TORO CO
Form 10-Q
September 01, 2011
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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	**1-8649**	**41-0580470**
(State of Incorporation)	(Commission File Number)	(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 to such filing requirements for the past 90 days. Yes x No o

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 x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

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THE TORO COMPANY

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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.

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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.

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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.

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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

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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 July 29, 2011	Three Months Ended July 30, 2010	Nine Months Ended July 29, 2011	Nine Months Ended 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 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

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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:

	Three Months Ended		**Nine Months Ended**	
(Shares in thousands)	**July 29, 2011**	**July 30, 2010**	**July 29, 2011**	**July 30, 2010**
Basic				
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
Diluted				
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

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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

(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.

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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 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

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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:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	July 29, 2011	July 30, 2010	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

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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								

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

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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)	Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain (Loss) Reclassified from AOCL into Income (Effective Portion)	Gain (Loss) Reclassified from AOCL into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and excluded from Effectiveness Testing)	Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Excluded from Effectiveness Testing)	
For the three months ended	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.

		Gain (Loss) Recognized in Net Earnings			
		Three Months Ended		Nine Months Ended	
(Dollars in thousands)	Location of Gain (Loss) Recognized in Net Earnings	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

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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

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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.

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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.

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

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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%		