in other income, net, on the consolidated statements of earnings together with the transaction gain or loss from the hedged balance sheet position.

The following table presents the fair value of the company's derivatives and consolidated balance sheet location.

	Asset Derivatives				Liability Derivatives			
	July 29, 2011		July 30, 2010		July 29, 2011		July 30, 2010	
(Dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Designated as Hedging Instruments								

Edgar Filing: TORO CO - Form 10-Q

Foreign exchange contracts	Prepaid expenses	\$	Prepaid expenses	\$	Accrued liabilities	\$	961	Accrued liabilities	\$	268
Derivatives Not Designated as Hedging Instruments										
Foreign exchange contracts	Prepaid expenses		Prepaid expenses		Accrued liabilities		3,212	Accrued liabilities		791
Total Derivatives		\$		\$		\$	4,173		\$	1,059

Edgar Filing: TORO CO - Form 10-Q

Table of Contents

The following table presents the impact of derivative instruments on the consolidated statements of earnings for the company's derivatives designed as cash flow hedging instruments for the three and nine months ended July 29, 2011 and July 30, 2010, respectively.

(Dollars in thousands) For the three months ended			Location of Gain			Location of Gain (Loss)			Gain (Loss)	
			Reclassified			Recognized in Income			Recognized	
			(Loss)			on Derivatives			in Income	
	Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		from AOCL into Income (Effective Portion)		Gain (Loss)		(Ineffective Portion and excluded from Effectiveness Testing)		Excluded from Effectiveness Testing)	
	July 29, 2011	July 30, 2010			July 29, 2011	July 30, 2010			July 29, 2011	July 30, 2010
Foreign exchange contracts	\$ 732	\$ 428	Net sales		\$ (1,992)	\$ 8	Other income, net		\$ (353)	\$ 51
Foreign exchange contracts	(28)	154	Cost of sales		387	178				
Total	\$ 704	\$ 582			\$ (1,605)	\$ 186				
For the nine months ended	July 29, 2011	July 30, 2010			July 29, 2011	July 30, 2010			July 29, 2011	July 30, 2010
Foreign exchange contracts	\$ (6,387)	\$ (1,917)	Net sales		\$ (4,582)	\$ (1,518)	Other income, net		\$ (711)	\$ (126)
Foreign exchange contracts	1,200	405	Cost of sales		761	273				
Total	\$ (5,187)	\$ (1,512)			\$ (3,821)	\$ (1,245)				

As of July 29, 2011, the company anticipates reclassifying approximately \$0.5 million of losses from AOCL to earnings during the next 12 months.

The following table presents the impact of derivative instruments on the consolidated statements of earnings for the company's derivatives not designated as hedging instruments.

(Dollars in thousands)	Location of Gain (Loss) Recognized in Net Earnings	Gain (Loss) Recognized in Net Earnings			
		Three Months Ended		Nine Months Ended	
		July 29, 2011	July 30, 2010	July 29, 2011	July 30, 2010
Foreign exchange contracts	Other income, net	\$ 543	\$ 2,247	\$ (8,966)	\$ 6,449

Fair Value Measurements

The company categorizes its assets and liabilities into one of three levels based on the assumptions (inputs) used in valuing the asset or liability. Estimates of fair value for financial assets and financial liabilities are based on the framework established in the accounting guidance for fair value measurements. The framework defines fair value, provides guidance for measuring fair value and requires certain disclosures. The framework discusses valuation techniques such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The framework utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs reflecting management's assumptions about the inputs used in pricing the asset or liability.

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820)*. ASU No. 2010-06 requires new disclosures regarding activity in Level 3 fair value measurements, including information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The company adopted the provision of ASU No. 2010-06 for Level 3 fair-value measurements for its third fiscal quarter beginning on April 30, 2011, as required. The adoption of ASU No. 2010-06 for Level 3 fair value measurements did not have an impact on the company's disclosures.

Cash and cash equivalents are valued at their carrying amounts in the consolidated balance sheets, which are reasonable estimates of their fair value due to their short maturities. Foreign currency forward exchange contracts are valued at fair market value using the market approach based on exchange rates as of the reporting date, which is the amount the company would

Table of Contents

receive or pay to terminate the contracts. The unfunded deferred compensation liability is primarily subject to changes in fixed-income investment contracts based on current yields. For accounts receivable and accounts payable, carrying amounts are a reasonable estimate of fair value given their short-term nature.

Assets and liabilities measured at fair value on a recurring basis, as of July 29, 2011, are summarized below:

(Dollars in thousands)	Fair Value	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 118,113	\$ 118,113		
Total Assets	\$ 118,113	\$ 118,113		
Liabilities:				
Foreign exchange contracts	\$ 4,173		\$ 4,173	
Deferred compensation liabilities	4,477		4,477	
Total Liabilities	\$ 8,650		\$ 8,650	

Assets measured at fair value on a nonrecurring basis related to the company's acquisitions of Lawn Solutions and Unique Lighting, as of July 29, 2011, are summarized below:

(Dollars in thousands)	Fair Value	Level 1	Level 2	Level 3	Valuation Technique
Assets:					
Trade name	\$ 1,500		\$ 1,500		(a)
Patents	700			700	(a)
Non-compete agreements	3,100			3,100	(a)
Customer list	713			713	(b)
Developed technology	11,250			11,250	(a)
Total Assets	\$ 17,263		\$ 17,263		

Assets and liabilities measured at fair value are based on one or more valuation techniques. The valuation techniques are identified in the table above and are as follows:

(a) We used an internally developed income based approach to value these assets. Inputs for this valuation model were based on internally developed forecasts and assumptions.

(b) We used a replacement cost model to value these assets. Inputs for this valuation model were based on internal estimates of the cost to recreate these assets.

Contingencies

Litigation

General. The company is party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive as well as compensatory damages arising out of use of the company's products. Although the company is self-insured to some extent, the company maintains insurance against certain product liability losses. The company is also subject to administrative proceedings with respect to claims involving the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for remedial investigations and clean up costs. The company is also typically involved in commercial disputes, employment disputes, and patent litigation cases in which it is asserting or defending against patent infringement claims. To prevent possible infringement of the company's patents by others, the company periodically reviews competitors' products. To avoid potential liability with respect to others' patents, the company regularly reviews certain patents issued by the United States Patent and Trademark Office (USPTO) and foreign patent offices. Management believes these activities help minimize its risk of being a defendant in patent infringement litigation.

Lawnmower Engine Horsepower Marketing and Sales Practices Litigation. Beginning in June 2004, various plaintiffs filed class action lawsuits in state and federal courts throughout the country against the company and other defendants alleging that the horsepower labels on the products the plaintiffs purchased were inaccurate. The plaintiffs (i) asserted statutory and common law

Table of Contents

claims, and (ii) sought an injunction, unspecified compensatory and punitive damages, treble damages, and attorneys' fees. In December 2008, all lawsuits were transferred to the United States District Court for the Eastern District of Wisconsin for coordinated or consolidated pretrial proceedings.

In February 2010, the company and certain other defendants entered into a settlement agreement with plaintiffs and, ultimately, all defendants entered into various settlement agreements with the plaintiffs. The company's settlement agreement provides for, among other things, (i) a monetary settlement, (ii) an additional warranty period for certain engines that are subject to the litigation, and (iii) injunctive relief relating to power rating labeling practices.

In August 2010, the Court entered an order and judgment in which it determined that the company's settlement is fair, reasonable, and adequate, and approved the settlement. The Court also entered an order certifying a settlement class consisting of all persons in the United States who, beginning January 1, 1994 and through April 12, 2010, purchased a lawnmower containing a two-stroke or four-stroke gas combustible engine up to 30 horsepower that was manufactured or sold by the company and other defendants. The Court entered similar orders and judgments approving the settlements entered into by other defendants. Also in August 2010, certain objectors filed notices with the United States Court of Appeals for the Seventh Circuit to appeal the order and judgment approving the company's settlement and the other orders and judgments approving the settlements with the other defendants.

In February 2011, all objectors to the company's settlement dismissed their appeals. Accordingly, the company's settlement agreement became final. The expected costs of the company's performance of its settlement obligations are consistent with accruals established in prior periods and, as such, management does not currently expect that the settlement will have a material adverse effect on the company's consolidated operating results or financial condition.

In March 2010, individuals who claim to have purchased lawnmowers in Canada filed class action litigation against the company and other defendants that (i) contains allegations under applicable Canadian law that are similar to the allegations made by the United States plaintiffs, (ii) seeks certification of a class of all persons in Canada who, beginning January 1, 1994 purchased a lawnmower containing a gas combustible engine up to 30 horsepower that was manufactured or sold by the company and other defendants, and (iii) seeks under applicable Canadian law unspecified compensatory and punitive damages, attorneys' costs and fees, and equitable relief.

Management continues to evaluate this Canadian litigation. In the event the company is unable to favorably resolve this litigation, management is unable to assess at this time whether this litigation would have a material adverse effect on the company's annual consolidated operating results or financial condition, although an unfavorable resolution or outcome could be material to the company's consolidated operating results for a particular period.

Subsequent Events

The company evaluated all subsequent events and concluded that no additional subsequent events have occurred that would require recognition in the consolidated financial statements or disclosure in the notes to the consolidated financial statements.

Table of Contents

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

Nature of Operations

The Toro Company is in the business of designing, manufacturing, and marketing professional turf maintenance equipment and services, turf irrigation systems, agricultural micro-irrigation systems, landscaping equipment and lighting, and residential yard and snow removal products. We sell our products worldwide through a network of distributors, dealers, hardware retailers, home centers, mass retailers, and over the Internet. Our businesses are organized into three reportable business segments: Professional, Residential, and Distribution. Our Distribution segment, which consists of our company-owned domestic distributorships, has been combined with our corporate activities and is shown as Other. Our emphasis is to provide innovative, well-built, and dependable products supported by an extensive service network. A significant portion of our revenues has historically been, and we expect will continue to be, attributable to new and enhanced products. We define new products as those introduced in the current and previous two fiscal years.

This Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the MD&A included in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended October 31, 2010.

RESULTS OF OPERATIONS

Overview

Our results for the third quarter of fiscal 2011 were positive with net sales growth of 9.2 percent and net earnings growth of 5.0 percent, each as compared to the third quarter of fiscal 2010. Net sales and net earnings for the year-to-date period of fiscal 2011 grew 12.0 percent and 25.1 percent, respectively, as compared to the same period in the prior fiscal year. Sales for most professional segment businesses increased due to higher demand for the company's products resulting from the successful introduction of new products, better product availability, and improved economic conditions, mainly in the first half of fiscal 2011. Rebound in the rental market and continued demand for our micro-irrigation products also contributed to the growth of professional segment sales. To meet increasing worldwide demand for micro-irrigation products for the agricultural market, particularly in Eastern Europe, we expect to complete the construction of our new manufacturing facility in Romania in the fourth quarter of fiscal 2011 with production also anticipated to begin during the fourth quarter of fiscal 2011. Residential segment sales also increased, driven primarily from strong preseason shipments of snow thrower products due to higher demand for these products resulting from depleted field inventory levels entering the 2011/2012 snow season following strong sales from heavy snow falls during the 2010/2011 snow season. Somewhat offsetting this increase were unfavorable weather conditions that dampened sales of walk power mowers and riding products for the third quarter of fiscal 2011 compared to the same period in the prior fiscal year. Net earnings as a percentage of net sales declined to 7.0 percent compared to 7.3 percent in the third quarter of fiscal 2010. Our net earnings were primarily hampered by a pre-tax charge of \$4.5 million due to costs associated with a rework for a non-safety quality issue that affected a large number of our residential segment walk power mowers, as well as lower gross margins from higher commodity costs and fuel prices.

Edgar Filing: TORO CO - Form 10-Q

Our overall financial condition remains strong. Our receivables increased by 17.0 percent as of the end of the third quarter of fiscal 2011 compared to the end of the third quarter of fiscal 2010 due mainly to higher sales volumes and foreign currency exchange rates. Our inventory levels also increased by 31.1 percent as of the end of the third quarter of fiscal 2011 compared to the end of the third quarter of fiscal 2010 as we prebuilt inventory, mainly for new residential products, in anticipation of higher demand, which did not occur as expected due to unfavorable weather conditions, as well as higher foreign currency exchange rates. As of the end of our third quarter of fiscal 2011, our average net working capital (accounts receivable plus inventory less trade payables) as a percentage of net sales was 14.5 percent compared to 15.4 percent as of the end of our third quarter of fiscal 2010. We also increased our third quarter cash dividend by 11 percent from \$0.18 to \$0.20 per share compared to the quarterly cash dividend paid in the third quarter of fiscal 2010.

We are off to a good start with our new multi-year initiative, Destination 2014, that will take us to our centennial in 2014 and into our second century. This four-year initiative is intended to focus our efforts on driving our legacy of excellence through building caring relationships and engaging in innovation. Through our Destination 2014 initiative financial goals, we will strive to achieve \$100 million in organic revenue growth in each of fiscal 2011, 2012, 2013, and 2014, and 12 percent operating earnings as a percentage of net sales by the end of fiscal 2014. We currently believe that we will achieve our organic revenue growth goal of \$100 million for fiscal 2011. We define organic revenue growth as the increase in net sales, less net sales from acquisitions that occurred in the current fiscal year.

We believe that the positive momentum experienced in the first nine months should continue through the remainder of fiscal 2011, despite challenges from the current level of economic uncertainty and unfavorable weather patterns. Our continued focus is

Table of Contents

on generating customer demand and aggressively driving retail sales for our innovative products, while keeping production closely aligned with expected shipment volumes. We will continue to keep a cautionary eye on the global economies and the uncertainty of the pace and degree of recovery, retail demand, field inventory levels, commodity prices, weather conditions, competitive actions, expenses, and other factors identified below under the heading Forward-Looking Information, which could cause our actual results to differ from our anticipated outlook.

Net Earnings

Net earnings for the third quarter of fiscal 2011 were \$35.1 million, or \$1.11 per diluted share, compared to \$33.4 million, or \$1.01 per diluted share, for the third quarter of fiscal 2010, resulting in net earnings per diluted share increase of 9.9 percent. Year-to-date net earnings in fiscal 2011 were \$112.6 million, or \$3.51 per diluted share, compared to \$90.0 million, or \$2.66 per diluted share, last fiscal year, resulting in net earnings per diluted share increase of 32.0 percent. The primary factors contributing to our earnings improvements were higher sales volumes, an increase in gross profit, and a lower effective tax rate, somewhat offset by an increase in selling, general, and administrative (SG&A) expense and a pre-tax charge of \$4.5 million due to costs associated with a rework for a non-safety quality issue, as discussed previously. In addition, net earnings per diluted share for the third quarter and year-to-date periods of fiscal 2011 were benefited by approximately \$0.05 per share and \$0.18 per share, respectively, compared to the same periods in fiscal 2010, as a result of reduced shares outstanding from repurchases of our common stock.

The following table summarizes the major operating costs and other income as a percentage of net sales:

	Three Months Ended		Nine Months Ended	
	July 29, 2011	July 30, 2010	July 29, 2011	July 30, 2010
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(66.5)	(64.8)	(65.8)	(65.6)
Gross margin	33.5	35.2	34.2	34.4
SG&A expense	(22.6)	(23.5)	(22.6)	(23.6)
Operating earnings	10.9	11.7	11.6	10.8
Interest expense	(0.9)	(0.9)	(0.8)	(0.9)
Other income, net	0.4	0.5	0.2	0.3
Provision for income taxes	(3.4)	(4.0)	(3.6)	(3.5)
Net earnings	7.0%	7.3%	7.4%	6.7%

Net Sales

Worldwide consolidated net sales for the third quarter and year-to-date periods of fiscal 2011 were up 9.2 percent and 12.0 percent, respectively, from the same periods in the prior fiscal year. Worldwide professional segment net sales were up 8.8 percent and 16.2 percent for the third quarter and year-to-date periods of fiscal 2011, respectively, compared to the same periods in the prior fiscal year. Shipments for most professional segment businesses increased due to higher demand for the company's products resulting from the successful introduction of new products, better product availability, and improved economic conditions, mainly in the first half of fiscal 2011. Demand for golf equipment and irrigation systems was particularly strong for the year-to-date period of fiscal 2011 compared to the same period last fiscal year due to golf development projects in key international markets and domestic renovation projects. In addition, shipments of products from our Sitework Systems business were up as a result of the rebound in the rental market, as well as new products that were positively received by customers. Micro-irrigation product sales also increased due to the continued growing market demand, particularly in Eastern Europe, and additional

Edgar Filing: TORO CO - Form 10-Q

manufacturing capacity that increased production and sales of our water-conserving products. Early shipments of landscape contractor equipment were strong, which benefited our sales growth for the year-to-date period of fiscal 2011 as compared to the same period last fiscal year. However, severe drought conditions in key markets resulted in decreased demand and shipments of our landscape contractor equipment products for the third quarter of fiscal 2011 compared to the same period last fiscal year. Worldwide residential segment net sales increased 8.6 percent and 3.8 percent for the third quarter and year-to-date periods of fiscal 2011, respectively, compared to the same periods in fiscal 2010. These increases were driven primarily from strong preseason shipments of snow thrower products due to higher demand for these products resulting from depleted field inventory levels entering the 2011/2012 snow season following strong sales from heavy snow falls during the 2010/2011 snow season. Somewhat offsetting this increase were unfavorable weather conditions that dampened sales of walk power mowers and riding products for the third quarter of fiscal 2011 compared to the same period in the prior fiscal year. International net sales for the third quarter and year-to-date periods of fiscal 2011 increased 12.6 percent and 14.0 percent, respectively, from the same periods in the prior fiscal year due to the same factors discussed above, as well as a weaker U.S.

Table of Contents

dollar compared to other currencies in which we transact business that accounted for approximately \$9.3 million and \$15.4 million of additional net sales for the third quarter and year-to-date periods of fiscal 2011, respectively.

Gross Profit

As a percentage of net sales, gross profit for the third quarter of fiscal 2011 decreased 170 basis points to 33.5 percent compared to 35.2 percent in the third quarter of fiscal 2010. Gross profit as a percent of net sales for the year-to-date period of fiscal 2011 also decreased by 20 basis points to 34.2 percent compared to 34.4 percent for year-to-date period of fiscal 2010. These decreases were primarily due to the following factors: (i) rework costs associated with a non-safety quality issue that affected a large number of our residential segment walk power mowers; (ii) higher average prices paid for commodities in fiscal 2011 compared to fiscal 2010; and (iii) increased freight expense due to higher fuel prices in fiscal 2011 compared to fiscal 2010. Somewhat offsetting those negative factors were lower manufacturing costs for the year-to-date period of fiscal 2011 compared to the same period last fiscal year from higher plant utilization, mainly related to increased demand for our products.

Selling, General, and Administrative Expense

SG&A expense increased \$5.1 million, or 4.7 percent, for the third quarter of fiscal 2011 compared to the third quarter of fiscal 2010, and increased \$22.9 million, or 7.2 percent, for the year-to-date period of fiscal 2011 compared to the year-to-date period of fiscal 2010. As a percentage of net sales, SG&A expense decreased 90 basis points and 100 basis points for the third quarter and year-to-date periods of fiscal 2011, respectively, compared to the same periods in the prior fiscal year. These decreases were primarily attributable to leveraging SG&A costs over higher sales volumes and lower incentive compensation expense, which was lower by \$4.2 million and \$2.6 million for the third quarter and the year-to-date periods of fiscal 2011, respectively, compared to the same periods in the prior fiscal year due to changes in financial performance.

Interest Expense

Interest expense for the third quarter of fiscal 2011 increased slightly, by 1.2 percent, compared to the third quarter of fiscal 2010, but was down slightly by 1.3 percent for the year-to-date period of fiscal 2011 compared to the same period in the prior fiscal year as a result of lower average debt levels.

Other Income, Net

Other income, net for the third quarter of fiscal 2011 decreased \$0.5 million compared to the same period in the prior fiscal year due primarily to an increase in foreign currency exchange rate losses, somewhat offset by an increase in income from affiliates. Other income, net for the year-to-date period of fiscal 2011 increased \$0.4 million compared to the same period last fiscal year due mainly to an increase in income from equity investments, somewhat offset by higher foreign currency exchange rate losses.

Provision for Income Taxes

The effective tax rate for the third quarter of fiscal 2011 was 32.9 percent compared to 35.7 percent for the third quarter of fiscal 2010. The effective tax rate for the year-to-date periods of fiscal 2011 and 2010 was 32.7 percent and 34.4 percent, respectively. The reduction in the effective tax rate was primarily the result of the retroactive reenactment of the federal research and development tax credit and a benefit from the finalization of the fiscal 2010 tax return as compared to the tax provision.

BUSINESS SEGMENTS

As described previously, we operate in three reportable business segments: Professional, Residential, and Distribution. Our Distribution segment, which consists of our company-owned domestic distributorships, has been combined with our corporate activities and elimination of intersegment revenues and expenses that is shown as "Other" in the following tables. Operating earnings for our Professional and Residential segments are defined as operating earnings plus other income, net. Operating loss for "Other" includes operating earnings (loss), corporate activities, other income, net, and interest expense.

Edgar Filing: TORO CO - Form 10-Q

Table of Contents

The following table summarizes net sales by segment:

(Dollars in thousands)	Three Months Ended				
	July 29, 2011	July 30, 2010	\$ Change	% Change	
Professional	\$ 345,972	\$ 317,876	\$ 28,096	8.8%	
Residential	147,479	135,759	11,720	8.6	
Other	7,594	5,255	2,339	44.5	
Total *	\$ 501,045	\$ 458,890	\$ 42,155	9.2%	

* Includes international sales of:	\$ 146,678	\$ 130,317	\$ 16,361	12.6%
------------------------------------	------------	------------	-----------	-------

(Dollars in thousands)	Nine Months Ended				
	July 29, 2011	July 30, 2010	\$ Change	% Change	
Professional	\$ 1,022,536	\$ 880,252	\$ 142,284	16.2%	
Residential	480,404	462,613	17,791	3.8	
Other	12,918	10,202	2,716	26.6	
Total *	\$ 1,515,858	\$ 1,353,067	\$ 162,791	12.0%	

* Includes international sales of:	\$ 487,325	\$ 427,646	\$ 59,679	14.0%
------------------------------------	------------	------------	-----------	-------

The following table summarizes segment earnings (loss) before income taxes:

(Dollars in thousands)	Three Months Ended				
	July 29, 2011	July 30, 2010	\$ Change	% Change	
Professional	\$ 64,344	\$ 62,681	\$ 1,663	2.7%	
Residential	4,638	10,650	(6,012)	(56.5)	
Other	(16,691)	(21,366)	4,675	21.9	
Total	\$ 52,291	\$ 51,965	\$ 326	0.6%	

(Dollars in thousands)	Nine Months Ended				
	July 29, 2011	July 30, 2010	\$ Change	% Change	
Professional	\$ 187,869	\$ 156,094	\$ 31,775	20.4%	
Residential	42,545	49,190	(6,645)	(13.5)	
Other	(63,170)	(68,114)	4,944	7.3	
Total	\$ 167,244	\$ 137,170	\$ 30,074	21.9%	

Professional

Net Sales. Worldwide net sales for the professional segment in the third quarter and year-to-date periods of fiscal 2011 increased 8.8 percent and 16.2 percent, respectively, compared to the same periods in the prior fiscal year. Shipments for most professional segment businesses increased due to higher demand for our products resulting from the successful introduction of new products, better product availability, and improved economic conditions, mainly for the first half of fiscal 2011. Demand for golf equipment and irrigation systems was particularly strong for the year-to-date period of fiscal 2011 compared to the same period last fiscal year due to golf development projects in key international markets and domestic renovation projects. In addition, shipments of products from our Sitework Systems business were up as a result of the rebound in the rental market, as well as new products that were positively received by customers. Micro-irrigation product sales also increased due to the continued growing market demand, particularly in Eastern Europe, and additional manufacturing capacity that increased production and sales of our water-conserving products. Early shipments of landscape contractor equipment were strong, which benefited our sales growth for the year-to-date period of fiscal 2011 as compared to the same period last fiscal year. However, severe drought conditions in key

Table of Contents

markets resulted in decreased demand and shipments of our landscape contractor equipment products for the third quarter of fiscal 2011 compared to the same period last fiscal year.

Operating Earnings. Operating earnings for the professional segment in the third quarter and year-to-date periods of fiscal 2011 increased 2.7 percent and 20.4 percent, respectively, compared to the same periods in fiscal 2010. Expressed as a percentage of net sales, professional segment operating margin decreased to 18.6 percent compared to 19.7 percent in the third quarter of fiscal 2010 due mainly to lower gross margin from higher commodity prices and increased freight expense in fiscal 2011. Professional segment operating margin for the year-to-date period of fiscal 2011 increased to 18.4 percent compared to 17.7 percent in the same period last fiscal year. This profit improvement was primarily attributable to higher sales volumes and lower SG&A expense as a percentage of net sales due to leveraging fixed SG&A costs over higher sales volumes, somewhat offset by a decline in gross margin, as previously discussed.

Residential

Net Sales. Worldwide net sales for the residential segment in the third quarter and year-to-date periods of fiscal 2011 increased 8.6 percent and 3.8 percent, respectively, compared to the same periods in the prior fiscal year. These increases were driven primarily from strong preseason shipments of snow thrower products due to higher demand for these products resulting from depleted field inventory levels entering the 2011/2012 snow season following strong sales from heavy snow falls during the 2010/2011 snow season. Net sales of the company's Pope products sold in Australia also increased in the third quarter of fiscal 2011 compared to the third quarter of fiscal 2010; however, shipments of Pope products were down for the year-to-date comparison due to heavy rains and flooding in Australia that negatively affected demand in the first quarter of fiscal 2011. Unfavorable weather conditions dampened sales of walk power mowers and riding products for the third quarter of fiscal 2011 compared to the same period in the prior fiscal year. However, for the year-to-date period of fiscal 2011 compared to the year-to-date period last fiscal year, riding product sales were up as a result of positive customer acceptance for our new line of zero-turn radius riding mowers, as well as better product availability. Residential segment field inventory levels were up as of the end of the third quarter of fiscal 2011 compared to the same period last fiscal year due to strong preseason demand of snow thrower products and higher riding product field inventory levels from continued strong demand for our new riding mower products.

Operating Earnings. Operating earnings for the residential segment in the third quarter and year-to-date periods of fiscal 2011 decreased 56.5 percent and 13.5 percent, respectively, compared to the same periods in fiscal 2010. Expressed as a percentage of net sales, residential segment operating margin for the third quarter of fiscal 2011 also decreased to 3.1 percent compared to 7.8 percent in the third quarter of fiscal 2010, and fiscal 2011 year-to-date residential segment operating margin decreased to 8.9 percent compared to 10.6 percent in the same period last fiscal year. These profit declines were primarily attributable to a pre-tax charge of \$4.5 million due to costs associated with a rework for a non-safety quality issue that affected a large number of our walk power mowers, lower gross margin from higher commodity prices and increased freight expense in fiscal 2011, and higher SG&A expense, mainly from an increase in warranty expense due to special provisions for product modifications, and increased expenses for marketing, warehousing, and engineering.

Other

Net Sales. Net sales for the other segment include sales from our wholly owned domestic distribution companies less sales from the professional and residential segments to those distribution companies. The other segment net sales for the third quarter and year-to-date periods of fiscal 2011 increased by \$2.3 million and \$2.7 million, respectively, compared to the same periods in the prior fiscal year, due to incremental sales from the addition of a U.S. Western-based distribution company that was acquired on October 29, 2010.

Operating Losses. Operating losses for the other segment were down for the third quarter and year-to-date periods of fiscal 2011 by \$4.7 million, or 21.9 percent, and \$4.9 million, or 7.3 percent, respectively, compared to the same periods in the prior fiscal year. These loss declines were primarily attributable to the following factors: (i) lower incentive compensation expense; (ii) improved profitability at our wholly owned domestic distribution companies; (iii) lower self-insured health care costs; and (iv) an increase in income from affiliates. Somewhat offsetting those factors were higher foreign currency exchange rate losses.

Table of Contents

FINANCIAL POSITION

Working Capital

We have taken proactive measures to improve working capital utilization, including managing our assets and adjusting production plans. As such, our financial condition remains strong. We continue to place emphasis on asset management, with a focus on minimizing the amount of working capital in the supply chain and maintaining or improving order replenishment and service levels to end users.

Receivables as of the end of the third quarter of fiscal 2011 were up \$28.9 million, or 17.0 percent, compared to the end of the third quarter of fiscal 2010 due mainly to higher sales volumes and foreign currency exchange rates, which accounted for approximately \$8 million of the receivables increase. Our average days sales outstanding for receivables improved to 37 days based on sales for the last twelve months ended July 29, 2011, compared to 42 days for the twelve months ended July 30, 2010 primarily as the result of floor plan receivables and certain open account receivables financed with Red Iron, our financing joint venture with TCFIF, instead of with us. Inventory levels as of the end of the third quarter of fiscal 2011 were up \$55.2 million, or 31.1 percent, compared to the end of the third quarter of fiscal 2010 as we prebuilt inventory, mainly for new residential products, in anticipation of higher demand, which did not occur as expected due to unfavorable weather conditions, as well as higher foreign currency exchange rates, which accounted for approximately \$10 million of the inventory increase. Average inventory turnover also declined by 8.6 percent for the twelve months ended July 29, 2011 compared to the twelve months ended July 30, 2010. Accounts payable increased as of the end of our third quarter of fiscal 2011 by \$8.7 million, or 7.4 percent, driven by higher levels of inventory and production and our supply chain initiatives. Our average net working capital as a percentage of net sales for the twelve months ended July 29, 2011 was 14.5 percent compared to 15.4 percent for the twelve months ended July 30, 2010.

Liquidity and Capital Resources

Our businesses are seasonally working capital intensive and require funding for purchases of raw materials used in production, replacement parts inventory, payroll and other administrative costs, capital expenditures, establishment of new facilities, expansion and upgrading of existing facilities, as well as for financing of receivables from customers that are not financed with Red Iron. We believe that anticipated cash generated from operations, together with our fixed rate long-term debt, bank credit lines, and cash on hand, will provide us with adequate liquidity to meet our anticipated operating requirements. We believe that the funds available through existing financing arrangements and forecasted cash flows will be sufficient to provide the necessary capital resources for our anticipated working capital needs, capital expenditures, investments, debt repayments, quarterly cash dividend payments, and stock repurchases for at least the next twelve months.

Our Board of Directors approved a cash dividend of \$0.20 per share for the third quarter of fiscal 2011 paid on July 8, 2011, which was an increase of 11 percent over our cash dividend of \$0.18 per share for the third quarter of fiscal 2010.

Cash Flow. Cash provided by operating activities for the first nine months of fiscal 2011 decreased \$84.9 million compared to the first nine months of fiscal 2010, due to an increase in working capital for the first nine months of fiscal 2011 as compared to the first nine months of fiscal 2010, as described above, somewhat offset by higher net earnings. Cash used for investing activities was up by \$16.1 million compared to the first nine months of fiscal 2010, due to an increase in cash utilized for acquisitions and higher levels of cash used for purchases of property, plant, and equipment, mainly for a new manufacturing facility in Romania. Cash used for financing activities for the first nine months of fiscal

Edgar Filing: TORO CO - Form 10-Q

2011 was down by \$61.3 million. This decline was primarily attributable to lower levels of funds used to repurchase our common stock during the first nine months of fiscal 2011 compared to the first nine months of fiscal 2010.

Credit Lines and Other Capital Resources. Our businesses are seasonal, with accounts receivable balances historically increasing between January and April as a result of higher sales volumes and extended payment terms made available to our customers, and decreasing between May and December when payments are received. The seasonality of production and shipments causes our working capital requirements to fluctuate during the year. Seasonal cash requirements are financed from operations, cash on hand, and with short-term financing arrangements, including a four-year, \$150.0 million unsecured senior revolving credit facility entered into on July 28, 2011. This replaced the prior revolving credit facility that was scheduled to mature in January 2012. Included in the \$150.0 million revolving credit facility is a sublimit for standby letters of credit and a sublimit for swingline loans. At the election of the company, and the approval of the named borrowers on the revolving credit facility, the aggregate maximum principal amount available under the facility may be increased by an amount up to \$100.0 million in aggregate. Funds are available under the revolving credit facility for working capital, capital expenditures, and other lawful purposes, including, but not limited to, acquisitions and stock repurchases. We had no outstanding short-term debt under this revolving credit facility as of July 29, 2011. Interest expense on this credit line is determined based on a LIBOR rate (or other rates quoted by the Administrative Agent, Bank of America, N.A.) plus a basis point spread defined in the credit agreement. In addition, our non-U.S. operations maintain unsecured short-term lines of credit in the aggregate amount of approximately \$20

Table of Contents

million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. As of July 29, 2011, we had no outstanding short-term debt under these lines of credit. As of July 29, 2011, we had \$6.2 million of outstanding standby letters of credit. As of July 29, 2011, we had \$164.3 million of unutilized availability under our credit agreements. In addition, we had \$0.1 million in short-term debt for certain receivables for which we provided recourse to Red Iron as of July 29, 2011.

The revolving credit facility contains standard covenants, including, without limitation, financial covenants, such as the maintenance of minimum interest coverage and maximum debt to earnings ratios; and negative covenants, which among other things, limit loans and investments, disposition of assets, consolidations and mergers, transactions with affiliates, restricted payments, contingent obligations, liens and other matters customarily restricted in such agreements. Most of these restrictions are subject to certain minimum thresholds and exceptions. We were in compliance with all covenants related to our credit agreement for our revolving credit facility as of July 29, 2011, and we expect to be in compliance with all covenants during the remainder of fiscal 2011. If we were out of compliance with any debt covenant required by this credit agreement following the applicable cure period, the banks could terminate their commitments unless we could negotiate a covenant waiver from the banks. In addition, our long-term senior notes and debentures could become due and payable if we were unable to obtain a covenant waiver or refinance our short-term debt under our credit agreement. If our credit rating falls below investment grade and/or our average debt to EBITDA ratio rises above 2.00, the basis point spread over LIBOR (or other rates quoted by the Administrative Agent, Bank of America, N.A.) we currently pay on our outstanding short-term debt under the credit agreement would increase. However, the credit commitment could not be cancelled by the banks based solely on a ratings downgrade. Our debt rating for long-term unsecured senior, non-credit enhanced debt was unchanged during the third quarter of fiscal 2011 by Standard and Poor's Ratings Group at BBB- and by Moody's Investors Service at Baa3.

Customer Financing Arrangements and Contractual Obligations

In fiscal 2009, we established our Red Iron joint venture with TCFIF. The purpose of Red Iron is to provide inventory financing, including floor plan and open account receivable financing, to distributors and dealers of our products in the U.S. and to select distributors of our products in Canada to enable our distributors and dealers to carry representative inventories of our products. Some independent international dealers continue to finance their products with a third party finance company. This third party financing company purchased \$15.5 million of receivables from us during the first nine months of fiscal 2011. As of July 29, 2011, \$9.2 million of receivables financed by the third party financing company, excluding Red Iron, were outstanding, and also includes outstanding receivables that were financed by third party sources before the establishment of Red Iron. See our most recently filed Annual Report on Form 10-K for further details regarding our customer financing arrangements and contractual obligations.

Inflation

We are subject to the effects of inflation, deflation, and changing prices. In the first nine months of fiscal 2011, average prices paid for fuel, commodities and components we purchase were higher compared to the average prices paid for fuel, commodities and components in the first nine months of fiscal 2010, which contributed to the decline in our gross margin rate for the first nine months of fiscal 2011 compared to the first nine months of fiscal 2010. We will continue to closely follow the fuel, commodities and components costs that affect our product lines, and we anticipate average prices paid for fuel, commodities and components to be higher for the remainder of fiscal 2011 as compared to fiscal 2010. We expect to mitigate the impact of inflationary pressures by engaging in proactive vendor negotiations, reviewing alternative sourcing options, substituting materials, engaging in internal cost reduction efforts, and increasing prices on some of our products, all as appropriate.

Critical Accounting Policies and Estimates

See our most recent Annual Report on Form 10-K for the fiscal year ended October 31, 2010 for a discussion of our critical accounting policies.

New Accounting Pronouncements to be Adopted

In June 2011, FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. The ASU 2011-05 guidance amended the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the

Table of Contents

option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and is to be applied retrospectively. The company will adopt this guidance at the beginning of its first quarter of fiscal year 2013. The adoption of this guidance is not expected to have a material impact on the company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. The amendments result in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards. The amendments clarify the application of existing fair value measurement and disclosure requirements, including: a) application of the highest and best use and valuation premise concepts, b) measurement of the fair value of an instrument classified in a reporting entity's shareholders' equity, and c) quantitative disclosure about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy. The amendments also change a particular principle or requirement for fair value measurement and disclosure, including: a) measurement of the fair value of financial instruments that are managed within a portfolio, b) application of premiums and discounts in a fair value measurement, and c) additional disclosure about fair value measurements. The amendments are effective during interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. The company will adopt the amendments of ASU No. 2011-04 at the beginning of its second quarter of fiscal year 2012. The adoption of this guidance is not expected to have a material impact on the company's disclosures.

Forward-Looking Information

This Quarterly Report on Form 10-Q contains not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and that are subject to the safe harbor created by those sections. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or web casts open to the public, in press releases or reports, on our web sites, or otherwise. Statements that are not historical are forward-looking and reflect expectations and assumptions. We try to identify forward-looking statements in this report and elsewhere by using words such as expect, strive, looking ahead, outlook, forecast, optimistic, plan, anticipate, continue, estimate, believe, could, should, will, would, may, possible, likely, intend, and similar expressions and by using future dates. Our forward-looking statements generally relate to our future performance, including our anticipated operating results and liquidity requirements, our business strategies and goals, and the effect of laws, rules, regulations, new accounting pronouncements, and outstanding litigation on our business and future performance.

Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or implied. These risks and uncertainties include factors that affect all businesses operating in a global market as well as matters specific to Toro. The following are some of the factors known to us that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements:

- Economic conditions and outlook in the United States and around the world could adversely affect our net sales and earnings, which includes but is not limited to recessionary conditions; slow or negative economic growth rates; slow down or reductions in levels of golf course development, renovation, and improvement; golf course closures; continued slow down or reductions in levels of home ownership, construction, and home sales; home foreclosures; reduced consumer spending levels; reduced credit availability or unfavorable credit terms for our distributors, dealers, and end-user customers; higher commodity and component costs and fuel prices; higher short-term, mortgage, and other interest rates; continued high unemployment rates; inflationary or deflationary pressures; negative consumer confidence; the impact of sovereign and state debt; and general economic and political conditions and expectations in the U.S. and the other countries in which we conduct business.

- Increases in the cost or disruption in the availability of raw materials and components that we purchase, such as steel, engines, hydraulics, resins and other commodities and components, and increases in our other costs of doing business, such as transportation costs, may adversely affect our profit margins and business.
- Weather conditions may reduce demand for some of our products and adversely affect our net sales.
- Our professional segment net sales are dependent upon golf course revenues and the amount of investment in golf course renovations and improvements; the level of new golf course development and golf course closures; the level of homeowners who outsource their lawn care; the level of residential and commercial construction; availability of credit to professional segment customers on acceptable terms to finance new product purchases; and the amount of government revenues, budget, and spending levels for grounds maintenance equipment; and other factors.
- Our residential segment net sales are dependent upon The Home Depot, Inc. as a major customer, the amount of product placement at retailers, consumer confidence and spending levels, and changing buying patterns of customers.

Table of Contents

- If we are unable to continue to enhance existing products and develop and market new products that respond to customer needs and preferences and achieve market acceptance, or if we experience unforeseen product quality or other problems in the development, production, or use of new and existing products, we may experience a decrease in demand for our products, and our business could suffer.
- We face intense competition in all of our product lines with numerous manufacturers, including from some competitors that have greater operations and financial resources than us. We may not be able to compete effectively against competitors' actions, which could harm our business and operating results.
- A significant percentage of our consolidated net sales are generated outside of the United States, and we intend to continue to expand our international operations. Our international operations require significant management attention and financial resources; expose us to difficulties presented by international economic, political, legal, accounting, and business factors, including political, economic and/or social instability in the countries in which we sell products resulting in contraction or disruption of such markets; and may not be successful or produce desired levels of net sales.
- Fluctuations in foreign currency exchange rates could result in declines in our reported net sales and net earnings.
- We manufacture our products at and distribute our products from several locations in the United States and internationally. Any disruption at any of these facilities or our inability to cost-effectively expand existing, open and manage new, and/or move production between manufacturing facilities could adversely affect our business and operating results. We expect to complete the construction of our new manufacturing facility in Romania for micro-irrigation products and begin production in the fourth quarter of fiscal 2011. If this facility does not produce the anticipated manufacturing or operational efficiencies, or if the micro-irrigation products to be produced at this facility are not accepted into the new geographic markets at expected levels, we may not recover the costs of the new facility and our operating results may be adversely affected.
- We intend to grow our business in part through additional acquisitions and alliances, stronger customer relations, and new joint ventures and partnerships, which are risky and could harm our business, particularly if we are not able to successfully integrate such acquisitions and alliances, joint ventures, and partnerships.
- As a result of our financing joint venture with TCFIF, we are dependent upon the joint venture to provide competitive inventory financing programs, including floor plan and open account receivable financing, to certain distributors and dealers of our products. Any material change in the availability or terms of credit offered to our customers by the joint venture, any termination or disruption of our joint venture relationship or any delay in securing replacement credit sources could adversely affect our net sales and operating results.
- A portion of our international net sales are financed by third parties. The termination of our agreements with these third parties, any material change to the terms of our agreements with these third parties or in the availability or terms of credit offered to our international customers by these third parties, or any delay in securing replacement credit sources, could adversely affect our sales and operating results.

- We rely on our management information systems for inventory management, distribution, and other functions. If our information systems fail to adequately perform these functions or if we experience an interruption in their operation, our business and operating results could be adversely affected.
- Our reliance upon patents, trademark laws, and contractual provisions to protect our proprietary rights may not be sufficient to protect our intellectual property from others who may sell similar products. Our products may infringe the proprietary rights of others.
- Our business, properties, and products are subject to governmental regulation with which compliance may require us to incur expenses or modify our products or operations and non-compliance may expose us to penalties. Governmental regulation may also adversely affect the demand for some of our products and our operating results. The United States Environmental Protection Agency has adopted increasingly stringent engine emission regulations, including Tier 4 emission requirements that beginning in 2012 are applicable to diesel engines in a specified horsepower range that are used in some of our products. Although we are developing plans to achieve substantial compliance with Tier 4 requirements, these plans will be subject to many variables and if we are unable to successfully execute such plans, our ability to sell our products into certain markets may be inhibited, which could adversely affect our competitive position and financial results.
- Legislative enactments could impact the competitive landscape within our markets and affect demand for our products.
- We are subject to product liability claims, product quality issues, and other litigation from time to time that could adversely affect our operating results or financial condition.
- If we are unable to retain our key employees and attract and retain other qualified personnel, we may not be able to meet strategic objectives and our business could suffer.

Table of Contents

- The terms of our credit arrangements and the indentures governing our senior notes and debentures could limit our ability to conduct our business, take advantage of business opportunities, and respond to changing business, market, and economic conditions. Additionally, we are subject to counterparty risk in our credit arrangements. If we are unable to comply with the terms of our credit arrangements and indentures, especially the financial covenants, our credit arrangements could be terminated and our senior notes and debentures could become due and payable.
- Our business is subject to a number of other factors that may adversely affect our operating results, financial condition, or business, such as: our ability to achieve the revenue growth, operating earnings, and employee engagement goals of our new, multi-year employee initiative called Destination 2014 ; natural or man-made disasters or global pandemics that may result in shortages of raw materials and components, higher fuel and commodity costs, and an increase in insurance premiums; financial viability of our distributors and dealers, changes in distributor ownership, changes in channel distribution of our products, relationships with our distribution channel partners, our success in partnering with new dealers, and our customers' ability to pay amounts owed to us; ability of management to adapt to unplanned events; drug cartel-related violence, which may disrupt our production activities and maquiladora operations based in Juarez, Mexico; and continued threat of terrorist acts and war that may result in heightened security and higher costs for import and export shipments of components or finished goods, reduced leisure travel, and contraction of the U.S. and world economies.

For more information regarding these and other uncertainties and factors that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements or otherwise could materially adversely affect our business, financial condition, or operating results, see our most recently filed Annual Report on Form 10-K, Part I, Item 1A, Risk Factors.

All forward-looking statements included in this report are expressly qualified in their entirety by the foregoing cautionary statements. We wish to caution readers not to place undue reliance on any forward-looking statement which speaks only as of the date made and to recognize that forward-looking statements are predictions of future results, which may not occur as anticipated. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the risks and uncertainties described above, as well as others that we may consider immaterial or do not anticipate at this time. The foregoing risks and uncertainties are not exclusive and further information concerning the company and our businesses, including factors that potentially could materially affect our financial results or condition, may emerge from time to time. We assume no obligation to update forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. We advise you, however, to consult any further disclosures we make on related subjects in our future Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K we file with or furnish to the Securities and Exchange Commission.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk stemming from changes in foreign currency exchange rates, interest rates, and commodity prices. Changes in these factors could cause fluctuations in our net earnings, other operating results, and cash flows. See further discussions on these market risks below. We are also exposed to equity market risk pertaining to the trading price of our common stock.

Foreign Currency Exchange Rate Risk. In the normal course of business, we actively manage the exposure of our foreign currency exchange rate market risk by entering into various hedging instruments, authorized under company policies that place controls on these activities, with counterparties that are highly rated financial institutions. Our hedging activities involve the primary use of forward currency contracts. We use derivative instruments only in an attempt to limit underlying exposure from currency fluctuations and to minimize earnings and cash flow

Edgar Filing: TORO CO - Form 10-Q

volatility associated with foreign currency exchange rate changes and not for trading purposes. We are exposed to foreign currency exchange rate risk arising from transactions in the normal course of business, such as sales and loans to wholly owned foreign subsidiaries, foreign plant operations, and purchases from suppliers. Because our products are manufactured or sourced primarily from the United States and Mexico, a stronger U.S. dollar and Mexican peso generally has a negative impact on our results from operations, while a weaker dollar and peso generally has a positive effect. Our primary currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the British pound, the Mexican peso, and the Japanese yen against the U.S. dollar. We also have exposure with the Romanian New Lei against the Euro and U.S. dollar as a result of our new manufacturing facility in Romania.

We enter into various contracts, principally forward contracts that change in value as foreign currency exchange rates change, to protect the value of existing foreign currency assets, liabilities, anticipated sales, and probable commitments. Decisions on

Table of Contents

whether to use such contracts are made based on the amount of exposures to the currency involved and an assessment of the near-term market value for each currency. Worldwide foreign currency exchange rate exposures are reviewed monthly. The gains and losses on these contracts offset changes in market values of the related exposures. Therefore, changes in market values of these hedge instruments are highly correlated with changes in market values of underlying hedged items both at inception of the hedge and over the life of the hedge contract. Additional information regarding gains and losses on our derivative instruments is presented in the Notes to Condensed Consolidated Financial Statements (Unaudited) in Item 1 of this Quarterly Report on Form 10-Q, in the section entitled **Derivative Instruments and Hedging Activities**.

The following foreign currency exchange contracts held by us have maturity dates in fiscal 2011, 2012, and 2013. All items are non-trading and stated in U.S. dollars. Some derivative instruments we enter into do not meet the cash flow hedging criteria; therefore, changes in fair value are recorded in other income, net. The average contracted rate, notional amount, pre-tax value of derivative instruments in accumulated other comprehensive loss, and fair value impact of derivative instruments in other income, net as of and for the fiscal period ended July 29, 2011 were as follows:

Dollars in thousands (except average contracted rate)	Average Contracted Rate	Notional Amount	Value in Accumulated Other Comprehensive Income (Loss)	Fair Value Impact Gain (Loss)
Buy US dollar/Sell Australian dollar	\$ 1.0051	\$ 57,585.3	\$ (2,095.7)	\$ (5,309.0)
Buy US dollar/Sell Canadian dollar	0.9785	13,183.6	(246.8)	(358.6)
Buy US dollar/Sell Euro	1.4284	92,562.0	536.8	(2,750.7)
Buy US dollar/Sell British pound	1.6316	4,242.2		(1.6)
Buy Canadian dollar/Sell US dollar	0.9480	3,164.6		(7.0)
Buy Mexican peso/Sell US dollar	12.1436	23,386.9	439.0	516.0
Buy Euro/Sell Romanian New Lei	4.2720	11,559.0		(181.7)
Buy Swiss Franc/Sell Romanian New Lei	3.4383	2,531.8	206.9	(35.8)

Our net investment in foreign subsidiaries translated into U.S. dollars is not hedged. Any changes in foreign currency exchange rates would be reflected as a foreign currency translation adjustment, a component of accumulated other comprehensive loss in stockholders' equity, and would not impact net earnings.

Interest Rate Risk. Our market risk on interest rates relates primarily to LIBOR-based short-term debt from commercial banks, as well as the potential increase in fair value of long-term debt resulting from a potential decrease in interest rates. However, we do not have a cash flow or earnings exposure due to market risks on long-term debt. We generally do not use interest rate swaps to mitigate the impact of fluctuations in interest rates. See our most recently filed Annual Report on Form 10-K (Item 7A Quantitative and Qualitative Disclosures about Market Risk). There has been no material change in this information.

Commodity Price Risk. Some raw materials used in our products are exposed to commodity price changes. The primary commodity price exposures are with steel, aluminum, fuel, petroleum-based resin, and linerboard. In addition, we are a purchaser of components and parts containing various commodities, including steel, aluminum, copper, lead, rubber, and others which are integrated into our end products. Further information regarding rising prices for commodities is presented in Item 2 of this Quarterly Report on Form 10-Q, in the section entitled **Inflation**.

Edgar Filing: TORO CO - Form 10-Q

We enter into fixed-price contracts for future purchases of natural gas in the normal course of operations as a means to manage natural gas price risks.

Table of Contents

Item 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we are required to apply our judgment in evaluating the cost-benefit relationship of possible internal controls. Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered in this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of such period to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. There was no change in our internal control over financial reporting that occurred during our third fiscal quarter ended July 29, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are a party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive as well as compensatory damages arising out of use of our products. Although we are self-insured to some extent, we maintain insurance against certain product liability losses. We are also subject to administrative proceedings with respect to claims involving the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for remedial investigations and clean up costs. We are also typically involved in commercial disputes, employment disputes, and patent litigation cases in which we are asserting or defending against patent infringement claims. To prevent possible infringement of our patents by others, we periodically review competitors' products. To avoid potential liability with respect to others' patents, we regularly review certain patents issued by the USPTO and foreign patent offices. We believe these activities help us minimize our risk of being a defendant in patent infringement litigation.

For a description of our material legal proceedings, see Notes to Condensed Consolidated Financial Statements under the heading "Litigation" included in Item 1 of this Quarterly Report on Form 10-Q, which is incorporated into this Part II. Item 1 by reference.

Item 1A. RISK FACTORS

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. The significant factors known to us that could materially adversely affect our business, financial condition, or operating results or could cause our actual results to differ materially from our anticipated results or other expectations, including those expressed in any forward-looking statement made in this report, are described in our most recently filed Annual Report on Form 10-K (Item 1A. Risk Factors). There has been no material change in those risk factors.

Table of Contents**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table shows our third quarter of fiscal 2011 stock repurchase activity.

Period	Total Number of Shares (or Units) Purchased (1)(2)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased As Part of Publicly Announced Plans or Programs	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)(2)
April 30, 2011 through May 27, 2011	119,598	\$ 64.11	119,598	3,461,690
May 28, 2011 through June 24, 2011	279,900	60.15	279,900	3,181,790
June 25, 2011 through July 29, 2011	1,330(3)	61.56		3,181,790
Total	400,828	\$ 61.34	399,498	

(1) On July 21, 2009, the company's Board of Directors authorized the repurchase of 5,000,000 shares of the company's common stock in open-market or in privately negotiated transactions. This program has no expiration date but may be terminated by the company's Board of Directors at any time. As of July 29, 2011, there were 181,790 shares remaining for repurchase under this program.

(2) On December 1, 2010, the company's Board of Directors authorized the repurchase of up to an additional 3,000,000 shares of the company's common stock in open-market or in privately negotiated transactions. This program has no expiration date but may be terminated by the company's Board of Directors at any time. No shares were repurchased under this program during the third quarter of fiscal 2011. As of July 29, 2011, there were 3,000,000 shares remaining for purchase under this program.

(3) Includes 1,330 units (shares) of the company's common stock purchased in open-market transactions at an average price of \$61.56 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 1,330 shares were not repurchased under the company's repurchase programs described in footnotes 1 and 2 above.

Item 6. EXHIBITS

(a) Exhibits

3.1 and 4.1 Restated Certificate of Incorporation of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated June 17, 2008, Commission File No. 1-8649).

Edgar Filing: TORO CO - Form 10-Q

- 3.2 and 4.2 Amended and Restated Bylaws of The Toro Company (incorporated by reference to Exhibit 3.2 to Registrant's Current Report on Form 8-K dated June 17, 2008, Commission File No. 1-8649).
- 4.3 Specimen Form of Common Stock Certificate (incorporated by reference to Exhibit 4(c) to Registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended August 1, 2008, Commission File No. 1-8649).
- 4.4 Indenture dated as of January 31, 1997, between Registrant and First National Trust Association, as Trustee, relating to The Toro Company's 7.80% Debentures due June 15, 2027 (incorporated by reference to Exhibit 4(a) to Registrant's Current Report on Form 8-K dated June 24, 1997, Commission File No. 1-8649).

Edgar Filing: TORO CO - Form 10-Q

Table of Contents

4.5	Indenture dated as of April 20, 2007, between Registrant and The Bank of New York Trust Company, N.A., as Trustee, relating to The Toro Company's 6.625% Notes due May 1, 2037 (incorporated by reference to Exhibit 4.3 to Registrant's Registration Statement on Form S-3 filed with the Securities and Exchange Commission on April 23, 2007, Registration No. 333-142282).
4.6	First Supplemental Indenture dated as of April 26, 2007, between Registrant and The Bank of New York Trust Company, N.A., as Trustee, relating to The Toro Company's 6.625% Notes due May 1, 2037 (incorporated by reference to Exhibit 4.1 to Registrant's Current Report on Form 8-K dated April 23, 2007, Commission File No. 1-8649).
4.7	Form of The Toro Company 6.625% Note due May 1, 2037 (incorporated by reference to Exhibit 4.2 to Registrant's Current Report on Form 8-K dated April 23, 2007, Commission File No. 1-8649).
10.1	Credit Agreement dated as of July 28, 2011, among The Toro Company, Toro Manufacturing LLC, Exmark Manufacturing Company Incorporated, Toro International Company and certain subsidiaries, as Borrowers, the lenders from time to time party thereto, Bank of America, N.A., as Administrative Agent, Swingline Lender and Letter of Credit Issuer and Wells Fargo Bank, National Association, as Syndication Agent (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K dated July 28, 2011, Commission File No. 1-8649).
10.2	Offer Letter dated July 25, 2011 between The Toro Company and Renee J. Peterson (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K dated July 29, 2011, Commission File No. 1-8649).
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) (Section 302 of the Sarbanes-Oxley Act of 2002) (filed herewith).
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) (Section 302 of the Sarbanes-Oxley Act of 2002) (filed herewith).
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
101	The following financial information from The Toro Company's Quarterly Report on Form 10-Q for the quarterly period ended July 29, 2011, filed with the SEC on September 1, 2011, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Earnings for the three and nine-month periods ended July 29, 2011 and July 30, 2010, (ii) Condensed Consolidated Balance Sheets as of July 29, 2011, July 30, 2010, and October 31, 2010, (iii) Condensed Consolidated Statement of Cash Flows for the nine months ended July 29, 2011 and July 30, 2010, and (iv) Notes to Condensed Consolidated Financial Statements.**

** Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under Section 11 or 12 of the Securities Act of 1933, as amended, or otherwise subject to the liability of those sections, except as shall be expressly set forth by specific reference in such filings.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

THE TORO COMPANY
(Registrant)

Date: September 1, 2011

By /s/ Renee J. Peterson
Renee J. Peterson
Vice President, Finance
and Chief Financial Officer
(duly authorized officer and principal financial officer)