

TORO CO  
Form 10-Q  
August 31, 2016  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the Quarterly Period Ended July 29, 2016**

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

**For the Transition Period from            to**

**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**

Edgar Filing: TORO CO - Form 10-Q

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  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

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares of the registrant's common stock outstanding as of August 25, 2016 was 54,656,474.

Table of Contents

**THE TORO COMPANY**

**INDEX TO FORM 10-Q**

	<b>Page Number</b>
<b><u>PART I.</u></b>	
<b><u>FINANCIAL INFORMATION:</u></b>	
<b><u>Item 1.</u></b>	
<u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Earnings (Unaudited) Three and Nine Months Ended July 29, 2016 and July 31, 2015</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited) Three and Nine Months Ended July 29, 2016 and July 31, 2015</u>	3
<u>Condensed Consolidated Balance Sheets (Unaudited) July 29, 2016, July 31, 2015, and October 31, 2015</u>	4
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) Nine Months Ended July 29, 2016 and July 31, 2015</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6-17
<b><u>Item 2.</u></b>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17-28
<b><u>Item 3.</u></b>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	29-30
<b><u>Item 4.</u></b>	
<u>Controls and Procedures</u>	30
<b><u>PART II.</u></b>	
<b><u>OTHER INFORMATION:</u></b>	
<b><u>Item 1.</u></b>	
<u>Legal Proceedings</u>	30
<b><u>Item 1A.</u></b>	
<u>Risk Factors</u>	30-31
<b><u>Item 2.</u></b>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
<b><u>Item 5.</u></b>	
<u>Other Information</u>	31
<b><u>Item 6.</u></b>	
<u>Exhibits</u>	31-32
<u>Signatures</u>	33

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, 2016	July 31, 2015	July 29, 2016	July 31, 2015
Net sales	\$ 600,980	\$ 609,615	\$ 1,923,819	\$ 1,910,068
Cost of sales	384,363	393,225	1,221,361	1,242,707
Gross profit	216,617	216,390	702,458	667,361
Selling, general, and administrative expense	134,664	136,985	411,576	405,079
Operating earnings	81,953	79,405	290,882	262,282
Interest expense	(4,646)	(4,587)	(14,021)	(14,071)
Other income, net	3,480	2,798	11,865	7,515
Earnings before income taxes	80,787	77,616	288,726	255,726
Provision for income taxes	24,965	24,292	87,962	77,689
Net earnings	\$ 55,822	\$ 53,324	\$ 200,764	\$ 178,037
Basic net earnings per share of common stock	\$ 1.02	\$ 0.96	\$ 3.65	\$ 3.19
Diluted net earnings per share of common stock	\$ 1.00	\$ 0.94	\$ 3.58	\$ 3.13
Weighted-average number of shares of common stock outstanding Basic	54,983	55,310	54,973	55,739
Weighted-average number of shares of common stock outstanding Diluted	56,056	56,552	56,077	56,953

See accompanying Notes to Condensed Consolidated Financial Statements.

## THE TORO COMPANY AND SUBSIDIARIES

## Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)

Edgar Filing: TORO CO - Form 10-Q

	Three Months Ended		Nine Months Ended	
	July 29, 2016	July 31, 2015	July 29, 2016	July 31, 2015
Net earnings	\$ 55,822	\$ 53,324	\$ 200,764	\$ 178,037
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(5,753)	(3,534)	(4,803)	(10,648)
Derivative instruments, net of tax of \$652, \$(379), \$(1,000), and \$(526), respectively	667	(1,055)	(1,925)	(2,394)
Other comprehensive (loss) income	(5,086)	(4,589)	(6,728)	(13,042)
Comprehensive income	\$ 50,736	\$ 48,735	\$ 194,036	\$ 164,995

See accompanying Notes to Condensed Consolidated Financial Statements.

Edgar Filing: TORO CO - Form 10-Q

Table of Contents

THE TORO COMPANY AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(Dollars in thousands, except per share data)

	July 29, 2016		July 31, 2015		October 31, 2015
<b>ASSETS</b>					
Cash and cash equivalents	\$ 277,243	\$	110,335	\$	126,275
Receivables, net	202,389		227,806		177,013
Inventories, net	327,114		350,194		334,514
Prepaid expenses and other current assets	39,658		39,743		34,782
Deferred income taxes	39,062		43,339		38,095
Total current assets	885,466		771,417		710,679
Property, plant, and equipment, gross	833,664		802,305		804,598
Less accumulated depreciation	612,788		581,983		579,603
Property, plant, and equipment, net	220,876		220,322		224,995
Long-term deferred income taxes	26,154		26,364		28,568
Other assets	29,165		25,317		24,873
Goodwill	195,016		194,727		195,533
Other intangible assets, net	110,785		121,804		119,010
Total assets	\$ 1,467,462	\$	1,359,951	\$	1,303,658
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>					
Current portion of long-term debt	\$ 22,627	\$	23,279	\$	23,134
Short-term debt			5,189		222
Accounts payable	172,156		169,927		152,017
Accrued liabilities	318,628		300,576		268,361
Total current liabilities	513,411		498,971		443,734
Long-term debt, less current portion	334,658		358,053		354,818
Deferred revenue	11,958		11,324		11,365
Other long-term liabilities	29,585		26,430		31,576
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 175,000,000 shares; issued and outstanding 54,644,978 shares as of July 29, 2016, 54,835,233 shares as of July 31, 2015, and 54,650,916 shares as of October 31, 2015	54,645		54,835		54,651
Retained earnings	559,776		439,085		437,357
Accumulated other comprehensive loss	(36,571)		(28,747)		(29,843)
Total stockholders' equity	577,850		465,173		462,165
Total liabilities and stockholders' equity	\$ 1,467,462	\$	1,359,951	\$	1,303,658

See accompanying Notes to Condensed Consolidated Financial Statements.



Edgar Filing: TORO CO - Form 10-Q

Table of Contents

THE TORO COMPANY AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Nine Months Ended	
	July 29, 2016	July 31, 2015
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 200,764	\$ 178,037
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Non-cash income from finance affiliate	(7,302)	(6,223)
Provision for depreciation, amortization, and impairment loss	46,332	45,944
Stock-based compensation expense	7,723	7,815
Decrease/(increase) in deferred income taxes	256	(2,096)
Other	(464)	(67)
Changes in operating assets and liabilities, net of effect of acquisitions:		
Receivables, net	(23,699)	(74,916)
Inventories, net	3,428	(67,902)
Prepaid expenses and other assets	(2,108)	(5,563)
Accounts payable, accrued liabilities, deferred revenue, and other long-term liabilities	63,977	92,985
Net cash provided by/(used in) operating activities	288,907	168,014
<b>Cash flows from investing activities:</b>		
Purchases of property, plant, and equipment	(34,601)	(37,544)
Proceeds from asset disposals	232	77
Distributions from finance affiliate, net	3,594	1,928
Proceeds from sale of a business	1,500	
Acquisition, net of cash acquired		(198,329)
Net cash provided by/(used in) investing activities	(29,275)	(233,868)
<b>Cash flows from financing activities:</b>		
Repayments of short-term debt	(1,161)	(16,283)
(Repayments of)/ increase in long-term debt	(20,713)	(3,831)
Excess tax benefits from stock-based awards	15,078	7,808
Proceeds from exercise of stock options	19,691	8,615
Purchases of Toro common stock	(69,189)	(90,993)
Dividends paid on Toro common stock	(49,488)	(41,794)
Net cash provided by/(used in) financing activities	(105,782)	(136,478)
Effect of exchange rates on cash and cash equivalents	(2,882)	(2,206)
Net increase/(decrease) in cash and cash equivalents	150,968	(204,538)
Cash and cash equivalents as of the beginning of the fiscal period	126,275	314,873
Cash and cash equivalents as of the end of the fiscal period	\$ 277,243	\$ 110,335
<b>Supplemental disclosure of cash flow information:</b>		
Debt issued in connection with an acquisition	\$	\$ 31,161

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, 2016

**Note 1 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, 2016, cannot be annualized to determine the expected results for the fiscal year ending October 31, 2016.

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 calendar month 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, 2015. 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 impact 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 promotion and incentive accruals, incentive compensation accruals, inventory valuation, warranty reserves, earn-out 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 at the time they are made. 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. As future events and their effects cannot be determined with certainty, 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.

**Note 2 Divestiture**

On November 27, 2015, in the first quarter of fiscal 2016, the company completed the sale of its Northwestern U.S. distribution company. The divestiture was not material based on the company's consolidated financial condition and results of operations.

**Note 3 Investment in Joint Venture**

In fiscal 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 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, 2017, 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. 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.

Table of Contents

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. The company and TCFIF each 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, 2016 was \$22.7 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.

Under the repurchase agreement between Red Iron and the company, Red Iron provides financing for certain dealers and distributors. These 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. These payments extinguish the obligation of the dealer or distributor to make payment to the company under the terms of the applicable 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 31, 2016 and July 31, 2015 was \$1,389.5 million and \$1,117.7 million, respectively.

As of July 31, 2016, Red Iron's total assets were \$447.0 million and total liabilities were \$396.5 million.

**Note 4 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 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, 2016	July 31, 2015	October 31, 2015
Raw materials and work in process	\$ 88,581	\$ 102,580	\$ 107,086
Finished goods and service parts	302,573	315,110	291,468
Total FIFO value	391,154	417,690	398,554
Less: adjustment to LIFO value	64,040	67,496	64,040
Total inventories, net	\$ 327,114	\$ 350,194	\$ 334,514

**Note 5 Goodwill and Other Intangible Assets**

The changes in the net carrying amount of goodwill for the first nine months of fiscal 2016 were as follows:

Edgar Filing: TORO CO - Form 10-Q

<b>(Dollars in thousands)</b>	<b>Professional Segment</b>		<b>Residential Segment</b>		<b>Total</b>
Balance as of October 31, 2015	\$	184,766	\$	10,767	\$ 195,533
Translation adjustments		(296)		(221)	(517)
Balance as of July 29, 2016	\$	184,470	\$	10,546	\$ 195,016

Table of Contents

The components of other intangible assets were as follows:

(Dollars in thousands) July 29, 2016	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$ 15,159	\$ (10,692)	\$ 4,467
Non-compete agreements	6,894	(6,588)	306
Customer-related	84,427	(13,448)	70,979
Developed technology	28,694	(22,923)	5,771
Trade names	28,715	(3,895)	24,820
Other	800	(800)	
Total amortizable	164,689	(58,346)	106,343
Non-amortizable - trade names	4,442		4,442
Total other intangible assets, net	\$ 169,131	\$ (58,346)	\$ 110,785

(Dollars in thousands) October 31, 2015	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$ 15,191	\$ (10,175)	\$ 5,016
Non-compete agreements	6,922	(6,206)	716
Customer-related	84,599	(10,316)	74,283
Developed technology	28,804	(20,530)	8,274
Trade names	28,715	(2,825)	25,890
Other	800	(800)	
Total amortizable	165,031	(50,852)	114,179
Non-amortizable - trade names	4,831		4,831
Total other intangible assets, net	\$ 169,862	\$ (50,852)	\$ 119,010

Amortization expense for intangible assets during the first nine months of fiscal 2016 was \$8.1 million, compared to \$10.0 million for the same period last fiscal year. Estimated amortization expense for the remainder of fiscal 2016 and succeeding fiscal years is as follows: fiscal 2016 (remainder), \$2.5 million; fiscal 2017, \$9.5 million; fiscal 2018, \$7.4 million; fiscal 2019, \$6.6 million; fiscal 2020, \$6.0 million; fiscal 2021, \$5.6 million; and after fiscal 2021, \$68.7 million.

**Note 6 Stockholders Equity***Accumulated Other Comprehensive Loss*

Components of accumulated other comprehensive loss ( AOCL ), net of tax, are as follows:

(Dollars in thousands)	July 29, 2016	July 31, 2015	October 31, 2015
Foreign currency translation adjustments	\$ 29,636	\$ 23,255	\$ 24,328

Edgar Filing: TORO CO - Form 10-Q

Pension and post-retirement benefits		4,881		5,195		5,386
Derivative instruments		2,054		297		129
Total accumulated other comprehensive loss	\$	36,571	\$	28,747	\$	29,843

Table of Contents

The components and activity of AOCL for the first nine months of fiscal 2016 are as follows:

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Postretirement Benefits	Cash Flow Derivative Instruments	Total
Balance as of October 31, 2015	\$ 24,328	\$ 5,386	\$ 129	\$ 29,843
Other comprehensive loss (income) before reclassifications	5,308	(505)	2,140	6,943
Amounts reclassified from AOCL			(215)	(215)
Net current period other comprehensive loss (income)	5,308	(505)	1,925	6,728
Balance as of July 29, 2016	\$ 29,636	\$ 4,881	\$ 2,054	\$ 36,571

The components and activity of AOCL for the first nine months of fiscal 2015 are as follows:

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Postretirement Benefits	Cash Flow Derivative Instruments	Total
Balance as of October 31, 2014	\$ 12,536	\$ 5,266	\$ (2,097)	\$ 15,705
Other comprehensive loss (income) before reclassifications	10,719	(71)	(6,694)	3,954
Amounts reclassified from AOCL			9,088	9,088
Net current period other comprehensive loss (income)	10,719	(71)	2,394	13,042
Balance as of July 31, 2015	\$ 23,255	\$ 5,195	\$ 297	\$ 28,747

**Note 7 Stock-Based Compensation***Stock Option Awards*

Under The Toro Company Amended and Restated 2010 Equity and Incentive Plan, as amended (the 2010 plan), stock options 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 executive officers, other employees, and non-employee members of the company's Board of Directors on an annual basis in the first quarter of the company's fiscal year. Options generally vest one-third each year over a three-year period and have a ten-year term. Other options granted to certain 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. Stock options granted to executive officers and other employees are subject to accelerated expensing if the option holder meets the retirement definition set forth in the 2010 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 options to continue to vest following retirement. Similarly, if a non-employee director has served on the company's Board of Directors for ten full fiscal years or more, the awards vest immediately upon retirement, and therefore, the fair value of the options granted is fully expensed on the date of the grant.



## Edgar Filing: TORO CO - Form 10-Q

The fair value of each stock option is estimated on the date of grant using the Black-Scholes valuation method with 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 in which executive officers, other employees, and non-employee directors are expected to exercise their stock options, which is primarily based on historical experience. 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 historical cash dividends paid, expected future cash dividends and dividend yield, and expected changes in the company's stock price.

Table of Contents

The following table illustrates the assumptions for options granted in the following fiscal periods:

	<b>Fiscal 2016</b>	<b>Fiscal 2015</b>
Expected life of option in years	5.97	5.94
Expected stock price volatility	24.04%	29.67%
Risk-free interest rate	1.80%	1.61%
Expected dividend yield	1.24%	1.29%
Grant date per share weighted-average fair value	\$17.58	\$16.81

***Performance Share Awards***

The company grants performance share awards to executive officers and other employees under which they are entitled to receive shares of the company's common stock contingent on the achievement of performance goals of the company and businesses of the company, which are generally measured over a three-year period. The number of shares of common stock 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 at the end of a three-year period. Performance share awards are generally 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 per share fair value as of the date of grant and the probability of achieving each performance goal. The per share fair value of performance share awards granted during the first quarter of each of fiscal 2016 and 2015 was \$77.77 and \$65.68, respectively. No performance share awards were granted during the second or third quarters of fiscal 2016 or 2015.

***Restricted Stock and Restricted Stock Unit Awards***

Under the 2010 plan, restricted stock and restricted stock unit awards are generally granted to certain employees that are not executive officers. Occasionally, restricted stock or restricted stock unit awards may be granted, including to executive officers, in connection with hiring, mid-year promotions, leadership transition, or retention. Restricted stock and restricted stock unit 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. Such awards may have performance-based rather than time-based vesting requirements. 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 multiplied by the number of shares subject to the restricted stock and restricted stock unit awards, is recognized for these awards over the vesting period. The per share weighted-average fair value of restricted stock and restricted stock unit awards granted during the first nine months of fiscal 2016 and 2015 was \$83.67 and \$66.10, respectively.

**Note 8 Per Share Data**

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

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>July 29,</b>	<b>July 31,</b>	<b>July 29,</b>	<b>July 31,</b>

Edgar Filing: TORO CO - Form 10-Q

(Shares in thousands)	2016	2015	2016	2015
<u>Basic</u>				
Weighted-average number of shares of common stock	54,983	55,310	54,955	55,724
Assumed issuance of contingent shares			18	15
Weighted-average number of shares of common stock and assumed issuance of contingent shares	54,983	55,310	54,973	55,739
<u>Diluted</u>				
Weighted-average number of shares of common stock and assumed issuance of contingent shares	54,983	55,310	54,973	55,739
Effect of dilutive securities	1,073	1,242	1,104	1,214
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	56,056	56,552	56,077	56,953

Table of Contents

Incremental shares from options, restricted stock, and restricted stock units are computed by the treasury stock method. Options to purchase 16,768 and 157,299 shares of common stock during the third quarter of fiscal 2016 and 2015, respectively, were excluded from the diluted net earnings per share because they were anti-dilutive. For the year-to-date periods through the third quarter of fiscal 2016 and 2015, options to purchase 243,871 and 245,818 shares of common stock, respectively, were excluded from the diluted net earnings per share because they were anti-dilutive.

**Note 9 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 the company-owned domestic distributorship, 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)**

<b>Three months ended July 29, 2016</b>	<b>Professional</b>	<b>Residential</b>	<b>Other</b>	<b>Total</b>
Net sales	\$ 427,784	\$ 167,815	\$ 5,381	\$ 600,980
Intersegment gross sales	6,134	92	(6,226)	
Earnings (loss) before income taxes	89,096	12,767	(21,076)	80,787

<b>Three months ended July 31, 2015</b>	<b>Professional</b>	<b>Residential</b>	<b>Other</b>	<b>Total</b>
Net sales	\$ 421,994	\$ 175,977	\$ 11,644	\$ 609,615
Intersegment gross sales	10,365	222	(10,587)	
Earnings (loss) before income taxes	82,253	20,566	(25,203)	77,616

<b>Nine months ended July 29, 2016</b>	<b>Professional</b>	<b>Residential</b>	<b>Other</b>	<b>Total</b>
Net sales	\$ 1,361,829	\$ 550,330	\$ 11,660	\$ 1,923,819
Intersegment gross sales	24,100	289	(24,389)	
Earnings (loss) before income taxes	292,311	64,494	(68,079)	288,726
Total assets	803,414	215,509	448,539	1,467,462

<b>Nine months ended July 31, 2015</b>	<b>Professional</b>	<b>Residential</b>	<b>Other</b>	<b>Total</b>
Net sales	\$ 1,314,474	\$ 578,587	\$ 17,007	\$ 1,910,068
Intersegment gross sales	38,651	410	(39,061)	
Earnings (loss) before income taxes	258,727	69,131	(72,132)	255,726
Total assets	846,400	226,835	286,716	1,359,951

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

Edgar Filing: TORO CO - Form 10-Q

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 29, 2016	July 31, 2015	July 29, 2016	July 31, 2015
Corporate expenses	\$ (19,872)	\$ (26,989)	\$ (68,270)	\$ (68,434)
Interest expense, net	(4,646)	(4,587)	(14,021)	(14,071)
Other	3,442	6,373	14,212	10,373
Total	\$ (21,076)	\$ (25,203)	\$ (68,079)	\$ (72,132)

**Note 10 Contingencies Litigation**

The company is party to litigation in the ordinary course of business. Such matters are generally subject to uncertainties and to outcomes that are not predictable with assurance and that may not be known for extended periods of time. Litigation

Table of Contents

occasionally involves claims for punitive, as well as compensatory, damages arising out of the 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 litigation and administrative and judicial proceedings with respect to claims involving asbestos and the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for personal injury, remedial investigations or clean up and other costs and damages. 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 and foreign patent offices. Management believes these activities help minimize its risk of being a defendant in patent infringement litigation. The company is currently involved in patent litigation cases, including cases by or against competitors, where it is asserting and defending against claims of patent infringement. Such cases are at varying stages in the litigation process. The company records a liability in its consolidated financial statements for costs related to claims, including future legal costs, settlements and judgments, where the company has assessed that a loss is probable and an amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, the company records the most probable estimate of the loss or the minimum amount when no amount within the range is a better estimate than any other amount. The company discloses a contingent liability even if the liability is not probable or the amount is not estimable, or both, if there is a reasonable possibility that a material loss may have been incurred. In the opinion of management, the amount of liability, if any, with respect to these matters, individually or in the aggregate, will not materially affect its consolidated results of operations, financial position, or cash flows.

**Note 11 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 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 months of fiscal 2016 and 2015 were as follows:

(Dollars in thousands)	Nine Months Ended	
	July 29, 2016	July 31, 2015
Beginning balance	\$ 70,734	\$ 71,080
Warranty provisions	36,673	34,532
Warranty claims	(28,596)	(26,728)
Changes in estimates	2,602	(221)
Ending balance	\$ 81,413	\$ 78,663

**Note 12 Derivative Instruments and Hedging Activities**

## Edgar Filing: TORO CO - Form 10-Q

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 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. The company's hedging activities primarily involve the use of forward currency contracts, as well as cross currency swaps that are intended to offset intercompany loan exposures. 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 primarily based on the amount of exposure to the currency involved and an assessment of the near-term market

Table of Contents

value for each currency. The company's policy does not allow the use of derivatives for trading or speculative purposes. The company also made an accounting policy election to use the portfolio exception with respect to measuring counterparty credit risk for derivative instruments, and to measure the fair value of a portfolio of financial assets and financial liabilities on the basis of the net open risk position with each counterparty. The company's primary currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the British pound, the Mexican peso, the Japanese yen, the Chinese Renminbi, and the Romanian New Leu against the U.S. dollar, as well as the Romanian New Leu against the Euro.

**Cash flow hedges.** The company recognizes all derivative instruments as either assets or liabilities at fair value on the consolidated balance sheet and formally documents relationships between cash flow hedging instruments and hedged transactions, as well as its risk-management objective and strategy for undertaking hedge transactions. This process includes linking all derivatives to the forecasted transactions, such as sales to third parties, foreign plant operations, and purchases from suppliers. Changes in fair values of outstanding cash flow hedge derivatives, except the ineffective portion, are recorded in other comprehensive income (OCI), 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 statements 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. Results of hedges of intercompany loans are recorded in other income, net as an offset to the remeasurement of the foreign loan balance.

The company formally assesses, at a hedge's inception and on an ongoing basis, whether the derivatives that are designated as hedges have been highly effective in offsetting changes in the cash flows of the hedged transactions 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 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 in AOCL 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 consolidated balance sheets, recognizing future changes in the fair value in other income, net. For the third quarter and year-to-date periods of fiscal 2016, there were immaterial losses on forward contracts reclassified into earnings as a result of the discontinuance of cash flow hedges. As of July 29, 2016 and July 31, 2015, the notional amount outstanding of forward contracts designated as cash flow hedges was \$86.0 million and \$102.8 million, respectively. As of July 31, 2015, the company had one cross currency interest rate swap instrument outstanding for a fixed pay notional of 36.6 million Romanian New Leu and receive floating notional of 8.5 million Euros. During the third quarter of fiscal 2016, the company terminated its one cross currency interest rate swap instrument outstanding with gains on the instrument recorded in other income.

**Derivatives not designated as hedging instruments.** The company also enters into foreign currency contracts that include forward currency contracts and cross currency swaps to mitigate the remeasurement 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.

Edgar Filing: TORO CO - Form 10-Q

Table of Contents

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

(Dollars in thousands)	Fair Value at July 29, 2016	Fair Value at July 31, 2015	Fair Value at October 31, 2015
<b>Asset Derivatives</b>			
<i>Derivatives Designated as Hedging Instruments</i>			
Prepaid expenses and other current assets			
Forward currency contracts	\$ 114	\$ 2,957	\$ 2,102
Cross currency contract			
<i>Derivatives Not Designated as Hedging Instruments</i>			
Prepaid expenses and other current assets			
Forward currency contracts	532	2,663	1,071
Cross currency contract		2,179	2,136
Total Assets	\$ 646	\$ 7,799	\$ 5,309
<b>Liability Derivatives</b>			
<i>Derivatives Designated as Hedging Instruments</i>			
Accrued liabilities			
Forward currency contracts	\$ 2,070	\$ 1,986	\$ 1,363
Cross currency contract		243	134
<i>Derivatives Not Designated as Hedging Instruments</i>			
Accrued liabilities			
Forward currency contracts	402	2	348
Cross currency contract			
Total Liabilities	\$ 2,472	\$ 2,231	\$ 1,845

The following table presents the impact of derivative instruments on the consolidated statements of earnings for the company's derivatives designated as cash flow hedging instruments for the three and nine months ended July 29, 2016 and July 31, 2015, respectively.

(Dollars in thousands)	Gain (Loss)		Effective Portion Location of Gain (Loss) Reclassified from AOCL into Income	Ineffective Portion and excluded from Effectiveness Testing Location of Gain (Loss)		Gain (Loss) Recognized in Income on Derivatives	
	Recognized in OCI on Derivatives July 29, 2016	July 31, 2015		Gain (Loss) Recognized from AOCL into Income July 29, 2016	July 31, 2015		
<b>For the three months ended</b>							
Forward currency contracts	\$ 983	\$ (654)	Net sales	\$ (192)	\$ 3,258	Other income, net	\$ (69) \$ 280
Forward currency contracts	(317)	(433)	Cost of sales	(931)	(817)		
Cross currency contracts		31	Other income, net		(85)		
Total derivatives designated as cash flow hedges	\$ 666	\$ (1,056)	Total	\$ (1,123)	\$ 2,356	Total	\$ (69) \$ 280
<b>For the nine months ended</b>							
Forward currency contracts	\$ (1,647)	\$ (950)	Net sales	\$ 1,809	\$ 11,188	Other income, net	\$ 162 \$ 563
Forward currency contracts	(537)	(1,615)	Cost of sales	(1,930)	(1,808)		
Cross currency contracts	255	167	Other income, net	(94)	(292)		

Edgar Filing: TORO CO - Form 10-Q

Total derivatives designated as cash flow hedges	\$	(1,929)	\$	(2,398)	Total	\$	(215)	\$	9,088	Total	\$	162	\$	563
--	----	---------	----	---------	-------	----	-------	----	-------	-------	----	-----	----	-----

As of July 29, 2016, the company expects to reclassify approximately \$1.6 million of gains from AOCL to earnings during the next twelve months.

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 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, 2016	July 31, 2015	July 29, 2016	July 31, 2015
Forward currency contracts	Other income, net	\$ 788	\$ (2,891)	\$ (553)	\$ 8,459
Cross currency contracts	Other income, net	(8)	139	(191)	1,441
Total derivatives not designated as hedges		\$ 780	\$ (2,752)	\$ (744)	\$ 9,900

The company entered into an International Swap Dealers Association (ISDA) Master Agreement with each counterparty that permits the net settlement of amounts owed under their respective contracts. The ISDA Master Agreement is an industry standardized contract that governs all derivative contracts entered into between the company and the respective counterparty. Under these master netting agreements, net settlement generally permits the company or the counterparty to determine the net amount payable or receivable for contracts due on the same date or in the same currency for similar types of derivative transactions. The company records the fair value of its derivative contracts at the net amount in its consolidated balance sheets.

The following tables show the effects of the master netting arrangements on the fair value of the company's derivative contracts that are recorded in the consolidated balance sheets:

(Dollars in thousands)	July 29, 2016	July 31, 2015	October 31, 2015
<b>Assets</b>			
<i>Forward currency contracts</i>			
Gross Amounts of Recognized Assets	\$ 885	\$ 5,855	\$ 3,380
Gross Liabilities Offset in the Balance Sheets	(239)	(235)	(207)
Net Amounts of Assets Presented in the Balance Sheets	646	5,620	3,173
<i>Cross currency contracts</i>			
Gross Amounts of Recognized Assets		2,179	2,136
Gross Liabilities Offset in the Balance Sheets			
Net Amounts of Assets Presented in the Balance Sheets		2,179	2,136
Total Assets	\$ 646	\$ 7,799	\$ 5,309
<b>Liabilities</b>			
<i>Forward currency contracts</i>			
Gross Amounts of Recognized Liabilities	\$ (2,475)	\$ (2,220)	\$ (1,711)
Gross Assets Offset in the Balance Sheets	3	232	
Net Amounts of Liabilities Presented in the Balance Sheets	(2,472)	(1,988)	(1,711)
<i>Cross currency contracts</i>			
Gross Amounts of Recognized Liabilities		(243)	(134)
Gross Assets Offset in the Balance Sheets			
Net Amounts of Liabilities Presented in the Balance Sheets		(243)	(134)
Total Liabilities	\$ (2,472)	\$ (2,231)	\$ (1,845)

**Note 13 Fair Value Measurements**

## Edgar Filing: TORO CO - Form 10-Q

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

Table of Contents

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.

Cash balances are valued at their carrying amounts in the consolidated balance sheets, which are reasonable estimates of their fair value due to their short-term nature. Forward currency contracts are valued based on observable market transactions of forward currency prices and spot currency rates as of the reporting date. The fair value of cross currency contracts is determined using discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs such as interest rates and foreign currency exchange rates. In addition, credit valuation adjustments, which consider the impact of any credit enhancements to the contracts, such as collateral postings, thresholds, mutual puts, and guarantees, are incorporated in the fair values to account for potential nonperformance risk. 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, 2016, July 31, 2015, and October 31, 2015 are summarized below:

(Dollars in thousands) July 29, 2016	Fair Value	Fair Value Measurements Using Inputs Considered as:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents	\$ 277,243	\$ 277,243	\$	\$
Forward currency contracts	646		646	
Cross currency contracts				
<b>Total Assets</b>	<b>\$ 277,889</b>	<b>\$ 277,243</b>	<b>\$ 646</b>	<b>\$</b>
<b>Liabilities:</b>				
Forward currency contracts	\$ 2,472	\$	\$ 2,472	\$
Cross currency contracts				
Deferred compensation liabilities	1,275		1,275	
<b>Total Liabilities</b>	<b>\$ 3,747</b>	<b>\$</b>	<b>\$ 3,747</b>	<b>\$</b>

(Dollars in thousands)

Fair Value Measurements Using Inputs Considered as:

Edgar Filing: TORO CO - Form 10-Q

July 31, 2015	Fair Value	Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents	\$ 110,335	\$ 110,335	\$	\$
Forward currency contracts	5,620		5,620	
Cross currency contracts	2,179		2,179	
<b>Total Assets</b>	<b>\$ 118,134</b>	<b>\$ 110,335</b>	<b>\$ 7,799</b>	<b>\$</b>
<b>Liabilities:</b>				
Forward currency contracts	\$ 1,988	\$	\$ 1,988	\$
Cross currency contracts	243		243	
Deferred compensation liabilities	1,775		1,775	
<b>Total Liabilities</b>	<b>\$ 4,006</b>	<b>\$</b>	<b>\$ 4,006</b>	<b>\$</b>

Table of Contents

(Dollars in thousands) October 31, 2015	Fair Value	Fair Value Measurements Using Inputs Considered as:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Cash and cash equivalents	\$ 126,275	\$ 126,275	\$	\$
Forward currency contracts	3,173		3,173	
Cross currency contracts	2,136		2,136	
<b>Total Assets</b>	<b>\$ 131,584</b>	<b>\$ 126,275</b>	<b>\$ 5,309</b>	<b>\$</b>
<b>Liabilities:</b>				
Forward currency contracts	\$ 1,711	\$	\$ 1,711	\$
Cross currency contracts	134		134	
Deferred compensation liabilities	1,652		1,652	
<b>Total Liabilities</b>	<b>\$ 3,497</b>	<b>\$</b>	<b>\$ 3,497</b>	<b>\$</b>

There were no transfers between Level 1 and Level 2 during the three and nine months ended July 29, 2016 and July 31, 2015, or the twelve months ended October 31, 2015.

**Note 14 Related Party Transaction**

On November 14, 2014, during the first quarter of fiscal 2015, the company acquired substantially all of the assets (excluding accounts receivable) of the BOSS® professional snow and ice management business of privately held Northern Star Industries, Inc. The purchase price included a cash payment and issuance of an unsecured promissory note in the aggregate principal amount of \$30 million. Under the terms of the note, interest will accrue at the rate of 4.0% per year and principal payments of \$10 million each, together with accrued interest, will be payable on the first, second, and third anniversaries of the closing date of the acquisition, subject to certain conditions. Effective as of the closing of the acquisition on November 14, 2014 and through May 31, 2016, the company employed David J. Brule II, who is also a minority shareholder of Northern Star Industries, Inc., as an executive officer of the company.

**Note 15 Subsequent Events**

On August 18, 2016, the Company's Board of Directors declared a two-for-one split of the Company's common stock, which will be effected in the form of a 100 percent stock dividend, and will be distributed September 16, 2016, to shareholders of record as of September 1, 2016.

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.

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



Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to provide a reader of our financial statements with a narrative from the perspective of management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Unless expressly stated otherwise, the comparisons presented in this MD&A refer to the same period in the prior fiscal year. Our MD&A is presented in six sections:

- Company Overview
- Results of Operations
- Business Segments
- Financial Position
- Critical Accounting Policies and Estimates
- Forward-Looking Information

This 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, 2015. This discussion contains various Forward-Looking Statements within the meaning of

Table of Contents

the Private Securities Litigation Reform Act of 1995 and we refer readers to the section titled "Forward-Looking Information" located at the end of Part I, Item 2 of this report for more information.

**COMPANY OVERVIEW**

The Toro Company is in the business of designing, manufacturing, and marketing professional turf maintenance equipment and services, turf irrigation systems, landscaping equipment and lighting, snow and ice management products, agricultural micro-irrigation systems, rental and specialty construction equipment, and residential yard and snow thrower products. We sell our products worldwide through a network of distributors, dealers, hardware retailers, home centers, mass retailers, and online.

We strive 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.

**RESULTS OF OPERATIONS**

**Overview**

For the third quarter of fiscal 2016, our net sales decreased 1.4 percent with a net earnings increase of 4.7 percent, each as compared to the third quarter of fiscal 2015. Year-to-date fiscal 2016 net earnings increased 12.8 percent compared to the same period in the prior fiscal year on a net sales increase of 0.7 percent. Professional segment net sales increased 1.4 percent and 3.6 percent for our third quarter and year-to-date periods of fiscal 2016, respectively, primarily due to strong demand for our golf equipment and irrigation businesses, along with continued growth in our rental and specialty construction businesses. For the third quarter comparison, these increases were offset by lower channel demand for our landscape contractor equipment. Residential segment net sales were down 4.6 percent and 4.9 percent for our third quarter and year-to-date periods of fiscal 2016, respectively. Third quarter comparison Residential segment net sales were down primarily due to reduced worldwide channel demand of walk power mowers, partially offset by higher shipments of snow products. Year-to-date Residential segment net sales of zero-turn riding mowers and snow products declined, partially offset by increased shipments of walk power mowers.

Changes in foreign currency exchange rates resulted in a reduction of our net sales of approximately \$6.1 million and \$29.2 million for the third quarter and year-to-date periods of fiscal 2016, respectively.

Our net earnings growth in the third quarter and year-to-date periods of fiscal 2016 was primarily attributable to gross margin increases of 50 basis points and 160 basis points, respectively. In addition to gross margin increases, we realized earnings growth attributed to a reduction in our selling, general and administrative ( SG&A ) expenses of 10 basis points for the third quarter comparison. Year-to-date, SG&A expenses increased as a percentage of net sales by 20 basis points.

We increased our third quarter cash dividend by 20 percent to \$0.30 per share compared to the \$0.25 per share quarterly cash dividend paid in the third quarter of fiscal 2015. On August 18, 2016, our Board of Directors declared a two-for-one split of our common stock, which will be effected in the form of a 100 percent stock dividend, and will be distributed September 16, 2016, to shareholders of record as of September 1, 2016.

Inventory levels decreased \$23.1 million, or 6.6 percent, as of the end of the third quarter of fiscal 2016 due primarily to inventory control initiatives during the third quarter. Receivables decreased \$25.4 million, or 11.2 percent, largely due to additional customers financing receivables with Red Iron. Field inventory levels were up as of the end of the third quarter of fiscal 2016, due to higher levels in the Professional segment with strong retail demand and anticipated increased sales of new products in fiscal 2016.

Our multi-year initiative, Destination PRIME, which began with our 2015 fiscal year, continues our journey into our second century. This is our second year of this three-year initiative, which is intended to help us drive revenue and earnings growth and further improve productivity, while also continuing our century-long commitment to innovation, relationships, and excellence. Through our Destination PRIME initiative, we strive to achieve our goals by pursuing a progression of annual milestones. Our organic revenue growth goal is to achieve five percent or more of organic revenue growth each fiscal year during this initiative. We define organic revenue growth as the increase in net sales, less net sales from acquisitions that occurred in the current fiscal

Table of Contents

year. Our operating earnings goal is to raise operating earnings as a percentage of net sales to more than 13 percent by the end of fiscal 2017. Additionally, our working capital goal is to drive down average net working capital as a percentage of net sales to less than 13 percent by the end of fiscal 2017. We define average net working capital as net accounts receivable plus net inventory less accounts payable as a percentage of net sales for a twelve month period.

**Net Sales**

Worldwide consolidated net sales for the third quarter of fiscal 2016 were \$601.0 million, down 1.4 percent compared to the third quarter of fiscal 2015. For the year-to-date period of fiscal 2016, net sales were \$1,923.8 million, up 0.7 percent from the same period in the prior fiscal year. Decreased net sales for the third quarter of fiscal 2016 were driven primarily by lower Residential shipments of walk power mowers and lower channel demand of Professional segment landscape contractor equipment, primarily offset by strong Professional segment sales in our golf equipment and irrigation businesses and continued growth in our rental and specialty construction businesses. Year-to-date fiscal 2016 net sales increased primarily due to strong Professional segment market demand for our innovative product offerings and the successful introduction of new products throughout the year. Partially offsetting this year-to-date net sales increase was a decrease in net sales for our Residential segment due mainly to lower shipments of zero-turn riding mowers and snow products.

International net sales were down 7.1 percent for the third quarter of fiscal 2016, mainly due to decreased shipments of zero-turn riding mowers in our Residential segment and unfavorable foreign currency exchange rates. Additionally, year-to-date fiscal 2016 international net sales were down 5.1 percent, primarily due to decreased sales of walk power mowers in our Residential segment and unfavorable foreign currency exchange rates. These decreases were partially offset by strong demand in our specialty construction business, particularly in Australia.

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, 2016	July 31, 2015	July 29, 2016	July 31, 2015
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(64.0)	(64.5)	(63.5)	(65.1)
Gross margin	36.0	35.5	36.5	34.9
SG&A expense	(22.4)	(22.5)	(21.4)	(21.2)
Operating earnings	13.6	13.0	15.1	13.7
Interest expense	(0.8)	(0.8)	(0.7)	(0.7)
Other income, net	0.6	0.5	0.6	0.4
Provision for income taxes	(4.2)	(4.0)	(4.6)	(4.1)
Net earnings	9.2%	8.7%	10.4%	9.3%

**Gross Profit**

As a percentage of net sales, gross profit for the third quarter of fiscal 2016 increased 50 basis points to 36.0 percent compared to 35.5 percent in the third quarter of fiscal 2015. Gross profit as a percent of net sales for the year-to-date period of fiscal 2016 increased 160 basis points to 36.5 percent compared to 34.9 percent for the year-to-date period of fiscal 2015. The increase for the third quarter fiscal 2016 comparison was primarily due to lower commodity prices, productivity improvements, and favorable segment mix, as we saw a higher proportion of Professional segment sales that generally carry higher average gross margins than our Residential segment. For the year-to-date period comparison, our gross profit increase was also primarily attributable to lower commodity prices, productivity improvements, and favorable segment mix, along with the purchase accounting impact of the incremental charge for the sale of inventory that was written-up to fair value related to the acquisition of the BOSS business in fiscal 2015 that was not repeated this fiscal year. These gross profit increases for both the third quarter and year-to-date fiscal 2016 periods were partially offset by unfavorable changes in foreign currency exchange rates.

Table of Contents

**Selling, General, and Administrative Expense**

SG&A expense decreased \$2.3 million, or 1.7 percent, for the third quarter of fiscal 2016, and increased \$6.5 million, or 1.6 percent, for the year-to-date period of fiscal 2016. As a percentage of net sales, SG&A expense decreased 10 basis points for the third quarter and increased 20 basis points for the year-to-date period of fiscal 2016. The decrease as a percentage of net sales for the third quarter comparison was primarily due to decreased incentive expense and administrative expenses, partially offset by increased marketing program expense. For the year-to-date comparison, the increase was largely due to increased warranty expense driven by higher sales and increased marketing program expense from various product promotions, partially offset by decreased incentive expense.

**Interest Expense**

Interest expense for the third quarter and year-to-date periods of fiscal 2016 increased slightly, by 1.3 percent, and remained flat, respectively.

**Other Income, Net**

Other income, net for the third quarter and year-to-date periods of fiscal 2016 increased \$0.7 million and \$4.3 million, respectively, compared to the same respective periods last fiscal year. The increase for the third quarter comparison was primarily due to additional investment income from our equity investment in Red Iron. Year-to-date fiscal 2016 other income, net increased mainly due to foreign currency exchange rate gains, higher earnings from our equity investment in Red Iron, recovery from a litigation settlement, and a gain on the sale of our Northwestern U.S. distribution.

**Provision for Income Taxes**

The effective tax rate for the third quarter of fiscal 2016 was 30.9 percent compared to 31.3 percent in the third quarter of 2015. The decrease was primarily driven by more favorable one-time adjustments related to prior years in fiscal 2016 when compared to fiscal 2015. The effective tax rate for the year-to-date periods of fiscal 2016 and 2015 was 30.5 percent and 30.4 percent, respectively. The slight increase was primarily the result of less favorable year-to-date adjustments related to prior years, partially offset by a lower tax rate on current year income due to the permanent extension of the research credit.

**Net Earnings**

Net earnings for the third quarter of fiscal 2016 were \$55.8 million, or \$1.00 per diluted share, compared to \$53.3 million, or \$0.94 per diluted share, for the third quarter of fiscal 2015, resulting in a net earnings per diluted share increase of 6.4 percent. Year-to-date net earnings in fiscal 2016 were \$200.8 million, or \$3.58 per diluted share, compared to \$178.0 million, or \$3.13 per diluted share, in the same comparable period last fiscal year, resulting in a net earnings per diluted share increase of 14.4 percent. The primary factors contributing to the net earnings increase for the third quarter comparison included an increase in our gross margin rate and higher other income, net. The year-to-date net earnings increase was mainly driven by higher net sales, an increase in our gross margin rate and higher other income, net. In addition, as a result of reduced shares outstanding from repurchases of our common stock, third quarter and year-to-date fiscal 2016 net earnings per diluted share were benefited by approximately \$0.01 per share and \$0.06 per share, respectively.

**BUSINESS SEGMENTS**

We operate in three reportable business segments: Professional, Residential, and Distribution. Our Distribution segment, which consists of our company-owned domestic distributorship, 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, 2016	July 31, 2015	\$ Change	% Change	
Professional	\$ 427,784	\$ 421,994	\$ 5,790		1.4%
Residential	167,815	175,977	(8,162)		(4.6)%
Other	5,381	11,644	(6,263)		(53.8)%
Total*	\$ 600,980	\$ 609,615	\$ (8,635)		(1.4)%
* Includes international sales of:	\$ 126,993	\$ 136,626	\$ (9,633)		(7.1)%

(Dollars in thousands)	Nine Months Ended				
	July 29, 2016	July 31, 2015	\$ Change	% Change	
Professional	\$ 1,361,829	\$ 1,314,474	\$ 47,355		3.6%
Residential	550,330	578,587	(28,257)		(4.9)%
Other	11,660	17,007	(5,347)		(31.4)%
Total*	\$ 1,923,819	\$ 1,910,068	\$ 13,751		0.7%
* Includes international sales of:	\$ 450,577	\$ 474,911	\$ (24,334)		(5.1)%

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

(Dollars in thousands)	Three Months Ended				
	July 29, 2016	July 31, 2015	\$ Change	% Change	
Professional	\$ 89,096	\$ 82,253	\$ 6,843		8.3%
Residential	12,767	20,566	(7,799)		(37.9)%
Other	(21,076)	(25,203)	4,127		(16.4)%
Total	\$ 80,787	\$ 77,616	\$ 3,171		4.1%

(Dollars in thousands)	Nine Months Ended				
	July 29, 2016	July 31, 2015	\$ Change	% Change	
Professional	\$ 292,311	\$ 258,727	\$ 33,584		13.0%
Residential	64,494	69,131	(4,637)		(6.7)%
Other	(68,079)	(72,132)	4,053		(5.6)%
Total	\$ 288,726	\$ 255,726	\$ 33,000		12.9%

### **Professional Segment**

*Net Sales.* Worldwide net sales for our Professional segment in the third quarter and year-to-date periods of fiscal 2016 increased 1.4 percent and 3.6 percent, respectively. Professional segment net sales were positively impacted by increased shipments of our golf equipment and irrigation products, primarily due to demand for our innovative



product offerings and the successful introduction of new products. Continued growth in our rental and specialty construction businesses also increased our Professional segment net sales mainly due to strong demand of our new Dingo® TX 1000 compact utility loader. Net sales of our landscape contractor equipment decreased in the third quarter comparison due to lower channel demand, while year-to-date net sales were higher for fiscal 2016 as contractors continued to value our turf management and productivity-enhancing product offerings. Net sales growth for the third quarter and year-to-date periods of fiscal 2016 were slightly offset by lower sales of our Professional snow and ice management equipment, along with being hampered by the impact of unfavorable foreign currency exchange rate fluctuations.

Table of Contents

*Operating Earnings.* Operating earnings for the Professional segment in the third quarter of fiscal 2016 increased by 8.3 percent compared to the third quarter of fiscal 2015 and increased to 20.8 percent as a percentage of net sales in the third quarter of fiscal 2016 compared to 19.5 percent in the third quarter of fiscal 2015. These increases were primarily due to higher gross margins from lower commodity prices and productivity improvements, partially offset by unfavorable foreign currency exchange rates. For the year-to-date period of fiscal 2016, Professional segment operating earnings increased by 13.0 percent compared to the same period in the prior fiscal year and increased to 21.5 percent as a percentage of net sales for the year-to-date period of fiscal 2016 compared to 19.7 percent in the same period last fiscal year. These increases were primarily due to higher gross margins from the impact of lower commodity prices, productivity improvements, and the purchase accounting impact of the incremental charge for the sale of inventory that was written-up to fair value related to the acquisition of the BOSS business in fiscal 2015 that was not repeated this fiscal year. These year-to-date gross margin increases were partially offset by unfavorable foreign currency exchange rate fluctuations.

**Residential Segment**

*Net Sales.* Worldwide net sales for the Residential segment in the third quarter and year-to-date periods of fiscal 2016 decreased 4.6 percent and 4.9 percent, respectively. The sales decrease in the third quarter comparison was primarily driven by reduced worldwide channel demand for walk power and riding mowers, partially offset by higher shipments of snow products in advance of the selling season. The year-to-date fiscal 2016 net sales decrease was driven by lower sales of our zero-turn radius riding mowers primarily due to variable weather conditions throughout the year and low snowfalls early in fiscal 2016 that affected demand for our residential snow products. These decreases were partially offset by higher shipments of walk power mowers driven by strong market demand for our all-wheel-drive and SMARTSTOW® mowers.

*Operating Earnings.* Operating earnings for the Residential segment in the third quarter and year-to-date periods of fiscal 2016 decreased 37.9 percent and 6.7 percent, respectively. Expressed as a percentage of net sales, Residential segment operating earnings decreased to 7.6 percent from 11.7 percent when compared to the third quarter of fiscal 2015, and fiscal 2016 year-to-date Residential segment operating earnings decreased to 11.7 percent from 11.9 percent in the same period last fiscal year. The operating earnings decrease for the third quarter and year-to-date comparisons was primarily driven by lower sales, higher SG&A expenses, and unfavorable foreign currency exchange rates. These operating earnings decreases were favorably offset by higher gross margins, mainly from lower commodity prices and productivity improvements.

**Other Segment**

*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 in

the third quarter and year-to-date periods of fiscal 2016 decreased by \$6.3 million and \$5.3 million, respectively. These decreases were mainly a result of the sale of our Northwestern U.S. distribution company early in the first quarter of fiscal 2016.

*Operating Loss.* Operating loss for the Other segment for both the third quarter and year-to-date periods of fiscal 2016 decreased \$4.1 million. The decrease in operating loss for the third quarter fiscal 2016 comparison was primarily attributable to decreased employee incentive expenses. The decrease in operating loss for the year-to-date fiscal 2016 period comparison was primarily attributable to decreased employee incentive accruals, partially offset by higher earnings from our equity investment in Red Iron, recovery from a litigation settlement, and a gain on the sale of our Northwestern U.S. distribution company.

## **FINANCIAL POSITION**

### **Working Capital**

During the remainder of fiscal 2016, we plan to place an increased emphasis on improving asset utilization with a focus on reducing the amount of working capital in the supply chain, adjusting production plans, and maintaining or improving order replenishment and service levels to end users. We calculate our average net working capital as net receivables plus net inventories, less accounts payable for a twelve month period as percentage of rolling twelve month net sales. Our average net working capital as a percentage of net sales for the twelve months ended July 29, 2016, was 16.4 percent compared to 15.9 percent for the twelve months ended July 31, 2015.

Inventory levels were down \$23.1 million, or 6.6 percent, as of the end of the third quarter of fiscal 2016 compared to the end of the third quarter of fiscal 2015 due to inventory control initiatives to lower production plans, increase emphasis on finished

Table of Contents

goods inventory and improve monitoring of product replenishment to our end users. Receivables as of the end of the third quarter of fiscal 2016 decreased \$25.4 million, or 11.2 percent, compared to the end of the third quarter of fiscal 2015 primarily as a result of additional customers financing receivables with Red Iron. Our average days sales outstanding for receivables decreased to 31.9 days based on sales for the last twelve months ended July 29, 2016, compared to 34.1 days for the twelve months ended July 31, 2015. In addition, accounts payable increased as of the end of our third quarter of fiscal 2016 compared to the end of the third quarter of fiscal 2015 by \$2.2 million, or 1.3 percent, due to recent purchases of commodities and components.

**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 renovation of existing facilities, as well as for financing receivables from customers that are not financed with Red Iron. We believe that anticipated cash generated from operations, together with our 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. As of July 29, 2016, cash and short-term investments held by our foreign subsidiaries that are not available to fund domestic operations unless repatriated were approximately \$125 million. We expect capital expenditures for fiscal 2016 to be approximately \$60 million.

Our Board of Directors approved a cash dividend of \$0.30 per share for the third quarter of fiscal 2016 that was paid on July 12, 2016. This was an increase of 20 percent over our cash dividend of \$0.25 per share for the third quarter of fiscal 2015. On August 18, 2016, our Board of Directors also declared a two-for-one split of our common stock, which will be effected in the form of a 100 percent stock dividend, and will be distributed September 16, 2016, to shareholders of record as of September 1, 2016.

*Cash Flow.* Cash provided by operating activities for the first nine months of fiscal 2016 increased \$120.9 million, or 72.0 percent, compared to the first nine months of fiscal 2015. This nine month comparison change was due mainly to a decrease in accounts receivable from additional customers financing receivables with Red Iron and a decrease in cash used in inventory due to inventory control initiatives. Cash used for investing activities decreased \$204.6 million during the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 due to cash utilized for the acquisition of the BOSS business in the first quarter of fiscal 2015. Cash used for financing activities for the first nine months of fiscal 2016 decreased \$30.7 million compared to the first nine months of fiscal 2015 mainly due to lower amounts of cash utilized for share repurchases, proceeds from stock options exercised due to rising share price and the favorable change in excess tax benefits from stock-based awards. These decreases were partially offset by increased common stock dividends paid.

*Credit Lines and Other Capital Resources.* Our businesses are seasonal, with accounts receivable balances historically increasing between January and April as a result of typically higher sales volumes and extended payment terms made available to our customers, and typically 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 our \$150.0 million unsecured senior five-year revolving credit facility that expires in October 2019. Included in our \$150.0 million revolving credit facility is a \$20.0 million sublimit for standby letters of credit and a \$20.0 million sublimit for swingline loans. At our election, and with 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. 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 short-term lines of credit in the aggregate amount of approximately \$9.3 million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. As of July 29, 2016, we had no outstanding short-term debt under these lines of credit compared to \$5.0 million outstanding short-term debt as of July 31, 2015. As of July 29, 2016, we had \$10.5 million of outstanding letters of credit and \$148.8 million of unutilized availability under our credit agreements.

Table of Contents

As of July 29, 2016, we had \$357.3 million outstanding in long-term debt that includes \$100.0 million of 7.8% debentures due June 15, 2027, \$123.7 million of 6.625% senior notes due May 1, 2037 and a \$113.8 million term loan. The term loan bears interest 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. The term loan can be repaid in part or in full at any time without penalty, but in any event must be paid in full by October 2019. We also have outstanding \$19.8 million in a note to the former owners of the BOSS business.

Our revolving and term loan 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. Under the revolving credit facility, we are not limited in the amount for payments of cash dividends and stock repurchases as long as our debt to earnings before interest, taxes, depreciation, and amortization ( EBITDA ) ratio from the previous quarter compliance certificate is less than or equal to 3.25, provided that immediately after giving effect of any such proposed action, no default or event of default would exist. As of July 29, 2016, we were not limited in the amount for payments of cash dividends and stock repurchases. We were in compliance with all covenants related to our credit agreement for our revolving credit facility as of July 29, 2016, and we expect to be in compliance with all covenants during the remainder of fiscal 2016. 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, debentures, term loan, and any amounts outstanding under the revolving credit facility 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 1.50, the basis point spread over LIBOR (or other rates quoted by the Administrative Agent, Bank of America, N.A.) we currently pay on outstanding 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 2016 by Standard and Poor's Ratings Group at BBB and by Moody's Investors Service at Baa3.

**Customer Financing Arrangements and Contractual Obligations**

Our Red Iron joint venture with TCFIF provides inventory 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 \$20.3 million of receivables from us during the first nine months of fiscal 2016. As of July 29, 2016, \$12.5 million of receivables financed by a third party financing company, excluding Red Iron, were outstanding. 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 2016, average prices paid for commodities and components we purchase were slightly lower compared to the average prices paid for commodities and components in the first nine months of fiscal 2015. We intend to continue to closely follow prices of commodities and components that affect our product lines, and we anticipate average prices paid for some commodities and components to be slightly lower for the remainder of fiscal 2016 as compared to fiscal 2015. Historically, we have mitigated, and we currently expect to continue to mitigate, commodity price increases, in part, by collaborating with suppliers, 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, 2015 for a discussion of our critical accounting policies.

Table of Contents

**New Accounting Pronouncements to be Adopted**

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers* that updates the principles for recognizing revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. The guidance also requires enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers* (Topic 606), which deferred the effective date of this standard by one year. We expect to adopt this guidance on November 1, 2018, as required, based on the new effective date. The guidance permits the use of either a retrospective or cumulative effect transition method. We have not yet selected a transition method and are currently evaluating the impact of the amended guidance on our existing revenue recognition policies and procedures.

In February 2015, the FASB issued ASU No. 2015-02, *Consolidation* (Topic 810), which amends certain requirements for determining whether a variable interest entity must be consolidated. The amended guidance will become effective for us commencing in the first quarter of fiscal 2017. Early adoption is permitted. We anticipate the adoption of this guidance will not have a material impact on our consolidated financial position.

In April 2015, the FASB issued ASU No. 2015-03, *Interest Imputation of Interest* (Subtopic 835-30): *Simplifying the Presentation of Debt Issuance Costs*. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability. The amended guidance will become effective for us commencing in the first quarter of fiscal 2017. Early adoption is permitted. We anticipate the adoption of this guidance will not have a material impact on our consolidated financial position.

In April 2015, the FASB issued ASU No. 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. This amended guidance requires customers to determine whether or not an arrangement contains a software license element. If the arrangement contains a software element, the related fees paid should be accounted for as an acquisition of a software license. If the arrangement does not contain a software license, it is accounted for as a service contract. The amended guidance will become effective for us commencing in the first quarter of fiscal 2017. Early adoption is permitted. We anticipate the adoption of this guidance will not have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory* (Topic 330): *Simplifying the Measurement of Inventory*. This amended guidance changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value. The amended guidance will become effective for us commencing in the first quarter of fiscal 2018. Early adoption is permitted. We are currently evaluating the impact of this amended guidance on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes* (Topic 740): *Balance Sheet Classification of Deferred Taxes*. This amended guidance requires an entity to present deferred tax assets and liabilities as noncurrent in the statement of financial position. The amended guidance will become effective for us commencing in the first quarter of fiscal 2018. Early adoption is permitted. We are currently evaluating the impact of this amended guidance on our consolidated financial statements.



## Edgar Filing: TORO CO - Form 10-Q

In February 2016, the FASB issued ASU 2016-02, *Leases*, which, among other things, requires lessees to recognize most leases on-balance sheet. The standard requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The amended guidance will become effective for us commencing in the first quarter of fiscal 2020. Entities are required to use a modified retrospective approach, with early adoption permitted. We are reviewing the revised guidance and assessing the impact on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Stock-based Compensation: Improvements to Employee Share-based Payment Accounting*, which simplifies several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, and statement of cash flow classification. The amended guidance will become effective for us commencing in the first quarter of fiscal 2018. Early adoption is permitted. We are currently evaluating the impact of this new standard on our consolidated financial statements.

Table of Contents

**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 ( Securities Act ), and Section 21E under the Securities Exchange Act of 1934, as amended ( Exchange Act ), 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. Forward-looking statements are based on our current expectations of future events, and often can be identified in this report and elsewhere by using words such as expect, strive, looking ahead, outlook, guidance, forecast, goal, optimistic, anticipate, continue, plan, estimate, project, believe, should, could, will, would, possible, may, likely, intend, can, seek, potential, pro forma, or the negative thereof and similar expressions or future dates. Our forward-looking statements generally relate to our future performance, including our anticipated operating results, liquidity requirements, and financial condition; 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. 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 in other countries in which we conduct business could adversely affect our net sales and earnings, which include but are not limited to recessionary conditions; slow or negative economic growth rates; the impact of U.S. federal debt, state debt and sovereign debt defaults and austerity measures by certain European countries; slow down or reductions in levels of golf course development, renovation, and improvement; golf course closures; reduced levels of home ownership, construction, and sales; home foreclosures; negative consumer confidence; reduced consumer spending levels resulting from tax increases or other factors; prolonged high unemployment rates; higher commodity and component costs and fuel prices; inflationary or deflationary pressures; reduced credit availability or unfavorable credit terms for our distributors, dealers, and end-user customers; higher short-term, mortgage, and other interest rates; and general economic and political conditions and expectations.
- Weather conditions, including unfavorable weather conditions exacerbated by global climate changes or otherwise, may reduce demand for some of our products and adversely affect our net sales and operating results, or may affect the timing of demand for some of our products and may adversely affect net sales and operating results in subsequent periods.
- Fluctuations in foreign currency exchange rates have already affected our operating results and could continue to result in declines in our reported net sales and net earnings.
- Increases in the cost, or disruption in the availability, of raw materials, components, and parts containing various commodities that we purchase, such as steel, aluminum, petroleum and natural gas-based resins, linerboard, copper, lead, rubber, engines, transmissions, transaxles, hydraulics, electric motors, and other commodities and components, and increases in our other costs of doing business, such as transportation costs.

- Our Professional segment net sales are dependent upon certain factors, including 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; continued acceptance of and demand for micro-irrigation solutions for agricultural markets; the integration of the BOSS business; demand for our products in the rental and specialty construction market; availability of cash or 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.
- Our Residential segment net sales are dependent upon consumers buying our products at dealers, mass retailers, and home centers, such as The Home Depot, Inc., the amount of product placement at retailers, consumer confidence and spending levels, and changing buying patterns of customers.
- Changes in our product mix impact our financial performance, including profit margins and net earnings, as our Professional segment products generally have higher profit margins than our Residential segment products.
- We intend to grow our business in part through acquisitions and alliances, stronger customer relations, and new joint ventures and partnerships, all of 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. If previous or future acquisitions do not produce the expected results or integration into our operations takes more time than expected, our business could

Table of Contents

be harmed. We cannot guarantee previous or future acquisitions, alliances, joint ventures or partnerships will in fact produce any benefits.

- Our ability to manage our inventory levels to meet our customer's demand for our products is important for our business. If we underestimate or overestimate demand for our products and do not maintain appropriate inventory levels, our net sales and/or working capital could be negatively impacted.
- Our business and operating results are subject to the inventory management decisions of our distribution channel customers. Any adjustments in the carrying amount of inventories by our distribution channel customers may impact our inventory management and working capital goals as well as operating results.
- We face intense competition in all of our product lines with numerous manufacturers, including from some competitors that have larger 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 also require significant management attention and financial resources, expose us to difficulties presented by international economic, political, legal, accounting, and business factors, including implications of the United Kingdom's vote to exit the European Union; and may not be successful or produce desired levels of net sales. In addition, 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.
- 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 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 facilities, open and manage new facilities, and/or move production between manufacturing facilities could adversely affect our business and operating results.
- Our production employee population fluctuates during the year, with an increase in the number of our production employees, some of which may be new to our manufacturing processes, during periods of peak manufacturing activity and any failure by such production employees to adequately perform their jobs or our inability to properly train such production employees could adversely affect our business, operating results, and reputation.
- Management information systems are critical to our business. If our information systems or those of our business partners or third party service providers fail to adequately perform, or if we, our business partners or third party service providers experience an interruption in their operation, including by theft, loss or damage from unauthorized access, security breaches, natural or man-made disasters, cyber attacks, computer viruses, power loss or other disruptive events, our business, reputation, financial condition, 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 result in harm to our reputation and/or expose us to penalties. Governmental regulation may also adversely affect the demand for some of our products and our operating results. In addition, changes in laws and regulations also may adversely affect our operating results, including, (i) taxation and tax policy changes, tax rate changes, new tax laws, revised tax law interpretations, which individually or in combination may cause our effective tax rate to increase, or (ii) healthcare laws or regulations, such as the Patient Protection and Affordable Care Act, which may cause us to incur higher employee healthcare and other costs.
- Climate change and climate change regulations may adversely impact our operations.
- Costs of complying with the various environmental laws related to our ownership and/or lease of real property, such as clean-up costs and liability that may be associated with certain hazardous waste disposal activities, could adversely affect our financial condition and operating results.
- Legislative enactments could impact the competitive landscape within our markets and affect demand for our products.
- We operate in many different jurisdictions and we could be adversely affected by violations of the U.S. Foreign Corrupt Practices Act and similar worldwide anti-corruption laws. The continued expansion of our international operations could increase the risk of violations of these laws in the future.

Table of Contents

- We are required to comply with conflict minerals rules promulgated by the SEC, which has imposed costs on us and raised reputational and other risks. We have, and we expect that we will continue to, incur additional costs and expenses, which may be significant in order to comply with these rules. Since our supply chain is complex, ultimately we may not be able to sufficiently verify the origin of the conflict minerals used in our products through the due diligence procedures that we implement or we may identify through our due diligence procedures that some or all of the conflict minerals in our products are sourced from covered regions, which may adversely affect our reputation with our customers, shareholders, and other stakeholders.
- We are subject to product liability claims, product quality issues, and other litigation from time to time that could adversely affect our business, reputation, operating results, or financial condition.
- If we are unable to retain our executive officers or other key employees, attract and retain other qualified personnel, or successfully implement executive officer, key employee or other qualified personnel transitions, we may not be able to meet strategic objectives and our business could suffer.
- As a result of our Red Iron joint venture, we are dependent upon the joint venture to provide competitive inventory financing programs 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, challenges or delays in transferring new distributors and dealers from any business we might acquire to this financing platform, 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.
- 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, debentures, term loan, and any amounts outstanding under our revolving credit facility could become due and payable.
- We are expanding and renovating our corporate facilities and could experience disruptions to our operations in connection with such efforts.
- 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 working capital goals of our Destination PRIME initiative; natural or man-made disasters or global pandemics that may result in shortages of raw materials and components, higher fuel and commodity costs, delays in shipments to customers, and increases 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; a decline in retail sales or financial difficulties of our distributors or dealers, which would cause us to repurchase financed product; and the 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 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, the risks described in our most recent Annual Report on Form 10-K, Part I, Item 1A, Risk Factors, 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 make no commitment to revise or update any forward-looking statements in order to reflect events or circumstances occurring or existing after the date any forward-looking statement is made. 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.*

Table of Contents

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. We are also exposed to equity market risk pertaining to the trading price of our common stock. Changes in these factors could cause fluctuations in our earnings and cash flows. See further discussion on these market risks below. See our most recent Annual Report on Form 10-K for discussion on equity market risk.

*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 primarily the 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 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 to third party customers, 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 have a negative impact on our results from operations, while a weaker dollar and peso generally have a positive effect. Our primary foreign currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the British pound, the Mexican peso, the Japanese yen, the Chinese Renminbi, the Romanian New Leu against the U.S. dollar, and the Romanian New Leu against the Euro, including exposure as a result of the volatility and uncertainty that may arise as a result of the United Kingdom's vote to exit the European Union.

We enter into various contracts, primarily 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 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 values of the related exposures. Therefore, changes in 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 Note 12 entitled "Derivative Instruments and Hedging Activities."

The following foreign currency exchange contracts held by us have maturity dates in fiscal 2016 and 2017. 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, 2016 were as follows:



Edgar Filing: TORO CO - Form 10-Q

(Dollars in thousands, except average contracted rate)	Average Contracted Rate	Notional Amount	Value in Accumulated Other Comprehensive Income (Loss)	Fair Value Impact (Loss) Gain
Buy US dollar/Sell Australian dollar	0.7280	43,703.8	(587.1)	(116.6)
Buy US dollar/Sell Canadian dollar	1.2931	16,680.9	318.8	(188.1)
Buy US dollar/Sell Euro	1.1191	58,874.0	(138.3)	1,314.9
Buy US dollar/Sell British pound	1.3692	26,178.3	188.4	1,194.8
Buy Mexican peso/Sell US dollar	17.7687	16,304.0	(1,775.4)	(2,012.9)

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 and a term loan from commercial banks, as well as the potential increase in fair value of our fixed-rate long-term debt resulting from a potential decrease in interest rates. We have no earnings or cash flow exposure due to market risks on our fixed-rate long-term debt obligations. 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.

Table of Contents

*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, petroleum and natural gas-based resins, and linerboard. In addition, we are a purchaser of components and parts containing various commodities, including steel, aluminum, copper, lead, rubber, and others that 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."

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.

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 quarter ended July 29, 2016 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 the 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 litigation and administrative and judicial proceedings with respect to claims involving asbestos and the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for personal injury, remedial investigations or clean-up, and other costs and damages. We are also typically involved in commercial disputes, employment disputes, and patent litigation cases in the ordinary course of business. 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. We are

## Edgar Filing: TORO CO - Form 10-Q

currently involved in patent litigation cases, including cases by or against competitors, where we are asserting and defending against claims of patent infringement. Such cases are at varying stages in the litigation process.

For a description of our material legal proceedings, see Note 10 in our Notes to Condensed Consolidated Financial Statements under the heading **Contingencies - 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

Table of Contents

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.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table shows our third quarter of fiscal 2016 stock repurchase activity.

Period	Total Number of Shares (or Units) Purchased (1,2,3)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased As Part of Publicly Announced Plans or Programs (1,2)	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1,2)
April 30, 2016 through May 27, 2016	27,100	\$ 86.09	27,100	4,585,776
May 28, 2016 through July 1, 2016	246,900	87.30	246,900	4,338,876
July 2, 2016 through July, 29 2016	42,805	87.95	41,915	4,296,961
Total	316,805	87.28	315,915	

(1) On December 11, 2012, 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. The company repurchased 315,915 shares during the period indicated above under this program and 296,961 shares remain available to repurchase under this program.

(2) On December 3, 2015, the company's Board of Directors authorized the repurchase of an additional 4,000,000 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 time period indicated above.

(3) Includes 890 units (shares) of the company's common stock purchased in open-market transactions at an average price of \$90.65 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 890 shares were not repurchased under the company's repurchase program described in 1 and 2 above.

## ITEM 5. OTHER INFORMATION

## Edgar Filing: TORO CO - Form 10-Q

As previously disclosed in our Current Report on Form 8-K dated July 19, 2016 (i) our Board of Directors elected Richard M. Olson as President and Chief Executive Officer, effective November 1, 2016, and (ii) current Chairman and Chief Executive Officer, Michael J. Hoffman, will remain an elected officer and employee of the company in the role of Chairman of the Board of Toro, also effective November 1, 2016.

On July 19, 2016, our Board of Directors adopted amendments to our Amended and Restated Bylaws to, among other things, update the orderly and efficient processes for shareholders seeking to nominate directors at a meeting of our shareholders. As part of this process, shareholders seeking to nominate directors at any meeting of our shareholders must provide information relevant to our and our shareholders' evaluation of the proposed nomination as detailed in the Amended and Restated Bylaws. The changes to such procedures require additional prescribed information in the notice and that the shareholder be present in person at the meeting. Please see our Amended and Restated Bylaws filed as Exhibit 3.1 to our Current Report on Form 8-K dated July 19, 2016, and incorporated herein by reference.

### ITEM 6. EXHIBITS

(a) Exhibit No.	Description
2.1 (1)	Third Amended and Restated Program and Repurchase Agreement, dated as of June 30, 2016, by and between The Toro Company and Red Iron Acceptance, LLC (incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K dated July 8, 2016, Commission File No. 1-8649).
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

### Table of Contents

- 3.2 and 4.2 Certificate of Amendment to 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 March 13, 2013, Commission File No. 1-8649).
- 3.3 and 4.3 Amended and Restated Bylaws of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated July 19, 2016, Commission File No. 1-8649).
- 4.4 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).
- 4.5 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).
- 4.6 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).
- 4.7 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).
- 4.8 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 Offer Letter dated July 19, 2016 between The Toro Company and Richard M. Olson (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K dated July 19, 2016, Commission File No. 1-8649).
- 10.2 Offer Letter dated July 19, 2016 between The Toro Company and Michael J. Hoffman (incorporated by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K dated July 19, 2016, 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, 2016, filed with the SEC on August 31, 2016, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Earnings for the three and nine-month periods ended July 29, 2016 and July 31, 2015, (ii) Condensed Consolidated Statements of Comprehensive Income for the three and nine-month periods ended July 29, 2016 and July 31, 2015, (iii) Condensed Consolidated Balance Sheets as of July 29, 2016, July 31, 2015, and October 31, 2015, (iv) Condensed Consolidated Statement of Cash Flows for the nine-month periods ended July 29, 2016 and July 31, 2015, and (v) Notes to Condensed Consolidated Financial Statements (filed herewith).

---

(1) Portions of this exhibit have been redacted and are subject to an order granting confidential treatment under the Securities Exchange Act of 1934, as amended (File No. 001-08649, CF #33999). The redacted material was filed separately with the Securities and Exchange Commission.



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: August 31, 2016

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