

TORO CO  
Form 10-Q  
September 02, 2015  
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 31, 2015**

**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 common stock outstanding as of August 25, 2015 was 54,809,131.

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 31, 2015 and August 1, 2014</u>	3
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited) Three and Nine Months Ended July 31, 2015 and August 1, 2014</u>	3
<u>Condensed Consolidated Balance Sheets (Unaudited) July 31, 2015, August 1, 2014, and October 31, 2014</u>	4
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) Nine Months Ended July 31, 2015 and August 1, 2014</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>	17-27
<b><u>Item 3.</u></b>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	27-28
<b><u>Item 4.</u></b>	
<u>Controls and Procedures</u>	29
<b><u>PART II.</u></b>	
<b><u>OTHER INFORMATION:</u></b>	
<b><u>Item 1.</u></b>	
<u>Legal Proceedings</u>	29
<b><u>Item 1A.</u></b>	
<u>Risk Factors</u>	29
<b><u>Item 2.</u></b>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
<b><u>Item 6.</u></b>	
<u>Exhibits</u>	31
<u>Signatures</u>	32

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 31, 2015	August 1, 2014	July 31, 2015	August 1, 2014
Net sales	\$ 609,615	\$ 567,540	\$ 1,910,068	\$ 1,758,551
Cost of sales	393,225	365,460	1,242,707	1,128,417
Gross profit	216,390	202,080	667,361	630,134
Selling, general, and administrative expense	136,985	130,043	405,079	386,620
Operating earnings	79,405	72,037	262,282	243,514
Interest expense	(4,587)	(3,629)	(14,071)	(11,065)
Other income, net	2,798	2,390	7,515	6,220
Earnings before income taxes	77,616	70,798	255,726	238,669
Provision for income taxes	24,292	20,785	77,689	75,701
Net earnings	\$ 53,324	\$ 50,013	\$ 178,037	\$ 162,968
Basic net earnings per share of common stock	\$ 0.96	\$ 0.89	\$ 3.19	\$ 2.88
Diluted net earnings per share of common stock	\$ 0.94	\$ 0.87	\$ 3.13	\$ 2.82
Weighted-average number of shares of common stock outstanding Basic	55,310	55,965	55,739	56,494
Weighted-average number of shares of common stock outstanding Diluted	56,552	57,320	56,953	57,800

**THE TORO COMPANY AND SUBSIDIARIES****Condensed Consolidated Statements of Comprehensive Income (Unaudited)**

(Dollars in thousands)

	Three Months Ended		Nine Months Ended	
	July 31, 2015	August 1, 2014	July 31, 2015	August 1, 2014
Net earnings	\$ 53,324	\$ 50,013	\$ 178,037	\$ 162,968
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(3,534)	(620)	(10,648)	541
Derivative instruments, net of tax of \$(379), \$531, \$(526), and \$891, respectively	(1,055)	446	(2,394)	1,036
Other comprehensive (loss) income	(4,589)	(174)	(13,042)	1,577

Edgar Filing: TORO CO - Form 10-Q

Comprehensive income	\$	48,735	\$	49,839	\$	164,995	\$	164,545
----------------------	----	--------	----	--------	----	---------	----	---------

See accompanying notes to condensed consolidated financial statements.

Table of Contents**THE TORO COMPANY AND SUBSIDIARIES****Condensed Consolidated Balance Sheets (Unaudited)****(Dollars in thousands, except per share data)**

	July 31, 2015	August 1, 2014	October 31, 2014
<b>ASSETS</b>			
Cash and cash equivalents	\$ 110,335	\$ 177,894	\$ 314,873
Receivables, net	227,806	215,595	158,158
Inventories, net	350,194	293,761	274,603
Prepaid expenses and other current assets	39,743	33,764	33,580
Deferred income taxes	43,339	38,735	42,822
Total current assets	771,417	759,749	824,036
Property, plant, and equipment	802,305	770,758	760,192
Less accumulated depreciation	581,983	567,930	554,997
	220,322	202,828	205,195
Long-term deferred income taxes	26,364	25,951	26,075
Other assets	25,317	22,226	21,429
Goodwill	194,727	91,812	91,851
Other intangible assets, net	121,804	25,261	23,829
Total assets	\$ 1,359,951	\$ 1,127,827	\$ 1,192,415
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current portion of long-term debt	\$ 23,279	\$ 140	\$ 6,640
Short-term debt	5,189	1,134	20,818
Accounts payable	169,927	168,956	124,271
Accrued liabilities	300,576	289,519	248,691
Total current liabilities	498,971	459,749	400,420
Long-term debt, less current portion	358,053	223,800	347,316
Deferred revenue	11,324	11,102	10,947
Deferred income taxes	7	5,969	
Other long-term liabilities	26,423	14,474	25,005
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 54,835,233 shares as of July 31, 2015, 55,705,894 shares as of August 1, 2014, and 55,678,419 shares as of October 31, 2014	54,835	55,706	55,678
Retained earnings	439,085	368,020	368,754
Accumulated other comprehensive loss	(28,747)	(10,993)	(15,705)
Total stockholders' equity	465,173	412,733	408,727
Total liabilities and stockholders' equity	\$ 1,359,951	\$ 1,127,827	\$ 1,192,415

See accompanying notes to condensed consolidated financial statements.



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

	<b>Nine Months Ended</b>	
	<b>July 31, 2015</b>	<b>August 1, 2014</b>
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 178,037	\$ 162,968
<b>Adjustments to reconcile net earnings to net cash provided by operating activities:</b>		
Non-cash income from finance affiliate	(6,223)	(5,598)
Provision for depreciation, amortization, and impairment loss	45,944	38,104
Stock-based compensation expense	7,815	8,478
Increase in deferred income taxes	(2,096)	(43)
Other	(67)	2
<b>Changes in operating assets and liabilities, net of effect of acquisitions:</b>		
Receivables, net	(74,916)	(59,774)
Inventories, net	(67,902)	(53,716)
Prepaid expenses and other assets	(5,563)	1,167
Accounts payable, accrued liabilities, deferred revenue, and other long-term liabilities	92,985	72,625
Net cash provided by operating activities	168,014	164,213
<b>Cash flows from investing activities:</b>		
Purchases of property, plant, and equipment	(37,544)	(53,228)
Proceeds from asset disposals	77	161
Distributions from finance affiliate, net	1,928	2,324
Acquisitions, net of cash acquired	(198,329)	(715)
Net cash used in investing activities	(233,868)	(51,458)
<b>Cash flows from financing activities:</b>		
(Repayments of) increase in short-term debt	(16,283)	300
(Repayments of) increase in long-term debt	(3,831)	18
Excess tax benefits from stock-based awards	7,808	8,536
Proceeds from exercise of stock options	8,615	6,813
Purchases of Toro common stock	(90,993)	(100,507)
Dividends paid on Toro common stock	(41,794)	(33,871)
Net cash used in financing activities	(136,478)	(118,711)
Effect of exchange rates on cash and cash equivalents	(2,206)	857
Net decrease in cash and cash equivalents	(204,538)	(5,099)
Cash and cash equivalents as of the beginning of the fiscal period	314,873	182,993
Cash and cash equivalents as of the end of the fiscal period	\$ 110,335	\$ 177,894
<b>Supplemental disclosure of cash flow information:</b>		
Debt issued in connection with an acquisition	\$ 31,161	\$



Table of Contents

**THE TORO COMPANY AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**July 31, 2015**

**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 31, 2015 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2015.

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, 2014. 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 promotions and incentives 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.

**Acquisition**

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. Based in Iron Mountain, Michigan, BOSS designs, manufactures, and sells a broad line of snowplows, salt and sand spreaders, and related parts and accessories for light and medium duty trucks, all terrain vehicles ( ATVs ), utility terrain vehicles ( UTVs ), skid steers, and front-end loaders. Through this acquisition, the company added another professional contractor brand; a portfolio of counter-seasonal equipment; manufacturing and distribution facilities located in Iron Mountain, Michigan; and a distribution network for these products. Management believes that this acquisition positions the company to strengthen and grow its relationships with professional contractors, municipalities, and other customers by enabling the company to provide them with the innovative, durable equipment and high-quality service they need each season.

The purchase price of this acquisition was \$229.5 million, which included a cash payment of \$198.3 million and issuance of a note payable at fair value of \$31.2 million. The company funded the acquisition with cash on hand, a \$130.0 million term loan, and short-term debt under the company's revolving credit facility.

Table of Contents

The purchase price of this acquisition was accounted for as a business combination using the acquisition method, which requires that, among other things, assets acquired and liabilities assumed, be recorded at their fair value as of the acquisition date using independent appraisals and other analyses. The excess of the consideration transferred over those fair values is recorded as goodwill. The following table presents the allocation of the purchase price to the acquired assets, liabilities, and goodwill.

<b>(Dollars in thousands)</b>	<b>July 31, 2015</b>	
Inventory	\$	14,106
Prepaid expenses		266
Property, plant, and equipment		13,689
Intangible assets		107,700
Goodwill		103,028
Current liabilities		(9,299)
Purchase price	\$	229,490

The goodwill recorded as part of the acquisition primarily reflects the value of the assembled workforce, cost synergies, expected future cash flows, and sales growth from integrating and expanding existing product lines. The amount of goodwill that is expected to be deductible for income tax purposes is \$101.9 million. The goodwill and intangible assets have been allocated to the Professional segment.

During the first nine months of fiscal 2015, the company expensed \$0.3 million of acquisition-related costs, which was recorded in selling, general, and administrative expense. The company also capitalized \$0.4 million of debt issuance costs in other assets related to the \$130.0 million term loan, which will be amortized over the term of the loan.

Operating results for this acquisition have been included in the company's consolidated statements of earnings from the date of acquisition and are reflected in the Professional segment. The sale of BOSS products contributed \$37.1 million and \$82.4 million of net sales for the third quarter and year-to-date periods of fiscal 2015, respectively, and had an immaterial impact on net earnings for both the third quarter and year-to-date periods of fiscal 2015. Pro-forma results are not presented, as the acquisition was not considered material to the company's consolidated results of operations.

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

Under the company's amended and restated equity and incentive 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 non-officer 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 officers and other employees are subject to accelerated expensing if the option holder meets the retirement definition set forth in the company's amended and restated equity and incentive plan. In that case, the fair value of the options is expensed in the fiscal year of grant because the option holder must

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

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.

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 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 2015</b>	<b>Fiscal 2014</b>
Expected life of option in years	5.94	6
Expected stock price volatility	29.67%	34.29%
Risk-free interest rate	1.61%	1.92%
Expected dividend yield	1.29%	1.25%
Grant date per share weighted-average fair value	\$16.81	\$18.69

***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 2015 and 2014 was \$65.68 and \$60.19, respectively. No performance share awards were granted during the second and third quarters of fiscal 2015 or 2014.

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

Under the company's amended and restated equity and incentive plan, restricted stock and restricted stock unit awards are generally granted to certain non-officer employees. 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 2015 and 2014 was \$66.10 and \$63.09, respectively.

**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 31,</b>	<b>August 1,</b>	<b>July 31,</b>	<b>August 1,</b>

Edgar Filing: TORO CO - Form 10-Q

(Shares in thousands)	2015	2014	2015	2014
<b><i>Basic</i></b>				
Weighted-average number of shares of common stock	55,310	55,965	55,724	56,477
Assumed issuance of contingent shares			15	17
Weighted-average number of shares of common stock and assumed issuance of contingent shares	55,310	55,965	55,739	56,494
<b><i>Diluted</i></b>				
Weighted-average number of shares of common stock and assumed issuance of contingent shares	55,310	55,965	55,739	56,494
Effect of dilutive securities	1,242	1,355	1,214	1,306
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	56,552	57,320	56,953	57,800

Incremental shares from options, restricted stock, and restricted stock units are computed by the treasury stock method. Options for the purchase of 157,299 and 153,651 shares of common stock during the third quarter of fiscal 2015 and 2014, 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 2015 and 2014, options for the purchase of 245,818 and 239,058 shares of common stock, respectively, were excluded from the diluted net earnings per share because they were anti-dilutive.

Table of Contents**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 31, 2015	August 1, 2014	October 31, 2014
Raw materials and work in process	\$ 102,580	\$ 88,140	\$ 95,144
Finished goods and service parts	315,110	270,996	246,954
Total FIFO value	417,690	359,136	342,098
Less: adjustment to LIFO value	67,496	65,375	67,495
Total	\$ 350,194	\$ 293,761	\$ 274,603

**Goodwill**

The changes in the net carrying amount of goodwill for the first nine months of fiscal 2015 were as follows:

(Dollars in thousands)	Professional Segment	Residential Segment	Total
Balance as of October 31, 2014	\$ 80,946	\$ 10,905	\$ 91,851
Goodwill acquired	103,028		103,028
Translation adjustments	(46)	(106)	(152)
Balance as of July 31, 2015	\$ 183,928	\$ 10,799	\$ 194,727

**Other Intangible Assets**

The components of other intangible assets were as follows:

(Dollars in thousands) July 31, 2015	Weighted-average Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	9.9	\$ 15,202	\$ (10,003)	\$ 5,199
Non-compete agreements	5.5	6,931	(6,071)	860
Customer-related	19.1	84,618	(9,156)	75,462

Edgar Filing: TORO CO - Form 10-Q

Developed technology	7.6	28,819	(19,704)	9,115
Trade names	19.2	28,715	(2,410)	26,305
Other		800	(800)	
Total amortizable		165,085	(48,144)	116,941
Non-amortizable - trade names		4,863		4,863
Total other intangible assets, net		\$ 169,948	\$ (48,144)	\$ 121,804

October 31, 2014	Weighted-average Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	9.4	\$ 10,711	\$ (8,942)	\$ 1,769
Non-compete agreements	5.4	7,039	(5,315)	1,724
Customer-related	10.7	8,650	(5,517)	3,133
Developed technology	7.6	28,841	(16,869)	11,972
Trade names	5.0	1,515	(1,165)	350
Other		800	(800)	
Total amortizable		57,556	(38,608)	18,948
Non-amortizable - trade names		4,881		4,881
Total other intangible assets, net		\$ 62,437	\$ (38,608)	\$ 23,829



Table of Contents

During the second quarter of fiscal 2015, the company determined certain amortizable intangible assets were impaired based on its assessment that the carrying amount may not be recovered. Based on the company's impairment analysis, the company wrote down \$1.4 million of other intangible assets in the second quarter of fiscal 2015.

Amortization expense for intangible assets during the first nine months of fiscal 2015 was \$10.0 million. Estimated amortization expense for the remainder of fiscal 2015 and succeeding fiscal years is as follows: fiscal 2015 (remainder), \$2.8 million; fiscal 2016, \$10.3 million; fiscal 2017, \$9.5 million; fiscal 2018, \$7.4 million; fiscal 2019, \$6.6 million; and after fiscal 2019, \$80.3 million.

**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, including floor plan and open account receivable financing, to distributors and dealers of the company's products in the U.S. and to select distributors of the company's products in Canada. The initial term of Red Iron will continue until October 31, 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.

The company owns 45 percent of Red Iron and TCFIF owns 55 percent of Red Iron. The company accounts for its investment in Red Iron under the equity method of accounting. Each of the company and TCFIF contributed a specified amount of the estimated cash required to enable Red Iron to purchase the company's inventory financing receivables and to provide financial support for Red Iron's inventory financing programs. Red Iron borrows the remaining requisite estimated cash utilizing a \$450 million secured revolving credit facility established under a credit agreement between Red Iron and TCFIF. The company's total investment in Red Iron as of July 31, 2015 was \$19.2 million. The company has not guaranteed the outstanding indebtedness of Red Iron. The company has agreed to repurchase products repossessed by Red Iron and the TCFIF Canadian affiliate, up to a maximum aggregate amount of \$7.5 million in a calendar year. In addition, the company has provided recourse to Red Iron for certain outstanding receivables, which amounted to a maximum amount of \$0.7 million as of July 31, 2015.

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, 2015 and August 1, 2014 was \$1,117.7 million and \$1,019.3 million, respectively.

As of July 31, 2015, Red Iron's total assets were \$383.7 million and total liabilities were \$340.3 million.

**Warranty Guarantees**

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

Table of Contents

Warranty provisions, claims, and changes in estimates for the first nine months of fiscal 2015 and 2014 were as follows:

(Dollars in thousands)	Nine Months Ended	
	July 31, 2015	August 1, 2014
Beginning balance	\$ 71,080	\$ 72,177
Warranty provisions	34,532	34,078
Warranty claims	(26,728)	(25,052)
Changes in estimates	(221)	(1,510)
Ending balance	\$ 78,663	\$ 79,693

**Stockholders Equity***Accumulated Other Comprehensive Loss*

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

(Dollars in thousands)	July 31, 2015	August 1, 2014	October 31, 2014
Foreign currency translation adjustments	\$ 23,255	\$ 7,166	\$ 12,536
Pension and post-retirement benefits	5,195	3,754	5,266
Derivative instruments	297	73	(2,097)
Total accumulated other comprehensive loss	\$ 28,747	\$ 10,993	\$ 15,705

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

The components and activity of AOCL for the first nine months of fiscal 2014 are as follows:

Edgar Filing: TORO CO - Form 10-Q

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Postretirement Benefits	Cash Flow Derivative Instruments	Total
Balance as of October 31, 2013	\$ 7,778	\$ 3,683	\$ 1,109	\$ 12,570
Other comprehensive (income) loss before reclassifications	(612)	71	450	(91)
Amounts reclassified from AOCL			(1,486)	(1,486)
Net current period other comprehensive (income) loss	\$ (612)	\$ 71	\$ (1,036)	\$ (1,577)
Balance as of August 1, 2014	\$ 7,166	\$ 3,754	\$ 73	\$ 10,993

Table of Contents

**Segment Data**

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

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

(Dollars in thousands)

Three months ended July 31, 2015	Professional	Residential	Other	Total
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

Three months ended August 1, 2014	Professional	Residential	Other	Total
Net sales	\$ 384,678	\$ 175,717	\$ 7,145	\$ 567,540
Intersegment gross sales	11,964	128	(12,092)	
Earnings (loss) before income taxes	74,835	18,698	(22,735)	70,798

Nine months ended July 31, 2015	Professional	Residential	Other	Total
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

Nine months ended August 1, 2014	Professional	Residential	Other	Total
Net sales	\$ 1,208,707	\$ 533,664	\$ 16,180	\$ 1,758,551
Intersegment gross sales	31,878	378	(32,256)	
Earnings (loss) before income taxes	244,665	60,654	(66,650)	238,669
Total assets	616,305	186,079	325,443	1,127,827

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

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	July 31, 2015	August 1, 2014	July 31, 2015	August 1, 2014
Corporate expenses	\$ (26,989)	\$ (22,101)	\$ (68,434)	\$ (62,448)
Interest expense, net	(4,587)	(3,629)	(14,071)	(11,065)
Other	6,373	2,995	10,373	6,863
Total	\$ (25,203)	\$ (22,735)	\$ (72,132)	\$ (66,650)



Table of Contents**Derivative Instruments and Hedging Activities**

The company is exposed to foreign currency exchange rate risk arising from transactions in the normal course of business, such as sales to third party customers, sales and loans to wholly owned foreign subsidiaries, foreign plant operations, and purchases from suppliers. The company actively manages the exposure of its foreign currency 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 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 and foreign plant operations. 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 2015, there were immaterial losses on contracts reclassified into earnings as a result of the discontinuance of cash flow hedges. As of July 31, 2015 and August 1, 2014, the notional amount outstanding of forward contracts designated as cash flow hedges was \$102.8 million and \$108.6 million, respectively. Additionally, as of July 31, 2015 and August 1, 2014, 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.

*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)	Asset Derivatives				Liability Derivatives			
	July 31, 2015		August 1, 2014		July 31, 2015		August 1, 2014	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives Designated as Hedging Instruments</b>								
Forward currency contracts	Prepaid expenses	\$ 2,957	Prepaid expenses	\$ 1,263	Accrued liabilities	\$ 1,986	Accrued liabilities	\$ 62
Cross currency contract	Prepaid expenses		Prepaid expenses		Accrued liabilities	243	Accrued liabilities	701
<b>Derivatives Not Designated as Hedging Instruments</b>								
Forward currency contracts	Prepaid expenses	2,663	Prepaid expenses	261	Accrued liabilities	2	Accrued liabilities	412
Cross currency contract	Prepaid expenses	2,179	Prepaid expenses	61	Accrued liabilities		Accrued liabilities	
<b>Total Derivatives</b>		<b>\$ 7,799</b>		<b>\$ 1,585</b>		<b>\$ 2,231</b>		<b>\$ 1,175</b>

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 31, 2015 and August 1, 2014, respectively.

(Dollars in thousands)	Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain (Loss) Reclassified from AOCL into Income (Effective Portion)	Gain (Loss) Reclassified from AOCL into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and excluded from Effectiveness Testing)	Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Excluded from Effectiveness Testing)	
	July 31,	August 1,		July 31,	August 1,		July 31,	August 1,
	2015	2014		2015	2014		2015	2014
<b>For the three months ended</b>								
Forward currency contracts	\$ (654)	\$ 952	Net sales	\$ 3,258	\$ (369)	Other income, net	\$ 280	\$ (63)
Forward currency contracts	(433)	(216)	Cost of sales	(817)	61			
Cross currency contracts	31	(292)	Other income, net	(85)	(212)			
Total	\$ (1,056)	\$ 444		\$ 2,356	\$ (520)			
<b>For the nine months ended</b>								
Forward currency contracts	\$ (950)	\$ 1,694	Net sales	\$ 11,188	\$ (1,140)	Other income, net	\$ 563	\$ (204)
Forward currency contracts	(1,615)	(333)	Cost of sales	(1,808)	93			
	167	(330)	Other income, net	(292)	(439)			

Edgar Filing: TORO CO - Form 10-Q

Cross currency contracts					
Total	\$	(2,398)	\$	1,031	\$ 9,088 \$ (1,486)

As of July 31, 2015, the company expects to reclassify approximately \$0.8 million of gains from AOCL to earnings during the next twelve months.

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

(Dollars in thousands)	Location of Gain (Loss) Recognized in Net Earnings	Gain (Loss) Recognized in Net Earnings			
		Three Months Ended		Nine Months Ended	
		July 31, 2015	August 1, 2014	July 31, 2015	August 1, 2014
Forward currency contracts	Other income, net	\$ (2,891)	\$ 2,474	\$ 8,459	\$ (553)
Cross currency contracts	Other income, net	139	421	1,441	181
		\$ (2,752)	\$ 2,895	\$ 9,900	\$ (372)

Table of Contents

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 31, 2015	Assets			Liabilities		
	Gross Amounts of Recognized Assets	Gross Liabilities Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Gross Amounts of Recognized Liabilities	Gross Assets offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet
Forward currency contracts	\$ 5,855	\$ (235)	\$ 5,620	\$ (2,220)	\$ 232	\$ (1,988)
Cross currency contracts	2,179		2,179	(243)		(243)
	\$ 8,034	\$ (235)	\$ 7,799	\$ (2,463)	\$ 232	\$ (2,231)

(Dollars in thousands) August 1, 2014	Assets			Liabilities		
	Gross Amounts of Recognized Assets	Gross Liabilities Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Gross Amounts of Recognized Liabilities	Gross Assets offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet
Forward currency contracts	\$ 1,572	\$ (48)	\$ 1,524	\$ (560)	\$ 86	\$ (474)
Cross currency contracts	61		61	(701)		(701)
	\$ 1,633	\$ (48)	\$ 1,585	\$ (1,261)	\$ 86	\$ (1,175)

**Fair Value Measurements**

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

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

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

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

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.

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

### Table of Contents

Assets and liabilities measured at fair value on a recurring basis, as of July 31, 2015, August 1, 2014, and October 31, 2014 are summarized below:

**(Dollars in thousands)**

<b>July 31, 2015</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<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>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>\$ 4,006</b>	

<b>August 1, 2014</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets:</b>				
Cash and cash equivalents	\$ 177,894	\$ 177,894		
Forward currency contracts	1,524		1,524	
Cross currency contracts	61		61	
<b>Total assets</b>	<b>\$ 179,479</b>	<b>\$ 177,894</b>	<b>\$ 1,585</b>	
<b>Liabilities:</b>				
Forward currency contracts	\$ 474		\$ 474	
Cross currency contracts	701		701	
Deferred compensation liabilities	2,290		2,290	
<b>Total liabilities</b>	<b>\$ 3,465</b>		<b>\$ 3,465</b>	

<b>October 31, 2014</b>	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets:</b>				
Cash and cash equivalents	\$ 314,873	\$ 314,873		
Forward currency contracts	6,030		6,030	
Cross currency contracts	831		831	
<b>Total assets</b>	<b>\$ 321,734</b>	<b>\$ 314,873</b>	<b>\$ 6,861</b>	
<b>Liabilities:</b>				
Forward currency contracts	\$ 9		\$ 9	
Cross currency contracts	536		536	
Deferred compensation liabilities	2,141		2,141	
<b>Total liabilities</b>	<b>\$ 2,686</b>		<b>\$ 2,686</b>	

The company measures certain assets and liabilities at fair value on a nonrecurring basis. Assets acquired and liabilities assumed as part of acquisitions are measured at fair value. Refer to Acquisition Note for additional information. There were no transfers between Level 1 and Level 2 during the three and nine months ended July 31, 2015 and August 1, 2014, or the twelve months ended October 31, 2014.

### **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 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

Table of Contents

its risk of being a defendant in patent infringement litigation. 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.

**Subsequent Events**

The company evaluated all subsequent events and concluded that no 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**

**Nature of Operations**

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, agricultural micro-irrigation systems, rental and specialty construction equipment, and residential yard and snow thrower products. Beginning in fiscal 2015 with our acquisition of BOSS®, we also design, manufacture, and market professional snow and ice management products. Through this acquisition, we added another professional contractor brand; a portfolio of counter-seasonal equipment; manufacturing and distribution facilities located in Iron Mountain, Michigan; and a distribution network for these products. We sell our products worldwide through a network of distributors, dealers, hardware retailers, home centers, mass retailers, and over the Internet. Our businesses are organized into three reportable business segments: Professional, Residential, and Distribution. Our Distribution segment, which consists of our company-owned domestic distributorships, has been combined with our corporate activities and is shown as Other. 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.

This Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with the MD&A included in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended October 31, 2014. This discussion contains various Forward-Looking Statements within the meaning of 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.

**RESULTS OF OPERATIONS**

**Overview**

Our results for the third quarter of fiscal 2015 were positive with a net sales increase of 7.4 percent and a net earnings increase of 6.6 percent, each as compared to the third quarter of fiscal 2014. Year-to-date net sales and net earnings also increased by 8.6 percent and 9.2 percent, respectively, in fiscal 2015 compared to the same period in the prior fiscal year. Professional segment net sales increased 9.7 percent and 8.8 percent for our third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods last fiscal year. The acquisition of the BOSS business resulted in incremental net sales for our professional segment of \$37.1 million and \$82.4 million for the third quarter and year-to-date periods of fiscal 2015, respectively. Professional segment net sales were also up due to the successful introduction of new products and continued growth and demand for our innovative landscape contractor and specialty construction products, partially offset by a decrease in sales of irrigation products primarily due to unfavorable weather conditions in key markets. Additionally, unfavorable foreign currency exchange rate fluctuations hindered our professional segment sales growth for both the third quarter and year-to-date periods of fiscal 2015. Residential segment net sales were slightly up, by 0.1 percent, for our third quarter of fiscal 2015 compared to our third quarter of fiscal 2014, and increased 8.4 percent for the year-to-date period of fiscal 2015 compared to the same period last fiscal year. Residential segment sales were up due to strong shipments and demand for our newly introduced riding and walk power mower products and expanded product placement, partially offset by a decrease in sales of snow thrower products primarily due to lower pre-season shipments in the third quarter of fiscal 2015 that are expected to ship in the fourth quarter of fiscal 2015 and unfavorable foreign currency exchange rate fluctuations. Our overall international net sales were down 3.5 percent and 4.6 percent for our third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods last fiscal year due to unfavorable foreign currency exchange rates that



Table of Contents

decreased net sales by approximately \$11 million and \$30 million for the third quarter and year-to-date periods of fiscal 2015, respectively.

Our net earnings growth in the third quarter and year-to-date periods of fiscal 2015 was primarily attributable to increased sales and leveraging selling, general, and administrative ( SG&A ) costs over higher sales volumes, partially offset by a decrease in our gross margin rate and an increase in interest expense. Our effective tax rate for the third quarter comparison increased mainly due to a discrete benefit last year that was not duplicated this year. However, our tax rate for the year-to-date comparison decreased mainly due to the retroactive re-enactment of the domestic research tax credit in the first quarter of fiscal 2015 for calendar year 2014. We increased our third quarter cash dividend by 25 percent to \$0.25 per share compared to the \$0.20 per share quarterly cash dividend paid in the third quarter of fiscal 2014.

Inventory levels increased \$56.4 million, or 19.2 percent, as of the end of the third quarter of fiscal 2015 compared to the end of the third quarter of fiscal 2014, mainly due to increased residential segment inventory levels as a result of anticipated strong demand for new products and incremental inventory of \$21.9 million from the acquisition of the BOSS business. Receivables as of the end of the third quarter of fiscal 2015 increased \$12.2 million, or 5.7 percent, compared to the end of the third quarter of fiscal 2014 as a result of higher sales volumes and incremental receivables from the acquisition of the BOSS business, which was partially offset by a decrease in international receivables due to lower foreign currency exchange rates. Field inventory levels were also up as of the end of the third quarter of fiscal 2015 compared to the end of the third quarter of fiscal 2014 primarily due to strong sales from new product introductions and anticipated retail demand.

Our new multi-year initiative, Destination PRIME, begins our journey into our second century. Similar to our previous Destination 2014 initiative, this three-year initiative 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 will strive to achieve our goals by pursuing a progression of annual milestones. Each fiscal year we will set forth organic revenue growth and operating earnings goals, while continuing to focus on the progress we made through our previous initiatives, such as working capital. 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 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 accounts receivable plus inventory less trade payables as a percentage of net sales for a twelve month period.

**Net Earnings**

Net earnings for the third quarter of fiscal 2015 were \$53.3 million, or \$0.94 per diluted share, compared to \$50.0 million, or \$0.87 per diluted share, for the third quarter of fiscal 2014, resulting in a net earnings per diluted share increase of 8.0 percent. The primary factor contributing to our third quarter comparison earnings improvement was leveraging SG&A costs over higher sales volumes, partially offset by an increase in our effective tax rate and higher interest expense.

Edgar Filing: TORO CO - Form 10-Q

Year-to-date net earnings in fiscal 2015 were \$178.0 million, or \$3.13 per diluted share, compared to \$163.0 million, or \$2.82 per diluted share, in the same comparable period last fiscal year, resulting in a net earnings per diluted share increase of 11.0 percent. The primary factors contributing to our earnings improvement for the year-to-date comparison were leveraging SG&A costs over higher sales volumes and a decline in our effective tax rate, somewhat offset by a decrease in gross margin rates and an increase in interest expense. In addition, third quarter and year-to-date fiscal 2015 net earnings per diluted share were benefited by approximately \$0.01 per share and \$0.05 per share, respectively, compared to the same periods in fiscal 2014, as a result of reduced shares outstanding from repurchases of our common stock.

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

	Three Months Ended		Nine Months Ended	
	July 31, 2015	August 1, 2014	July 31, 2015	August 1, 2014
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(64.5)	(64.4)	(65.1)	(64.2)
Gross margin	35.5	35.6	34.9	35.8
SG&A expense	(22.5)	(22.9)	(21.2)	(22.0)
Operating earnings	13.0	12.7	13.7	13.8
Interest expense	(0.8)	(0.6)	(0.7)	(0.6)
Other income, net	0.5	0.4	0.4	0.4
Provision for income taxes	(4.0)	(3.7)	(4.1)	(4.3)
Net earnings	8.7%	8.8%	9.3%	9.3%

Table of Contents

**Net Sales**

Worldwide consolidated net sales for the third quarter of fiscal 2015 were \$609.6 million, up 7.4 percent compared to the third quarter of fiscal 2014. For the year-to-date period of fiscal 2015, net sales were \$1.9 billion, up 8.6 percent from the same period in the prior fiscal year. Worldwide professional segment net sales were up 9.7 percent and 8.8 percent for the third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods in the prior fiscal year. The acquisition of the BOSS business added \$37.1 million and \$82.4 million of net sales for the professional segment in the third quarter and year-to-date periods of fiscal 2015, respectively. Our professional segment sales were also positively impacted by higher shipments of landscape contractor and specialty construction equipment due to increased demand for our innovative product offerings and newly introduced products. Partially offsetting the sales growth in both the third quarter and year-to-date periods of fiscal 2015 compared to the same periods last fiscal year for the professional segment were lower irrigation sales due to unfavorable weather conditions, as well as unfavorable foreign currency exchange rate fluctuations. For the year-to-date period of fiscal 2015 compared to the same period last fiscal year, lower sales of micro-irrigation products, which were primarily due to foreign currency exchange rate changes and continued adverse political and economic conditions in certain key international regions, also partially offset professional segment sales growth.

Residential segment net sales were up 0.1 percent and 8.4 percent for the third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods in the prior fiscal year. The sales increases in both periods for the residential segment were largely due to higher shipments from strong retail demand for our new platform of zero-turn riding mowers and walk power mowers, as well as expanded product placement for these new innovative products. However, these net sales increases were somewhat offset by a decrease in sales of snow thrower products due to lower pre-season shipments in the third quarter of fiscal 2015 that are expected to ship in the fourth quarter of fiscal 2015, including the introduction of new products. Sales of snow thrower products in Europe also declined due to the lack of snow fall in that region during the past two winter seasons. Additionally, unfavorable foreign currency exchange rate fluctuations hampered sales growth for our residential segment in both the third quarter and year-to-date periods of fiscal 2015.

Net sales for our other segment were up by \$4.5 million for the third quarter of fiscal 2015 and \$0.8 million for the year-to-date period of fiscal 2015 compared to the same periods last fiscal year due mainly to higher sales volumes driven by strong demand for commercial equipment at our company-owned distribution companies. International net sales were down, by 3.5 percent and 4.6 percent, for the third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods in the prior fiscal year due to unfavorable foreign currency exchange rate fluctuations. Changes in foreign currency exchange rates resulted in a reduction of our net sales of approximately \$11 million and \$30 million for the third quarter and year-to-date periods of fiscal 2015, respectively. Field inventory levels were up as of the end of the third quarter of fiscal 2015 compared to the end of the third quarter of fiscal 2014 primarily due to strong sales from new product introductions and anticipated retail demand.

**Gross Profit**

As a percentage of net sales, gross profit for the third quarter of fiscal 2015 decreased slightly, by 10 basis points, to 35.5 percent compared to 35.6 percent in the third quarter of fiscal 2014 mainly due to unfavorable foreign currency exchange rate fluctuations, partially offset by a higher proportion of professional segment sales that carry higher average gross margins than our residential segment. Gross profit as a percent of net sales for the year-to-date period of fiscal 2015 decreased 90 basis points to 34.9 percent compared to 35.8 percent for the year-to-date period of fiscal 2014. This decrease was also primarily attributable to unfavorable foreign currency exchange rate fluctuations and the purchase accounting impact of the incremental charge for the sale of inventory that was written-up to fair value as a result of the

acquisition of the BOSS business.

**Selling, General, and Administrative Expense**

SG&A expense increased \$6.9 million, or 5.3 percent, for the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014 and increased \$18.5 million, or 4.8 percent, for the year-to-date period of fiscal 2015 compared to the year-to-date period of fiscal 2014. As a percentage of net sales, SG&A expense decreased 40 basis points and 80 basis points for the third quarter and year-to-date periods of fiscal 2015, respectively, compared to the same periods in the prior fiscal year. These decreases as a percentage of net sales were largely due to leveraging SG&A expense over higher sales volumes and lower marketing expense, partially offset by incremental SG&A costs from the acquisition of the BOSS business.

**Interest Expense**

Interest expense for the third quarter and year-to-date periods of fiscal 2015 increased \$1.0 million and \$3.0 million, respectively, compared to the same periods last fiscal year due to higher levels of debt as a result of borrowings that were used to pay the purchase price for the BOSS business.

Table of Contents**Other Income, Net**

Other income, net for the third quarter and year-to-date periods of fiscal 2015 increased \$0.4 million and \$1.3 million, respectively, compared to the same periods last fiscal year primarily due to higher earnings from our equity investment in Red Iron and a decrease in foreign currency exchange rate losses.

**Provision for Income Taxes**

The effective tax rate for the third quarter of fiscal 2015 was 31.3 percent compared to 29.4 percent in the third quarter of 2014. This increase was mainly due to a discrete tax benefit for a change in tax accounting method in the third quarter of fiscal 2014 that was not duplicated this fiscal year, partially offset by higher earnings in lower tax jurisdictions. The effective tax rate for the year-to-date periods of fiscal 2015 and 2014 was 30.4 percent and 31.7 percent, respectively. The decrease in the effective tax rate for the year-to-date comparison was primarily the result of the benefit in the first quarter of fiscal 2015 for the retroactive re-enactment of the domestic research tax credit for calendar year 2014, as well as higher earnings in lower tax jurisdictions.

**BUSINESS SEGMENTS**

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

The following table summarizes net sales by segment:

(Dollars in thousands)	Three Months Ended				
	July 31, 2015	August 1, 2014		\$ Change	% Change
Professional	\$ 421,994	\$ 384,678	\$	37,316	9.7%
Residential	175,977	175,717	\$	260	0.1
Other	11,644	7,145	\$	4,499	63.0
Total*	\$ 609,615	\$ 567,540	\$	42,075	7.4%
* Includes international sales of:	\$ 136,626	\$ 141,649	\$	(5,023)	(3.5)%

(Dollars in thousands)	Nine Months Ended				
	July 31, 2015	August 1, 2014		\$ Change	% Change
Professional	\$ 1,314,474	\$ 1,208,707	\$	105,767	8.8%

Edgar Filing: TORO CO - Form 10-Q

Residential		578,587		533,664		44,923		8.4
Other		17,007		16,180		827		5.1
Total*	\$	1,910,068	\$	1,758,551	\$	151,517		8.6%
* Includes international sales of:	\$	474,911	\$	498,029	\$	(23,118)		(4.6)%

Table of Contents

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

(Dollars in thousands)	Three Months Ended				
	July 31, 2015	August 1, 2014		\$ Change	% Change
Professional	\$ 82,253	\$ 74,835	\$	7,418	9.9%
Residential	20,566	18,698		1,868	10.0
Other	(25,203)	(22,735)		(2,468)	(10.9)
Total	\$ 77,616	\$ 70,798	\$	6,818	9.6%

(Dollars in thousands)	Nine Months Ended				
	July 31, 2015	August 1, 2014		\$ Change	% Change
Professional	\$ 258,727	\$ 244,665	\$	14,062	5.7%
Residential	69,131	60,654		8,477	14.0
Other	(72,132)	(66,650)		(5,482)	(8.2)
Total	\$ 255,726	\$ 238,669	\$	17,057	7.1%

**Professional**

Net Sales. Worldwide net sales for the professional segment in the third quarter and year-to-date periods of fiscal 2015 increased 9.7 percent and 8.8 percent, respectively, compared to the same periods in the prior fiscal year. The acquisition of the BOSS business added \$37.1 million and \$82.4 million of net sales for the third quarter and year-to-date periods of fiscal 2015, respectively. Sales and demand of landscape contractor equipment were also up for the third quarter and year-to-date periods of fiscal 2015 compared to the same periods last fiscal year as contractors continued to invest capital in our turf management products, including our new product offerings. Professional segment sales were also positively impacted by increased shipments of our specialty construction equipment due to continued growth and demand and the successful introduction of new products. However, irrigation product sales in both the third quarter and year-to-date periods of fiscal 2015 were hampered by unfavorable weather conditions in key markets and unfavorable foreign currency exchange rate fluctuations. In addition, for the year-to-date period of fiscal 2015 compared to the same period last fiscal year, sales of micro-irrigation products were down due to foreign currency exchange rate changes, as well as continued adverse political and economic conditions in certain key international regions.

Operating Earnings. Operating earnings for the professional segment in the third quarter of fiscal 2015 increased 9.9 percent compared to the third quarter of fiscal 2014 due to increased sales volumes. Expressed as a percentage of net sales, professional segment operating margin remained unchanged at 19.5 percent in the third quarter of fiscal 2015 compared to the same period in the prior fiscal year. For the year-to-date period of fiscal 2015, professional segment operating earnings increased 5.7 percent compared to the same period in the prior fiscal year mainly due to higher sales volumes. However, as a percentage of net sales, professional segment operating margin decreased to 19.7 percent for the year-to-date period of fiscal 2015 compared to 20.2 percent in the same period last fiscal year. This decrease was due to lower gross margins primarily from the impact of unfavorable foreign currency exchange rate

fluctuations and the purchase accounting impact for the acquisition of the BOSS business, as previously discussed, partially offset by leveraging SG&A costs over higher sales volumes.

**Residential**

*Net Sales.* Worldwide net sales for the residential segment in the third quarter and year-to-date periods of fiscal 2015 increased 0.1 percent and 8.4 percent, respectively, compared to the same periods in the prior fiscal year. These sales increases were largely due to higher shipments driven by strong retail demand and additional product placement for our new platform of zero-turn riding mowers. Sales of walk power mowers also increased due to enhanced product placement and increased demand for our new product offerings, including our new all-wheel drive model. However, these net sales increases were somewhat offset by a decrease in sales of snow thrower products due to lower pre-season shipments in the third quarter of fiscal 2015 that are expected to ship in the fourth quarter of fiscal 2015, including the introduction of new products. Sales of snow thrower products in Europe also declined due to the lack of snow fall in that region during the past two winter seasons. Additionally, unfavorable foreign currency exchange rate fluctuations hampered sales growth for our residential segment in both the third quarter and year-to-date periods of fiscal 2015.



Table of Contents

*Operating Earnings.* Operating earnings for the residential segment in the third quarter and year-to-date periods of fiscal 2015 increased 10.0 percent and 14.0 percent, respectively, compared to the same periods in the prior fiscal year. Expressed as a percentage of net sales, residential segment operating margin increased to 11.7 percent from 10.6 percent in the third quarter of fiscal 2014, and fiscal 2015 year-to-date residential segment operating margin increased to 11.9 percent compared to 11.4 percent in the same period last fiscal year. The operating earnings improvement for the third quarter and year-to-date comparisons was largely due to leveraging SG&A costs over higher sales volumes and lower marketing expense, somewhat offset by lower gross margins for the year-to-date comparison mainly due to unfavorable foreign currency exchange rate fluctuations and increased manufacturing expenses.

**Other**

*Net Sales.* Net sales for the other segment include sales from our wholly owned domestic distribution companies less sales from the professional and residential segments to those distribution companies. The other segment net sales for the third quarter and year-to-date periods of fiscal 2015 increased by \$4.5 million and \$0.8 million, respectively, compared to the same periods in the prior fiscal year. These sales increases were mainly due to higher sales volumes driven by strong demand for commercial equipment at our company-owned distribution companies.

*Operating Losses.* Operating losses for the other segment in the third quarter and year-to-date periods of fiscal 2015 increased \$2.5 million and \$5.5 million, respectively, compared to the same periods in the prior fiscal year. The higher operating losses were primarily attributable to an increase in interest expense related to debt issued in connection with the acquisition of the BOSS business and an increase in incentive compensation expense.

**FINANCIAL POSITION**

**Working Capital**

During the first nine months of fiscal 2015, we continued to place 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. Inventory levels were up \$56.4 million, or 19.2 percent, as of the end of the third quarter of fiscal 2015 compared to the end of the third quarter of fiscal 2014 mainly due to increased residential segment inventory levels as a result of anticipated strong demand for new products and incremental inventory of \$21.9 million from the acquisition of the BOSS business. Receivables as of the end of the third quarter of fiscal 2015 also increased by \$12.2 million, or 5.7 percent, compared to the end of the third quarter of fiscal 2014 as a result of higher sales volumes and incremental receivables from the acquisition of the BOSS business, which was partially offset by a decrease in international receivables primarily due to lower foreign currency exchange rates. Our average days sales outstanding for receivables decreased to 34.1 days based on sales for the last twelve months ended July 31, 2015, compared to 35.2 days for the twelve months ended August 1, 2014. In addition, accounts payable increased slightly as of the end of our third quarter of fiscal 2015 compared to the end of the third quarter of fiscal 2014 by \$1.0 million, or 0.6 percent. Our average net working capital as a percentage of net sales for the twelve months ended July 31, 2015 was 15.9 percent compared to 14.9 percent for the twelve months ended August 1, 2014. This increase was primarily attributable to higher inventory levels, as

previously discussed.

### **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.

Our Board of Directors approved a cash dividend of \$0.25 per share for the third quarter of fiscal 2015 that was paid on July 13, 2015. This was an increase of 25 percent over our cash dividend of \$0.20 per share for the third quarter of fiscal 2014.

Cash Flow. Cash provided by operating activities for the first nine months of fiscal 2015 increased \$3.8 million, or 2.3 percent, compared to the first nine months of fiscal 2014 mainly due to higher net earnings, partially offset by an increase in working capital, as described above. Cash used for investing activities increased \$182.4 million during the first nine months of fiscal 2015 compared to the first nine months of fiscal 2014 due to cash utilized for the acquisition of the BOSS business, partially offset by lower purchases of property, plant, and equipment. Cash used for financing activities for the first nine months of fiscal 2015

Table of Contents

increased \$17.8 million compared to the first nine months of fiscal 2014 mainly due to repayments of debt and an increase in cash dividends paid on our stock, partially offset by lower amounts of cash utilized for share repurchases.

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 \$11.3 million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. As of July 31, 2015, we had \$5.0 million outstanding short-term debt under these lines of credit compared to \$1.1 million outstanding short-term debt as of August 1, 2014. As of July 31, 2015, we had \$9.7 million of outstanding letters of credit and \$146.6 million of unutilized availability under our credit agreements. In addition, we had \$0.2 million in short-term debt for certain receivables that we provided recourse to Red Iron as of July 31, 2015.

As of July 31, 2015, we had \$381.3 million outstanding in long-term debt that includes \$100.0 million in aggregate principal amount of 7.8% debentures due June 15, 2027 and \$125.0 million in aggregate principal amount of 6.625% senior notes due July 31, 2037. In late fiscal 2014 as part of our renewed credit facility, we also obtained a \$130.0 million term loan for cash required to close the acquisition of the BOSS business early in fiscal 2015. 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. On November 14, 2014, we issued a \$30.0 million in aggregate principal note to the former owners of the BOSS business that we acquired.

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 31, 2015, 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 31, 2015, and we expect to be in compliance with all covenants during the remainder of fiscal 2015. 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 2015 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, including floor plan and open accounts receivable financing, to distributors and dealers of our products in the U.S. and to select distributors of our products in Canada to enable our distributors and dealers to carry representative inventories of our products. Some independent international dealers continue to finance their products with a third party finance company. This third party financing company purchased \$17.0 million of receivables from us during the first nine months of fiscal 2015. As of July 31, 2015, \$8.9 million of receivables financed by a

Table of Contents

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 2015, 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 2014. 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 2015 as compared to fiscal 2014. Historically, we have mitigated, and we expect that we would 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, 2014 for a discussion of our critical accounting policies.

**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 July 2015, the FASB approved a one-year deferral of the effective date of this standard. We expect to adopt this guidance on November 1, 2018, as required, based on the new effective date recently approved by the FASB. 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 are currently evaluating the impact of this amended guidance on our consolidated financial statements.

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 are currently evaluating the impact of this amended guidance 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.

No new accounting pronouncement that has been issued but not yet effective for us during the third quarter of fiscal 2015 has had or is expected to have a material impact on our consolidated financial statements.

#### **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*

Table of Contents

*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, 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 may adversely affect profit margins and our business. Further, we could experience delays in receiving materials required to manufacture our products and delays in shipping products to our customers, which may adversely affect net sales and operating results.
- 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 into our professional portfolio; 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.
- 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; 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.



Table of Contents

- If we are unable to continue to enhance existing products and develop and market new products that respond to customer needs and preferences and achieve market acceptance, or if we experience unforeseen product quality or other problems in the development, production, or use of new and existing products, we may experience a decrease in demand for our products, and our business could suffer.
- We intend to grow our business in part through additional 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. In the first quarter of fiscal 2015, we acquired the BOSS business. If this acquisition, previous or future acquisitions do not produce the expected results or if integration into our operations take more time than expected, our business could be harmed. We cannot guarantee previous or future acquisitions, alliances, joint ventures or partnerships will in fact produce any benefits.
- 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.
- 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 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, or expiration of the domestic research tax credit, which individually or in combination may cause our effective tax rate to increase, or (ii) healthcare laws or regulations, which may cause us to incur higher employee healthcare and other costs.
- The United States Environmental Protection Agency has adopted increasingly stringent engine emission regulations, including Tier 4 emission requirements applicable to diesel engines in specified horsepower ranges that are used in some of our products. Beginning January 1, 2013, such requirements expanded to additional horsepower categories and, accordingly, apply to more of our products. We have implemented plans to achieve substantial compliance with Tier 4 diesel engine emission requirements for most of the horsepower categories affected and are implementing plans for other horsepower categories. These plans are subject to many variables including, among others, the ability of our suppliers to provide compliant engines on a timely basis or our ability to meet our production schedule. If we are unable to successfully execute such plans, our ability to sell our products into the market may be inhibited, which could adversely affect our competitive position and financial results. To the extent in which we cover or partially offset costs related to research, development, engineering, and other expenses to design Tier 4 diesel engine compliant products in the form of price increases to our customers, we may experience lower market demand for our products that may, ultimately, adversely affect our profit margins, net sales, and overall financial results. Alternatively, if our competitors implement different strategies with respect to compliance with Tier 4 requirements that, either in the short term or over the long term, enable them to limit price increases, introduce product modifications that gain widespread market acceptance, or otherwise changing customer preferences and buying

patterns in ways that we do not currently anticipate, we may experience lower market demand for our products that may, ultimately, adversely affect our net sales, profit margins, and overall financial results.

- Climate change and climate change regulations may adversely impact our operations.
- 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.
- 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.
- 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

Table of Contents

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.

- 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 key employees, and attract and retain other qualified personnel, we may not be able to meet strategic objectives and our business could suffer.
- As a result of our financing joint venture with TCFIF, we are dependent upon the joint venture to provide competitive inventory financing programs, including floor plan and open account receivable financing, to certain distributors and dealers of our products. Any material change in the availability or terms of credit offered to our customers by the joint venture, 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 undertake no obligation to update forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. We advise you, however, to consult any further disclosures we make on related subjects in our future Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K we file with or furnish to the Securities and Exchange Commission.*

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk stemming from changes in foreign currency exchange rates, interest rates, and commodity prices. 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.

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

Table of Contents

primarily the use of forward currency contracts. We also utilize cross currency swaps to offset intercompany loan exposures. 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, and the Romanian New Leu against the U.S. dollar, as well as the Romanian New Leu against the Euro.

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 the section entitled Derivative Instruments and Hedging Activities.

The following foreign currency exchange contracts held by us have maturity dates in fiscal 2015 through 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 31, 2015 were as follows:

Dollars in thousands (except average contracted rate)	Average Contracted Rate	Notional Amount	Value in Accumulated Other Comprehensive Income (Loss)	Fair Value Impact (Loss) Gain
Buy US dollar/Sell Australian dollar	0.7563	\$ 35,222.7	\$ 990.1	\$ 2,703.1
Buy US dollar/Sell Canadian dollar	1.2008	12,516.2	1,005.1	1,104.1
Buy US dollar/Sell Euro	1.1553	78,953.3	1,818.2	9,444.9
Buy US dollar/Sell British pound	1.5648	21,124.6	(34.9)	726.2
Buy Euro/Sell US dollar	1.0985	7,737.6		2,178.9
Buy Mexican peso/Sell US dollar	15.1642	18,464.6	(2,257.2)	(2,051.9)
Buy Euro/Sell Romanian New Leu	4.4167	9,336.7	(288.7)	(243.3)

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. Included in long-term debt is \$255.0 million of fixed-rate debt that is not subject to

variable interest rate fluctuations and \$130.0 million LIBOR-based term loan, which is subject to market risk based on changes in LIBOR 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, except for a note for the principal amount of \$30.0 million issued to the former owners of the BOSS business, which was recorded at fair value of \$31.2 million.

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.

Table of Contents

**Item 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we are required to apply our judgment in evaluating the cost-benefit relationship of possible internal controls. Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered in this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of such period to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. There was no change in our internal control over financial reporting that occurred during our third quarter ended July 31, 2015 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 currently involved in patent litigation cases where we are asserting and defending against claims of patent infringement.

For a description of our material legal proceedings, see 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

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

materially from our anticipated results or other expectations, including those expressed in any forward-looking statement made in this report, are described in our most recently filed Annual Report on Form 10-K (Item 1A. Risk Factors). There has been no material change in those risk factors.



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

The following table shows our third quarter of fiscal 2015 stock repurchase activity.

<b>Period</b>	<b>Total Number of Shares (or Units) Purchased (1,2,3)</b>	<b>Average Price Paid per Share (or Unit)</b>	<b>Total Number of Shares (or Units) Purchased As Part of Publicly Announced Plans or Programs (1)</b>	<b>Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)</b>
May 2, 2015 through May 29, 2015	254,660	\$ 68.22	254,445	1,730,160
May 30, 2015 through June 26, 2015	219,524	68.95	215,594	1,514,566
June 27, 2015 through July 31, 2015	130,247	68.03	129,178	1,385,388
<b>Total</b>	<b>604,431</b>		<b>599,217</b>	

(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.

(2) Includes 4,145 shares of the company's common stock surrendered by employees to satisfy minimum tax withholding obligations upon vesting of restricted stock granted under the company's amended and restated equity and incentive plan. These 4,145 shares were not repurchased under the company's repurchase program described in footnote 1 above.

(3) Includes 1,069 units (shares) of the company's common stock purchased in open-market transactions at an average price of \$68.50 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 1,069 shares were not repurchased under the company's repurchase program described in footnote 1 above.

Table of Contents

**Item 6. EXHIBITS**

(a) Exhibits

- 3.1 and 4.1 Restated Certificate of Incorporation of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated June 17, 2008, Commission File No. 1-8649).
- 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 3.2 to Registrant's Current Report on Form 8-K dated June 17, 2008, 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).
- 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 31, 2015, filed with the SEC on September 2, 2015, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Earnings for the three and nine-month periods ended July 31, 2015 and August 1, 2014, (ii) Condensed Consolidated Statements of Comprehensive Income for the three and nine-month periods ended July 31, 2015 and August 1, 2014, (iii) Condensed Consolidated Balance Sheets as of July 31, 2015, August 1, 2014, and October 31, 2014, (iv) Condensed Consolidated Statement of Cash Flows for the three and nine-month periods ended July 31, 2015 and August 1, 2014, and (v) Notes to Condensed Consolidated Financial Statements (filed herewith).

Table of Contents

**SIGNATURES**

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

THE TORO COMPANY

(Registrant)

Date: September 2, 2015

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