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 September 30, 2009

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period from ______ to ______

Commission File Number 0-24429

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**13-3728359**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**

Glenpointe Centre West

500 Frank W. Burr Blvd.

Teaneck, New Jersey	**07666**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code (201) 801-0233

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No: ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	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 x

Indicate the number of shares outstanding of each of the issuer s class of common stock, as of November 2, 2009:

Class	**Number of Shares**
Class A Common Stock, par value $.01 per share	294,713,446

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited).

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

(Unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenues	$ 853,488	$ 734,726	$ 2,375,942	$ 2,063,259
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization expense shown separately below)	475,599	405,936	1,328,647	1,153,068
Selling, general and administrative expenses	193,806	166,685	530,681	482,643
Depreciation and amortization expense	22,301	19,474	65,032	53,544
Income from operations	161,782	142,631	451,582	374,004
Other income (expense), net:				
Interest income	4,664	5,344	9,756	16,428
Other income (expense), net	(2,747)	(14,777)	7,016	(11,308)
Total other income (expense), net	1,917	(9,433)	16,772	5,120
Income before provision for income taxes	163,699	133,198	468,354	379,124
Provision for income taxes	27,127	20,370	77,395	60,567
Net income	$ 136,572	$ 112,828	$ 390,959	$ 318,557
Basic earnings per share	$ 0.47	$ 0.39	$ 1.34	$ 1.10
Diluted earnings per share	$ 0.45	$ 0.38	$ 1.30	$ 1.06
Weighted average number of common shares outstanding	293,664	291,341	292,538	289,740
Dilutive effect of shares issuable under stock-based compensation plans	8,918	8,464	7,411	9,656
Weighted average number of common and dilutive shares outstanding	302,582	299,805	299,949	299,396
Comprehensive income:				
Net income	$ 136,572	$ 112,828	$ 390,959	$ 318,557
Foreign currency translation adjustments	1,450	(15,507)	11,747	(12,942)
	(2,980)		4,096	

Net unrealized (loss) gain on cash flow hedges, net of taxes of $(115), $0, $159 and $0, respectively				
Unrealized gain loss on available-for-sale securities, net of taxes of $0, $31 $0 and $(2,601), respectively		46		(3,790)
Total comprehensive income	$ 135,042	$ 97,367	$ 406,802	$ 301,825

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

(in thousands, except par values)

	September 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 992,926	$ 735,066
Short-term investments	189,775	27,513
Trade accounts receivable, net of allowances of $15,906 and $13,441 respectively	586,938	517,481
Unbilled accounts receivable	97,832	62,158
Deferred income tax assets, net	51,936	48,315
Other current assets	97,419	77,586
Total current assets	2,016,826	1,468,119
Property and equipment, net of accumulated depreciation of $254,059 and $199,188, respectively	460,237	455,254
Long-term investments	157,032	161,693
Goodwill	160,881	154,035
Intangible assets, net	65,474	47,790
Deferred income tax assets, net	72,036	52,816
Other assets	43,996	34,853
Total assets	$ 2,976,482	$ 2,374,560
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 53,403	$ 39,970
Deferred revenue	36,777	38,123
Accrued expenses and other current liabilities	418,194	309,484
Total current liabilities	508,374	387,577
Deferred income tax liabilities, net		7,294
Other noncurrent liabilities	31,890	14,111
Total liabilities	540,264	408,982
Commitments and contingencies (See Note 9)		
Stockholders equity:		
Preferred stock, $.10 par value, 15,000 shares authorized, none issued		
Class A common stock, $.01 par value, 500,000 shares authorized, 294,650 and 291,670 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	2,946	2,917
Additional paid-in capital	605,544	541,735
Retained earnings	1,821,364	1,430,405
Accumulated other comprehensive income (loss)	6,364	(9,479)
Total stockholders equity	2,436,218	1,965,578

Total liabilities and stockholders equity	$ 2,976,482	$ 2,374,560

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	For the Nine Months Ended September 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 390,959	$ 318,557
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	65,032	53,544
Provision for doubtful accounts	2,682	7,776
Deferred income taxes	(17,663)	9,902
Stock-based compensation expense	32,005	32,957
Excess tax benefit on stock-based compensation arrangements	(12,401)	(16,259)
Other	(880)	
Changes in assets and liabilities:		
Trade accounts receivable	(61,962)	(156,066)
Other current assets	(43,394)	(24,570)
Other assets	(7,821)	(5,334)
Accounts payable	9,722	14,123
Other current and noncurrent liabilities	78,524	2,162
Net cash provided by operating activities	434,803	236,792
Cash flows from investing activities:		
Purchases of property and equipment	(62,013)	(146,325)
Purchases of investments	(228,827)	(128,332)
Proceeds from maturity or sale of investments	76,937	262,160
Acquisitions, net of cash acquired	(5,776)	(20,956)
Net cash used in investing activities	(219,679)	(33,453)
Cash flows from financing activities:		
Issuance of common stock under employee stock plans	33,760	48,813
Excess tax benefit on stock-based compensation arrangements	12,401	16,259
Repurchases of common stock	(14,564)	(27,835)
Net cash provided by financing activities	31,597	37,237
Effect of currency translation on cash and cash equivalents	11,139	(11,159)
Increase in cash and cash equivalents	257,860	229,417
Cash and cash equivalents, beginning of year	735,066	339,845
Cash and cash equivalents, end of period	$ 992,926	$ 569,262

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(dollar amounts in thousands)

Note 1 Interim Condensed Consolidated Financial Statements

The terms Cognizant, we, our, us and Company refer to Cognizant Technology Solutions Corporation unless the context indicates otherwise have prepared the accompanying unaudited condensed consolidated financial statements included herein in accordance with generally accepted accounting principles in the United States of America and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) included in our Annual Report on Form 10-K for the year ended December 31, 2008. In our opinion, all adjustments considered necessary for a fair presentation of the accompanying unaudited condensed consolidated financial statements have been included, and all adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year.

We have evaluated subsequent events that have occurred through November 6, 2009, the date on which this Quarterly Report on Form 10-Q was filed with the Securities and Exchange Commission, and have concluded no additional events or transactions have occurred that would require adjustment to, or additional disclosure in, our financial statements.

Note 2 Acquisitions

During the first nine months of 2009, we completed three acquisitions for aggregate consideration of approximately $34,500. In the third quarter of 2009, we entered into a transaction with Invensys where we acquired a multi-year service agreement, an assembled workforce and certain other assets. The acquisition was accounted for under the purchase method of accounting. Under the current authoritative business combination guidelines, this transaction qualified as a business combination and was recorded as an asset purchase acquisition. This transaction, with no initial cash consideration, expands our business process outsourcing expertise within engineering services. The remaining acquisitions were asset purchases and were completed to strengthen our retail and infrastructure management capabilities.

These acquisitions were included in our consolidated financial statement as of the date which they were acquired and were not material to our operations, financial position or cash flow. As a result of these transactions, we have allocated the purchase price to tangible and intangible assets and liabilities based upon their fair values.

Note 3 Investments

Investments as of September 30, 2009 and December 31, 2008 were as follows:

	September 30, 2009	December 31, 2008
Available-for-sale securities:		
Agency discount notes	$ 160	$ 7,008
Other	2	1,149
Total available-for-sale securities	162	8,157
Trading securities auction-rate securities	136,612	139,398
UBS Right	20,943	28,158
Time deposits	189,090	13,493
Total investments	$ 346,807	$ 189,206

The carrying value of the time deposits approximated fair value as of September 30, 2009 and December 31, 2008. Gross realized gains or losses on the sale of available-for-sale securities were immaterial for the periods presented. As of September 30, 2009 and December 31, 2008, available-for-sale securities in an unrealized loss or gain position were immaterial. All available-for-sale-securities at September 30, 2009 and December 31, 2008 contractually mature in 2009.

Our investments in auction-rate securities are recorded at fair value and consist of AAA/A3-rated municipal bonds with an auction reset feature whose underlying assets are generally student loans, which are substantially backed by the Federal Family Education Loan Program (FFELP). Since February 2008, auctions for these securities have failed. The auction failures do not affect the value of the collateral underlying the auction-rate securities, and the Company continues to earn and receive interest on its auction-rate securities at a pre-determined formula with spreads tied to particular interest rate indices. As of September 30, 2009 and

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

December 31, 2008, the majority of our investment in auction-rate securities was classified as a long-term investment. The classification of the auction-rate securities as long-term investments is due to continuing auction failures, the securities stated maturity of greater than one year and the Company s ability and intent to hold such securities beyond one year.

In November 2008, we accepted an offer from UBS AG (UBS) to sell to UBS, at par value ($157,775 as of September 30, 2009), our auction-rate securities at any time during an exercise period from June 30, 2010 to July 2, 2012 (the UBS Right). In accepting the UBS Right, we granted UBS the authority to purchase these auction-rate securities or sell them on our behalf at par anytime after the execution of the UBS Right through July 2, 2012. The offer is non-transferable. During the first nine months of 2009, $10,750 of auction rate securities were redeemed at par value.

Note 4 Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities are as follows:

	As of September 30, 2009	As of December 31, 2008
Compensation and benefits	$ 275,135	$ 187,063
Taxes	3,088	11,312
Customer volume incentives	33,022	24,560
Derivative contracts	11,282	
Other	95,667	86,549
Total accrued expenses and other current liabilities	$ 418,194	$ 309,484

Note 5 Stock Repurchase Program

Our current stock repurchase program authorizes both open market and private repurchase transactions of up to $50,000, excluding fees and expenses, of Class A common stock through December 2009. The program authorizes us to repurchase shares opportunistically from time to time, depending on market conditions. During the three months ended March 31, 2009, 650,000 shares were repurchased for $12,439 under this program. We did not purchase any shares during the second or third quarters of 2009. Additional stock repurchases were made in connection with our employee stock plan, whereby Company shares were tendered by employees for the payment of exercise price or applicable statutory withholding and India fringe benefit taxes. During the nine months ended September 30, 2009, such repurchases totaled 74,528 shares at an aggregate cost of $2,125.

At the time of repurchase, shares are returned to the status of authorized and unissued shares. We account for the repurchases as constructively retired and record such repurchases as a reduction of Class A common stock and additional paid-in capital.

Note 6 Income Taxes

Our Indian subsidiaries (collectively referred to as Cognizant India) are export-oriented companies, which, under the Indian Income Tax Act of 1961, are entitled to claim tax holidays for a period of ten consecutive years for each Software Technology Park (STP) with respect to export profits for each STP. Substantially all of the earnings of Cognizant India are attributable to export profits. The majority of our STPs in India are currently entitled to a 100% exemption from Indian income tax. In August 2009, the tax holidays for STPs were extended by one year and are currently scheduled to expire on March 31, 2011. In addition, we have located several new development centers in areas designated as Special Economic Zones (SEZs). Development centers operating in SEZs will be entitled to certain income tax incentives for periods up to 15 years. The incremental Indian taxes related to the taxable STPs, for which the income tax holiday has expired, have been incorporated into our effective income tax rate for 2009. The effective tax rate of 16.5% for the nine months ended September 30, 2009 increased from 16.0% for the nine months ended September 30, 2008. The principal difference between the income tax rates for the 2009 and 2008 periods and the U.S. federal statutory rate is the effect of the Indian tax holiday and earnings taxed in countries that have rates lower than the United States.

Note 7 Fair Value Measurements

As discussed in Note 11 Recent Accounting Pronouncements, on January 1, 2008 we adopted the authoritative guidance for fair value measurements and fair value option for financial assets and liabilities, which primarily relate to our investments and derivative contracts. On January 1, 2009, we adopted the fair value guidance for nonfinancial assets and liabilities.

The authoritative guidance defines fair value as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The authoritative guidance also establishes a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity s pricing based upon their own market assumptions.

The fair value hierarchy consists of the following three levels:

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

Level 2 Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

Level 3 Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

The following table summarizes our financial assets and (liabilities) measured at fair value on a recurring basis as of September 30, 2009:

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 524,581	$	$	$ 524,581
Investments:				
Available-for-sale securities current		162		162
Trading securities current			523	523
Trading securities non-current			136,089	136,089
UBS Right non-current			20,943	20,943
Other current assets:				
Derivative financial instruments forward foreign exchange contracts		7,736		7,736
Other current liabilities:				
Derivative financial instruments forward foreign exchange contracts		(11,282)		(11,282)
Other assets:				
Derivative financial instruments forward foreign exchange contracts		260		260
Other long-term liabilities:				
Derivative financial instruments forward foreign exchange contracts		(1,339)		(1,339)
Total assets and (liabilities) measured at fair value	$ 524,581	$ (4,463)	$ 157,555	$ 677,673

The following table summarizes our financial assets measured at fair value on a recurring as of December 31, 2008:

	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 291,432	$	$	$ 291,432
Agency discount notes and commercial paper		15,201		15,201
Investments:				
Available-for-sale securities current		8,157		8,157
Trading securities current			5,862	5,862
Trading securities non-current			133,536	133,536
UBS Right non-current			28,158	28,158
Other current assets:				
Derivative financial instruments forward foreign exchange contracts		598		598
Total assets measured at fair value	$ 291,432	$ 23,956	$ 167,556	$ 482,944

Level 3 assets consist of our investment in auction-rate securities and the related UBS Right. See Note 3 for additional information. The following table provides a summary of changes in fair value of the Company s Level 3 financial assets for the period ended September 30, 2009:

		Nine Months Ended September 30, 2009
Balance, at the beginning of the period	$	167,556
Transfers out: redemptions of called auction-rate securities		(10,750)
Gains related to auction-rate securities included in other income (expense), net		7,964
Loss related to UBS Right included in other income (expense), net		(7,215)
Balance, at the end of the period	$	157,555

We estimated the fair value of the auction-rate securities using a discounted cash flow model analysis which considered the following key inputs: (i) the underlying structure of each security; (ii) the timing of expected future principal and interest payments; and (iii) discount rates, inclusive of an illiquidity risk premium, that are believed to reflect current market conditions and the relevant risk associated with each security. We estimated that the fair market value of these securities at September 30, 2009 was $136,612. We estimated the value of the UBS Right using a fair value model analysis, which considered the following key inputs: discount rate, timing and amount of cash flow, and UBS counterparty risk. The assumptions used in valuing both the auction-rate securities and the UBS Right are volatile and subject to change as the underlying sources of these assumptions and market conditions change.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

In addition to the debt securities discussed above, we had approximately $189,090 of time deposits included in short-term investments as of September 30, 2009 and approximately $13,504 of time deposits included in cash and cash equivalents and short-term investments at December 31, 2008.

Note 8 Derivative Financial Instruments

In the normal course of business, we use forward foreign exchange contracts to manage foreign currency exchange rate risk. The estimated fair value of the forward foreign exchange contracts considers the following items: discount rate, timing and amount of cash flow and counterparty credit risk. The following table provides information on the location and fair values of derivative financial instruments included in our condensed consolidated statements of financial position as of September 30, 2009:

Designation of Derivatives	Location on Statement of Financial Position	Assets	Liabilities
Cash Flow Hedges Designated as hedging instruments			
Forward foreign exchange contracts	Other current assets	$ 7,736	$
	Accrued expenses and other current liabilities		1,905
	Noncurrent liabilities		979
	Total	7,736	2,884
Other Derivatives Not designated as hedging instruments			
Forward foreign exchange contracts	Other assets	260	
	Accrued expenses and other current liabilities		9,377
	Noncurrent liabilities		360
	Total	260	9,737
Total		$ 7,996	$ 12,621

As of December 31, 2008, the fair value of derivative financial instruments included in our condensed consolidated statements of financial position was $598. Such amount related to forward foreign exchange contracts that were designated as cash flow hedges. We did not hold derivative financial instruments during the nine month period ended September 30, 2008.

Cash Flow Hedges

During the fourth quarter of 2008 and the first nine months of 2009, we entered into a series of forward foreign exchange contracts that are designated as cash flow hedges of certain salary payments in India. These contracts are intended to partially offset the impact of movement of exchange rates on future operating costs and are scheduled to mature each month during 2009 and 2010. Under these contracts, we purchase Indian rupees and sell U.S. dollars and the changes in fair value of these contracts are initially reported in the caption accumulated other comprehensive income (loss) on our accompanying condensed consolidated statements of financial position and is subsequently reclassified to earnings in the same period the hedge contract settles. As of September 30, 2009 and December 31, 2008, the notional value of our outstanding contracts was $478,000 and $82,000, respectively, and the net unrealized gain included in accumulated other comprehensive income (loss) for such contracts was $4,671 and $576, respectively, Upon settlement or maturity of the cash flow hedge contracts, we record the related gain or loss, based on our designation at the commencement of the contract, to salary expense reported within cost of revenues and selling, general and administrative expenses. The tables below provide information on the location and amounts of gains or losses on our cash flow hedges included in our condensed consolidated statement of operations and comprehensive income for the three and nine months ended September 30, 2009.

Other Derivatives

We also use foreign currency forward contracts, which have not been designated as hedges, to hedge our balance sheet exposure to Indian rupee denominated net monetary assets. During 2009, we entered into a series of forward foreign exchange contracts to buy U.S. dollars and sell Indian rupees. At September 30, 2009, the notional value of outstanding contracts was $275,000. Realized gains or losses and changes in the estimated fair value of these derivative financial instruments are recorded in other income (expense), net in the condensed consolidated statements of operations and comprehensive income. For the three and nine months September 30, 2009, we reported a loss of $5,534 and $9,477, respectively, on these derivative contracts. The tables below provide information on the location and amounts of gains or losses on our other derivatives included in our condensed consolidated statement of operations and comprehensive income for the three and nine months ended September 30, 2009.

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

The following table provides information on the location and amounts of gains (losses) on our derivative financial instruments included in our condensed consolidated statement of operations and comprehensive income for the three months ended September 30, 2009:

	Net Derivative Gains (Losses) Recognized in Accumulated Other Comprehensive Income (Loss) (effective portion)	Location of Net Derivative Gains / (Losses) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)	Net Gain (Loss) Reclassified from Accumulated Other Comprehensive Income / (Loss) to Income (effective portion)
Cash Flow Hedges Designated as hedging instruments			
Forward foreign exchange contracts	$ 2,980	Cost of revenues	$ 2,045
		Selling, general and administrative expenses	524
Total	$ 2,980		$ 2,569

	Location of Net Gains /(Losses) on Derivative Instruments	Amount of Net Gains (Losses) on Derivative Instruments
Other Derivatives Not designated as hedging instruments		
Forward foreign exchange contracts	Other income (expense), net	$ (5,534)
Total		$ (5,534)

The following table provides information on the location and amounts of gains (losses) on our derivative financial instruments included in our condensed consolidated statement of operations and comprehensive income for the nine months ended September 30, 2009:

	Net Derivative Gains (Losses) Recognized in Accumulated Other Comprehensive Income (Loss) (effective portion)	Location of Net Derivative Gains / (Losses) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (effective portion)	Net Gain (Loss) Reclassified from Accumulated Other Comprehensive Income / (Loss) to Income (effective portion)

Cash Flow Hedges Designated as hedging instruments					
Forward foreign exchange contracts	$	(4,096)	Cost of revenues	$	2,499
			Selling, general and administrative expenses		779
Total	$	(4,096)		$	3,278

	Location of Net Gains /(Losses) on Derivative Instruments		Amount of Net Gains (Losses) on Derivative Instruments
Other Derivatives Not designated as hedging instruments			
Forward foreign exchange contracts	Other income (expense), net	$	(9,477)
Total		$	(9,477)

The related cash flow impacts of all of our derivative activities are reflected as cash flows from operating activities.

Note 9 Commitments and Contingencies

As of September 30, 2009, we had outstanding fixed capital commitments of approximately $44,223 related to our India development center expansion program.

In connection with a 2008 acquisition, additional purchase price not to exceed $14,000, payable in 2010, is contingent on the acquired company achieving certain financial and operating targets during an earn-out period. We will fund such payment, if any, from operating cash flow. The ultimate amount payable cannot be reasonably estimated because the amount is dependent on future

8

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

results of operations of the acquired business and therefore we have not recorded a liability for this item on our balance sheet because the definitive amount is not determinable or distributable. As this acquisition was completed in 2008, the contingent consideration, if paid, will be recorded as an additional element of the cost of the acquired company.

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the outcome of such claims and legal actions, if decided adversely, is not expected to have a material adverse effect on our business, financial condition and results of operations. Additionally, many of our engagements involve projects that are critical to the operations of our customers business and provide benefits that are difficult to quantify. Any failure in a customer s computer systems or an unauthorized disclosure of sensitive or confidential client or customer data could result in a claim for substantial damages against us, regardless of our responsibility for such failure or unauthorized disclosure. Although we attempt to contractually limit our liability for damages arising from negligent acts, errors, mistakes, or omissions in rendering our services, there can be no assurance that the limitations of liability set forth in our contracts will be enforceable in all instances or will otherwise protect us from liability for damages. Although we have general liability insurance coverage, including coverage for errors or omissions, there can be no assurance that such coverage will continue to be available on reasonable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage or changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, would have a material adverse effect on our business, results of operations and financial condition.

Note 10 Segment Information

Our reportable segments are: Financial Services, which includes customers providing banking/transaction processing, capital markets and insurance services; Healthcare, which includes healthcare providers and payers as well as life sciences customers; Manufacturing/Retail/Logistics, which includes manufacturers, retailers, travel and other hospitality customers, as well as customers providing logistics services; and Other, which is an aggregation of industry segments which, individually, are less than 10% of consolidated revenues and segment operating profit. The Other reportable segment includes media and information services, communications and high technology operating segments. Our sales managers, account executives, account managers and project teams are aligned in accordance with the specific industries they serve.

Our chief operating decision maker evaluates the Company s performance and allocates resources based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as a per seat charge for use of our IT development centers. Certain expenses, such as general and administrative, and a portion of depreciation and amortization, are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock-based compensation expense and the related stock-based Indian fringe benefit tax are not allocated to individual segments in internal management reports used by the chief operating decision maker. Accordingly, these expenses are separately disclosed as unallocated and adjusted only against our total income from operations. Additionally, management has determined that it is not practical to allocate identifiable assets by segment since such assets are used interchangeably among the segments.

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics, and Other reportable segments for the three and nine months ended September 30, 2009 and 2008, are as follows:

	Three Months Ended September 30,	Nine Months Ended September 30,

	2009	2008	2009	2008
Revenues:				
Financial Services	$ 364,196	$ 339,004	$ 1,028,086	$ 945,545
Healthcare	226,435	174,183	620,137	498,335
Manufacturing/Retail/Logistics	146,642	115,395	402,173	319,752
Other	116,215	106,144	325,546	299,627
Total revenues	$ 853,488	$ 734,726	$ 2,375,942	$ 2,063,259

Table of Contents

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Segment Operating Profit:				
Financial Services	$ 139,777	$ 113,981	$ 368,460	$ 327,162
Healthcare	94,863	66,783	241,613	197,847
Manufacturing/Retail/Logistics	52,175	32,955	134,751	104,551
Other	40,222	33,885	110,329	103,216
Total segment operating profit	327,037	247,604	855,153	732,776
Less: unallocated costs(1)	165,255	104,973	403,571	358,772
Income from operations	$ 161,782	$ 142,631	$ 451,582	$ 374,004

(1) Includes $11,856 and $32,005 of stock-based compensation expense and $(1,267) and $945 of stock-based Indian fringe benefit tax (income) / expense for the three months and nine months ended September 30, 2009, respectively, and $9,509 and $32,957 of stock-based compensation expense and $660 and $7,492 of stock-based Indian fringe benefit tax expense for the three months and nine months ended September 30, 2008, respectively.

Geographic Area Information

Revenue and long-lived assets, by geographic area, are as follows:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenues(1)				
North America(2)	$ 667,909	$ 577,109	$ 1,882,670	$ 1,627,226
Europe(3)	164,305	145,028	439,072	405,188
Other(5)	21,274	12,589	54,200	30,845
Total	$ 853,488	$ 734,726	$ 2,375,942	$ 2,063,259

	As of September 30, 2009	As of December 31, 2008
Long-lived Assets(4)		
North America(2)	$ 8,000	$ 7,494
Europe	3,023	2,470
Other(5)(6)	449,214	445,290

Total	$ 460,237	$ 455,254

(1) Revenues are attributed to regions based upon customer location.
(2) Substantially all relates to operations in the United States.
(3) Includes revenue from operations in the United Kingdom of $96,889 and $88,621 and $255,875 and $245,794 for the three and nine months ended September 30, 2009 and 2008, respectively.
(4) Long-lived assets include property and equipment, net of accumulated depreciation and amortization.
(5) Includes our operations in Asia Pacific, Middle East and South America.
(6) Substantially all of these long-lived assets relate to our operations in India.

Note 11 Recent Accounting Pronouncements

In 2006, the Financial Accounting Standards Board (FASB) issued authoritative guidance which defines fair value, establishes a market-based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. It is appropriate to apply fair value measurements whenever other sections of the authoritative guidance requires or permits assets and liabilities to be measured at fair value. This authoritative guidance does not expand or require any new fair value measures, however the application of this statement may change current practice. We adopted this authoritative guidance for financial assets and liabilities effective January 1, 2008 and for non-financial assets and liabilities effective January 1, 2009. The adoption of this authoritative guidance, which primarily affected the valuation of our investments and derivative contracts, did not have a material effect on our financial condition or results of operations.

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

In April 2009, the FASB issued several amendments to the accounting and disclosure requirements regarding fair value measurements and impairments of securities. These amendments are intended to provide guidance to:

- Determine fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive.

- Bring consistency to the timing of impairment recognition, and provide improved disclosures about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. The amendment also requires increased and timelier disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses.

- Disclose financial instruments that are not currently reflected on the balance sheet at fair value. Prior to issuing this amendment, fair values for these assets and liabilities were only disclosed once a year. The amendment now requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value.

We have elected to early adopt these amendments effective March 31, 2009. The adoption of these amendments did not have a material effect on our financial condition or results of operations.

In December 2007, the FASB revised the authoritative guidance for business combinations which establishes principles and requirements for how the acquiring entity in a business combination recognizes the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of transaction and restructuring costs; and requires the acquirer to disclose the information needed to evaluate and understand the nature and financial effect of the business combination. Effective January 1, 2009, we adopted this revised guidance, which applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The adoption of this revised guidance did not have a significant impact on our results of operations or financial condition; however, the impact of this revised guidance on our future consolidated financial statements will depend upon the nature, terms and size of the acquisitions we consummate in the future.

In April 2009, the FASB also issued amendments to the accounting and disclosure requirements regarding business combinations. These amendments address application issues raised by preparers, auditors and members of the legal profession on initial recognition and measurement, subsequent measurement and accounting, and accounting disclosure of assets and liabilities arising from contingencies in a business combination. We have elected to early adopt these amendments effective March 31, 2009. The adoption of these amendments did not have a material effect on our financial condition or results of operations.

In December 2007, the FASB issued authoritative guidance establishing accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. This guidance also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. We adopted this guidance effective January 1, 2009. We do not have any noncontrolling interests in other entities. Accordingly, the adoption of this guidance did not have a material effect on our financial condition or consolidated results of operations.

In March 2008, the FASB issued authoritative guidance which applies to all derivative instruments and related hedged items accounted for as hedges. This guidance requires entities to provide greater transparency about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under this guidance and its related interpretations, and how derivative instruments and related hedged items affect an entity s financial position, results of operations and cash flows. Effective January 1, 2009, we adopted this guidance and have presented the required information in Note 8.

In May 2009, the FASB issued authoritative guidance establishing principles and requirements for recognition and disclosure of subsequent events in the financial statements. The adoption of this guidance on June 30, 2009 did not have a material effect on our financial condition or consolidated results of operations.

In June 2009, the FASB issued authoritative guidance amending the consolidation guidance applicable to variable interest entities. This guidance is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the potential impact of this guidance on our financial condition and consolidated results of operations.

In June 2009, the FASB issued authoritative guidance, The FASB Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162 (the Codification). The Codification does not alter current U.S. GAAP, but rather integrates existing accounting standards with other authoritative guidance. Under the

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(dollar amounts in thousands)

Codification there will be a single source of authoritative U.S. GAAP for nongovernmental entities and will supersede all other previously issued non-SEC accounting and reporting guidance. The Codification is effective for financial statement periods ending after September 15, 2009. The adoption of the Codification on July 1, 2009 did not have a material effect on our financial condition or consolidated results of operations.

Note 12 Subsequent Events

On October 15, 2009, we entered into a definitive agreement with UBS AG to acquire UBS Service Centre (India) Private Limited (UBS ISC) for a purchase price of approximately $75,000. The completion of this acquisition is subject to the satisfaction of certain closing conditions.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
Executive Summary

During the three and nine months ended September 30, 2009, our revenue increased to $853.5 million and $2,375.9 million compared to $734.7 million and $2,063.3 million during the three months and nine months ended September 30, 2008. Net income increased to $136.6 million and $391.0 million, respectively, or $0.45 and $1.30 per diluted share, including stock-based compensation expense and stock-based Indian fringe benefit tax (income)/expense, net of tax, equal to $0.03 and $0.09 per diluted share, during the three and nine months ended September 30, 2009. This is compared to net income of $112.8 million and $318.6 million, respectively, or $0.38 and $1.06 per diluted share, including stock-based compensation expense and stock-based Indian fringe benefit tax expense, net of tax, of $0.02 and $0.12 per diluted share, during the three months and nine months ended September 30, 2008. The key drivers of our revenue growth during the three months ended September 30, 2009 were as follows:

- strong performance within our Healthcare and Manufacturing/Retail/Logistics business segments, each of which had revenue growth equal to or greater than 27.1% for the quarter as compared to the quarter ended September 30, 2008;

- strong performance in North America where we experienced revenue growth of 15.7% for the quarter as compared to the quarter ended September 30, 2008;

- expansion of our service offerings, which enabled us to cross-sell new services to our customers and meet the rapidly growing demand for complex large-scale outsourcing solutions;

- increased penetration at existing customers, including strategic customers; and

- continued expansion of the market for global delivery of IT services and business process outsourcing.

We saw a continued increase in demand from our customers for a broad range of IT solutions, particularly high performance web development initiatives and complex systems development engagements, testing, enterprise resource planning or ERP, infrastructure management, business process outsourcing and business intelligence. We finished the quarter with approximately 570 active clients compared to 551 as of

September 30, 2008 and increased the number of strategic clients by five during the quarter bringing the total number of our strategic clients to 139. We define a strategic client as one offering the potential to generate $5 million to $50 million or more in annual revenues at maturity. Our top five and top ten customers in the aggregate accounted for approximately 17.9% and 30.2%, respectively, of our total revenues during the quarter ended September 30, 2009 as compared to approximately 19.0% and 29.7%, respectively, for the quarter ended September 30, 2008. As we continue to add new customers and increase our penetration at existing customers, we expect the percentage of revenues from our top five and top ten customers to decline over time.

Our revenue from European customers increased by 13.3 % to approximately $164.3 million compared to approximately $145.0 million in the quarter ended September 30, 2008. For the quarter ended September 30, 2009, our operation in the United Kingdom (UK) reported a 9.3% increase in revenue as compared to the quarter ended September 30, 2008. This increase is primarily attributed to growth from existing and new customers in our Healthcare and Manufacturing /Retail/Logistics business segments and was offset by unfavorable movement in foreign exchange rates which reduced revenue by approximately $10.7 million in the 2009 period due to the strengthening of the U.S. dollar against the British Pound on the portion of British Pound denominated revenues. For the quarter ended September 30, 2009, revenue from Europe, excluding the UK, increased by approximately 19.5% from approximately $56.4 million in the quarter ended September 30, 2008 to approximately $67.4 million. We believe that Europe will continue to be an area of significant investment for us as we see this region and the Asia Pacific region, particularly Japan, India, Australia and Singapore, as growth opportunities for the long-term.

Our revenue growth is also attributed to increasing market acceptance of, and demand for, offshore IT software and services and business process outsourcing. Recent NASSCOM (India s National Association of Software and Service Companies) reports state that India s IT software and services and business process outsourcing sectors are expected to reach an estimated $48 -$50 billion by the end of the fiscal year March 31, 2010. This is an expected growth rate of approximately 4% to 7% over the prior fiscal year. According to the latest NASSCOM Perspective 2020: Transform Business, Transform India report, global changes and new megatrends within economic, demographic, business, social and environmental areas are set to expand the outsourcing industry by creating new dynamics and opportunities and are expected to result in export revenues of $175 billion by 2020.

Table of Contents

Our operating margin decreased to approximately 19.0% for the quarter ended September 30, 2009 compared to 19.4% for the quarter ended September 30, 2008. Excluding stock-based compensation costs of approximately $11.9 million and stock-based Indian fringe benefit tax income of $1.3 million, operating margin for the quarter ended September 30, 2009 was approximately 20.2%. This was slightly above our historic targeted operating margin range, excluding stock-based compensation costs and stock-based Indian fringe benefit tax expense, of 19% to 20% of total revenues. The operating margin decrease was primarily due to an increase in compensation costs, including incentive-based compensation, and investments to grow our business partially offset by the favorable impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies as a result of revenue growth outpacing our headcount growth. Historically, we have invested our profitability above the 19% to 20% operating margin level, which excludes stock-based compensation and stock-based Indian fringe benefit tax expense, back into our business, which we believe is a significant contributing factor to our strong revenue growth. This investment is primarily focused in the areas of: (i) hiring client partners and relationship personnel with specific industry experience or domain expertise; (ii) training our technical staff in a broader range of IT service offerings; (iii) strengthening our business analytic capabilities; (iv) strengthening and expanding our portfolio of services; (v) continuing to expand our geographic presence for both sales and delivery; and (vi) recognizing and rewarding exceptional performance by our employees. In addition, this investment includes maintaining a level of resources, trained in a broad range of service offerings, to be well positioned to respond to our customer requests to take on additional projects. For the year ending December 31, 2009, we expect to continue to invest amounts in excess of our historical targeted operating margin levels back into the business.

We finished the third quarter of 2009 with a total headcount of approximately 68,100, an increase of approximately 8,600 over the total headcount at September 30, 2008. The increases in the number of our technical personnel and the related infrastructure costs, to meet the demand for our services, are the primary drivers of the increase in our operating expenses in 2009. Annualized turnover, including both voluntary and involuntary, was approximately 12.3% during the three months ended September 30, 2009. The majority of our turnover occurs in India. As a result, annualized attrition rates on-site at clients are below our global attrition rate. In addition, attrition is weighted towards the more junior members of our staff. We have experienced wage inflation in India in the previous years. However, we expect wage inflation in India to be negligible this year. Indian wages represented less than 20% of our total operating expenses for the three months ended September 30, 2009.

Our current India real estate development program now includes planned construction of approximately 4.5 million square feet of new space. The expanded program, which commenced during the quarter ended March 31, 2007, includes the expenditure of approximately $330.0 million on land acquisition, facilities construction and furnishings to build new state-of-the-art IT development centers in regions primarily designated as Special Economic Zones located in India. During 2009, we expect to spend approximately $100.0 to $120.0 million globally for capital expenditures, a portion of which relates to our India real estate development program.

At September 30, 2009, we had cash and cash equivalents and short-term investments of $1,182.7 million and working capital of $1,508.5 million. Accordingly, we do not anticipate any near-term liquidity issues.

During the remainder of 2009, we expect the following factors to affect our business and our operating results:

- Stabilization of global economic conditions;
- Continuing pressure on customer IT budgets, which may result in delays or decreases in spending by customers on discretionary projects, specifically application development projects. However, we expect a continued focus by customers on directing IT spending towards cost containment projects, such as application maintenance, infrastructure management and BPO; and
- Foreign currency volatility.

In response to this challenging macroeconomic environment, we plan to continue to:

- Partner with our existing customers to see where we can provide innovative solutions resulting in our garnering an increased portion of our customers overall IT spend;

Continue our focus on growing our business in Europe and the Asia Pacific region, where we believe there are opportunities to gain market share;

Expand our BPO and infrastructure management practices, which are in high demand in this challenging business environment;

Continue to aggressively increase our customer base across all of our business segments;

Opportunistically look for acquisitions and other business opportunities that can improve our overall service delivery capabilities; and

13

Table of Contents

Continue operating focus and discipline to appropriately manage our cost structure.

Critical Accounting Estimates and Risks

Management s discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities, including the recoverability of tangible and intangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. On an on-going basis, we evaluate our estimates. The most significant estimates relate to the recognition of revenue and profits based on the percentage of completion method of accounting for certain fixed-bid contracts, the allowance for doubtful accounts, income taxes, valuation of goodwill and other long-lived assets, valuation of short and long-term investments, assumptions used in valuing stock-based compensation arrangements, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. The actual amounts may differ from the estimates used in the preparation of the accompanying unaudited condensed consolidated financial statements. Our significant accounting policies are described in Note 1 to the audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2008.

We believe the following critical accounting policies require a higher level of management judgments and estimates than others in preparing the consolidated financial statements:

Revenue Recognition. Revenues related to our highly complex information technology application development contracts, which are predominantly fixed-priced contracts, are recognized as the service is performed using the percentage of completion method of accounting. Under this method, total contract revenue during the term of an agreement is recognized on the basis of the percentage that each contract s total labor cost to date bears to the total expected labor cost (cost to cost method). This method is followed where reasonably dependable estimates of revenues and costs can be made. Management reviews total expected labor costs on an ongoing basis. Revisions to our estimates may result in increases or decreases to revenues and income and are reflected in the consolidated financial statements in the periods in which they are first identified. If our estimates indicate that a contract loss will be incurred, a loss provision is recorded in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated costs of the contract exceed the estimated total revenues that will be generated by the contract and are included in cost of revenues in our consolidated statement of operations. Contract losses for the periods presented were immaterial.

Stock-Based Compensation. Utilizing the fair value recognition provisions prescribed by the authoritative guidance, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating the expected term over which the stock awards will be outstanding before they are exercised, the expected volatility of our stock, the number of stock-based awards that are expected to be forfeited and the expected exercise proceeds for applicable stock-based awards subject to the Indian fringe benefit tax. In addition, for stock performance units, we are required to estimate the most probable outcome of the performance conditions in order to determine the amount of stock compensation costs to be recorded over the vesting period. If actual results differ significantly from our estimates, stock-based compensation expense and our results of operations could be materially impacted.

Income Taxes. Determining the consolidated provision for income tax expense, deferred income tax assets and liabilities and related valuation allowance, if any, involves judgment. As a global company, we are required to calculate and provide for income taxes in each of the jurisdictions where we operate. Changes in the geographic mix or estimated level of annual pre-tax income can also affect the overall effective income tax rate.

Our provision for income taxes also includes the impact of provisions established for uncertain income tax positions, as well as the related net interest. Tax exposures can involve complex issues and may require an extended period to resolve. Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters differs from the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made.

On an on-going basis, we evaluate whether a valuation allowance is needed to reduce our deferred income tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and on-going prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we determine that we will be able to realize deferred income tax assets in the future in excess of the net recorded amount, an adjustment to the deferred income tax asset would increase income in the period such determination was made. Likewise, should we determine that we will not be able to realize all or part of the net deferred income tax asset in the future, an adjustment to the deferred income tax asset would be charged to income in the period such determination was made.

Table of Contents

Our Indian subsidiaries (collectively, Cognizant India) are export-oriented companies which, under the Indian Income Tax Act of 1961, are entitled to claim tax holidays for a period of ten consecutive years for each Software Technology Park (STP) with respect to export profits for each STP. Substantially all of the earnings of Cognizant India are attributable to export profits. The majority of our STPs in India are currently entitled to a 100% exemption from Indian income tax. In August 2009, the tax holidays for STPs were extended by one year and are currently scheduled to expire on March 31, 2011. Thereafter, export profits from our existing STPs will be fully taxable at the Indian statutory rate (33.99% as of September 30, 2009) in effect at such time. If the tax holidays relating to our Indian STPs are not extended or new tax incentives are not introduced that would effectively extend the income tax holiday benefits beyond March 2011, we expect that our effective income tax rate would increase significantly beginning in calendar year 2011. In addition, we expect to continue to locate a portion of our new development centers in areas designated as Special Economic Zones (SEZs). Development centers operating in SEZs are entitled to certain income tax incentives for periods up to 15 years.

Investments. Historically, our investments have been in municipal debt securities with interest rates that reset through a Dutch auction process, corporate notes and bonds, U.S. government agencies, bank time deposits and commercial paper meeting certain criteria. We evaluate our available-for-sale investments periodically for possible other-than-temporary impairment by reviewing factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer and our ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery of market value. An impairment charge would be recorded to the extent that the carrying value of our available-for-sale securities exceeds the fair market value of the securities and the decline in value is determined to be other-than-temporary.

Determining the fair value of our investment in auction-rate securities with unobservable inputs that are supported by little or no market activity requires judgment, including determining the appropriate holding period and discount rate to be used in valuing such securities. We value our investment in auction-rate securities using a discounted cash flow analysis, which incorporates the following key inputs: (i) the underlying structure of each security; (ii) frequency and amounts of cash flows; (iii) expected holding period for the security; and (iv) discount rates that are believed to reflect current market conditions and the relevant risk associated with each security. In estimating the holding period, we considered the current developments in the auction-rate market including: our ability to hold the securities for such period of time, recent calls of auction-rate securities by issuers and the possible reestablishment of an active market for the auction-rate securities that we hold. Based upon these factors, we used a holding period of five years for securities with a stated maturity beyond five years, which represents the period of time we anticipate will elapse before a liquidity event will occur. An increase or decrease in the holding period by two years would change the fair value of our investment in auction-rate securities by approximately $8.0 million. We derive the discount rate by considering observable interest rate yields for bonds supported by student loans and pricing of new bond issuances, and adding an illiquidity premium to such rates. The illiquidity premium was estimated by management considering current market conditions. As of September 30, 2009, we used a weighted-average illiquidity premium of 287 basis points. This weighted-average illiquidity premium has been impacted by overall issues within the credit and capital markets and related increases in volatility including uncertainty of the credit and money markets. An increase or decrease to the illiquidity premium of 100 basis points would change the estimated fair value of our investment in auction-rate securities by approximately $6.5 million. Our valuation is also impacted by changes in market interest rates because the interest payments we receive on our auction-rate securities vary based on a pre-determined formula with spreads tied to particular interest rate indices. An increase or decrease in market interest rates of 25 basis points would change the estimated fair value of our investment in auction-rate securities by approximately $5.0 million. We anticipate there will be ongoing developments in the credit markets and the market for the auction-rate securities that we hold. Accordingly, our estimates of the expected holding period and illiquidity premium used in valuing such securities are reasonably likely to change in the short-term.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is determined by evaluating the relative credit-worthiness of each customer, historical collections experience and other information, including the aging of the receivables. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Goodwill. We evaluate goodwill for impairment at least annually, or as circumstances warrant. When determining the fair value of our reporting units, we utilize various assumptions, including projections of future cash flows. Any adverse changes in key assumptions about our businesses and their prospects or an adverse change in market conditions may cause a change in the estimation of fair value and could result in an impairment charge. As of September 30, 2009, our goodwill balance was $160.9 million.

Table of Contents

Long-Lived Assets. We review long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In general, we will recognize an impairment loss when the sum of undiscounted expected future cash flows is less than the carrying amount of such asset. The measurement for such an impairment loss is then based on the fair value of the asset. If such assets were determined to be impaired, it could have a material adverse effect on our business, results of operations and financial condition.

Risks. The majority of our IT development centers, including a majority of our employees, are located in India. As a result, we may be subject to certain risks associated with international operations, including risks associated with foreign currency exchange rate fluctuations and risks associated with the application and imposition of protective legislation and regulations relating to import and export or otherwise resulting from foreign policy or the variability of foreign economic or political conditions. Additional risks associated with international operations include difficulties in enforcing intellectual property rights, limitations on immigration programs, the burdens of complying with a wide variety of foreign laws, potential geo-political and other risks associated with terrorist activities and local and cross border conflicts, and potentially adverse tax consequences, tariffs, quotas and other barriers. We are also subject to risks associated with our overall compliance with Section 404 of the Sarbanes-Oxley Act of 2002. The inability of our management and our independent auditor to provide us with reasonable assurance regarding the adequacy and effectiveness of our internal control over financial reporting for future year ends could result in adverse consequences to us, including, but not limited to, a loss of investor confidence in the reliability of our financial statements, which could cause the market price of our stock to decline. See Part II, Item 1A. Risk Factors.

Results of Operations

Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008

The following table sets forth, for the periods indicated, certain financial data expressed for the three months ended September 30:

(Dollars in thousands)

	2009	% of Revenues	2008	% of Revenues	Increase	% Increase
Revenues	$ 853,488	100.0%	$ 734,726	100.0%	$ 118,762	16.2%
Cost of revenues(1)	475,599	55.7	405,936	55.2	69,663	17.2
Selling, general and administrative expenses(2)	193,806	22.7	166,685	22.7	27,121	16.3
Depreciation and amortization expense	22,301	2.6	19,474	2.7	2,827	14.5
Income from operations	161,782	19.0	142,631	19.4	19,151	13.4
Other income (expense), net	1,917		(9,433)		11,350	120.3
Provision for income taxes	27,127		20,370		6,757	33.2
Net income	$ 136,572	16.0%	$ 112,828	15.4%	$ 23,744	21.0%

(1) Includes stock-based compensation expense of $3,264 in 2009 and $4,434 in 2008, and stock-based Indian fringe benefit tax (income) expense of $(192) in 2009 and $200 in 2008 and is exclusive of depreciation and amortization expense.

(2) Includes stock-based compensation expense of $8,592 in 2009 and $5,075 in 2008, and stock-based Indian fringe benefit tax (income) expense of $(1,075) in 2009 and $460 in 2008 and is exclusive of depreciation and amortization expense.

The following table includes non-GAAP income from operations, excluding stock-based compensation and applicable stock-based Indian fringe benefit tax, a measure defined by the Securities and Exchange Commission as a non-GAAP financial measure. This non-GAAP financial measure is not based on any comprehensive set of accounting rules or principles and should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and may be different from non-GAAP measures used by other companies. In addition, this non-GAAP measure, the financial statements prepared in accordance with GAAP and reconciliations of our GAAP financial statements to such non-GAAP measure should be carefully evaluated.

We seek to manage the Company to a targeted operating margin, excluding stock-based compensation costs and applicable stock-based Indian fringe benefit tax, of 19% to 20% of revenues. Accordingly, we believe that non-GAAP income from operations, excluding stock-based compensation costs and applicable stock-based Indian fringe benefit tax (income) /expense, is a meaningful measure for investors to evaluate our financial performance. For our internal management reporting and budgeting purposes, we use financial statements that do not include stock-based compensation expense and applicable stock-based Indian fringe benefit tax for financial and operational decision making, to evaluate period-to-period comparisons and for making comparisons of our operating results to those of our competitors. Moreover, because of varying available valuation methodologies and the variety of award types that companies can use to account for stock-based compensation, we believe that providing a non-GAAP financial measure that excludes stock-based compensation expense and applicable stock-based Indian fringe benefit tax allows investors to make additional comparisons between our operating results and those of other companies. Accordingly, we believe that the presentation of non-GAAP income from operations when read in conjunction with our reported GAAP income from operations can provide useful supplemental information to our management and to investors regarding financial and business trends relating to our financial condition and results of operations.

Table of Contents

A limitation of using non-GAAP income from operations versus income from operations reported in accordance with GAAP is that non-GAAP income from operations, excludes costs, namely, stock-based compensation that is recurring and applicable stock-based Indian fringe benefit tax which was repealed during the third quarter of 2009 retroactive to April 1, 2009. Stock-based compensation expense will continue to be for the foreseeable future a significant recurring expense in our business. In addition, other companies may calculate non-GAAP financial measures differently than us, thereby limiting the usefulness of this non-GAAP financial measure as a comparative tool. We compensate for these limitations by providing specific information regarding the GAAP amounts excluded from non-GAAP income from operations and evaluating such non-GAAP financial measures with financial measures calculated in accordance with GAAP.

A reconciliation of income from operations as reported and non-GAAP income from operations, excluding stock-based compensation expense and applicable stock-based Indian fringe benefit tax (income) / expense, is as follows for the three months ended September 30:

(Dollars in thousands)

	2009	% of Revenues	2008	% of Revenues
Income from operations, as reported	$ 161,782	19.0%	$ 142,631	19.4%
Add: stock-based compensation expense	11,856	1.4	9,509	1.3
Add: stock-based Indian fringe benefit tax (income) /expense	(1,267)	(0.2)	660	0.1
Non-GAAP income from operations, excluding stock-based compensation expense and stock-based Indian fringe benefit tax (income) /expense	$ 172,371	20.2%	$ 152,800	20.8%

The fringe benefit tax regulation in India obligated us to pay, upon exercise or distribution of shares under a stock-based compensation award, a non-income related tax on the appreciation of the award from date of grant to date of vest. There was no cash cost to us as we recovered the cost of the Indian fringe benefit tax from the employee s proceeds from the award. Under U.S. GAAP, the stock-based Indian fringe benefit tax expense is required to be recorded as an operating expense and the related recovery of such tax from our employee is required to be recorded to stockholders equity as proceeds from a stock-based compensation award. During the third quarter, the Indian government repealed the fringe benefit tax retroactive to April 1, 2009. Accordingly, the fringe benefit tax expense recorded during the three months ended June 30, 2009 was reversed as a reduction of expenses during the three months ended September 30, 2009.

Revenue. Revenue increased by 16.2%, or approximately $118.8 million, from approximately $734.7 million during the three months ended September 30, 2008 to approximately $853.5 million during the three months ended September 30, 2009. This increase is primarily attributed to greater acceptance of the on-site/offshore delivery model among an increasing number of industries, continued interest in using the on-site/offshore delivery model as a means to reduce overall IT costs, continued growth in North America and Europe and greater penetration in the Asian market. Revenue from customers existing as of September 30, 2008 increased by approximately $80.5 million and revenue from new customers added since September 30, 2008 was approximately $38.2 million or approximately 32.2% of the period over period revenue increase and 4.5% of total revenues for the three months ended September 30, 2009.

In addition, revenue from North American and European customers for the three months ended September 30, 2009 increased by $90.8 million and $19.3 million, respectively, over the comparable 2008 quarter. We had approximately 570 active clients as of September 30, 2009 as compared to 551 active clients as of September 30, 2008. In addition, we experienced growth across all of our business segments for an increasingly broad range of services. Our Healthcare and Manufacturing/ Retail/Logistics business segments accounted for approximately $52.3 million and $31.2 million, respectively, of the $118.8 million increase in revenue. Additionally, our IT consulting and technology services and IT outsourcing revenues increased by approximately 9.7% and 21.9%, respectively, compared to the three months ended September 30, 2008 and represented approximately 44.4% and 55.6%, respectively, of total revenues for the three months ended September 30, 2009. No customer accounted for sales in excess of 10% of revenues during the three months ended September 30, 2009 and 2008.

Cost of Revenues (Exclusive of Depreciation and Amortization Expense). Our cost of revenues consists primarily of the cost of salaries, incentive-based compensation, stock-based compensation expense and applicable stock-based Indian fringe benefit tax, payroll taxes, benefits, immigration and project-related travel for technical personnel, the cost of subcontracting and the cost of sales commissions related to revenues. Our cost of revenues increased by 17.2%, or approximately $69.7 million, from approximately $405.9 million during the three months ended September 30, 2008 to approximately $475.6 million during the three months ended September 30, 2009. The increase was due primarily to higher compensation and benefits costs of approximately $73.2 million inclusive, of the benefit of the depreciation of the Indian rupee, resulting from the increase in the number of our technical personnel and incentive-based compensation partially offset continued improvements in operational efficiencies.

Table of Contents

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of salaries, incentive-based compensation, stock-based compensation expense and applicable stock-based Indian fringe benefit tax, employee benefits, travel, promotion, communications, management, finance, administrative and occupancy costs. Selling, general and administrative expenses, including depreciation and amortization, increased by 16.1%, or approximately $29.9 million, from approximately $186.2 million during the three months ended September 30, 2008 to approximately $216.1 million during the three months ended September 30, 2009, and was relatively unchanged as a percentage of revenue at 25.3%. During the quarter, increases in compensation and benefit costs, including incentive-based compensation, and increases in costs resulting from our expanded sales and marketing activities were offset by the depreciation of the Indian rupee versus the U.S.dollar.

Income from Operations. Income from operations increased 13.4%, or approximately $19.2 million, from approximately $142.6 million during the three months ended September 30, 2008 to approximately $161.8 million during the three months ended September 30, 2009, representing operating margins of 19.4% and 19.0% of revenues, respectively. The operating margin decrease was primarily due to increases in compensation and benefit costs, including incentive-based compensation, related to an increase in the number of our technical personnel and investments to grow our business partially offset by the depreciation of the Indian rupee versus the U.S.dollar. Excluding stock-based compensation expense and stock-based Indian fringe benefit tax (income) / expense of $10.6 million and $10.2 million, operating margin for the three months ended September 30, 2009 and September 30, 2008 was 20.2% and 20.8% of revenues, respectively.

Excluding the impact of applicable designated cash flow hedges, the depreciation of the Indian rupee against the U.S. dollar favorably impacted our operating margin by approximately 221 basis points or 2.2 percentage points and was offset by compensation increases and investments to grow our business. Each additional 1.0% change in the exchange rate between the Indian rupee and the U.S. dollar will have the effect of moving our operating margin by approximately 23 basis points or 0.23 percentage points. We entered into forward foreign exchange contracts to hedge certain salary payments in India. These hedges are intended to mitigate the volatility of the changes in the exchange rate between the U.S. dollar and the Indian rupee. At September 30, 2009, the notional value of these contracts was $478.0 million and the contracts are scheduled to mature over the next fifteen months.

Other Income (Expense), Net. Other income (expense), net consists primarily of foreign currency gains and (losses) and interest income. The following table sets forth, for the periods indicated, other income (expense), net for the three months ended September 30:

(Dollars in thousands)

	2009	**2008**	**Increase/ (Decrease)**
Foreign currency exchange gains (losses)	$ 2,620	$ (14,803)	$ 17,423
Gains (losses) on forward foreign exchange contracts not designated as hedging instruments	(5,534)		(5,534)
Interest income	4,664	5,344	(680)
Other income (expense), net	167	26	141
Total Other income (expense), net	$ 1,917	$ (9,433)	$ 11,350

The foreign currency exchange gains reported in the quarter of approximately $2.6 million are primarily attributed to (i) U.S. dollar denominated intercompany payables from our European subsidiaries to Cognizant India for services performed by Cognizant India on behalf of our European customers, and (ii) the remeasurement of the Indian rupee net monetary assets on Cognizant India s books to the U.S. dollar functional currency. The $5.5 million of losses on forward foreign exchange contracts are related to the change in fair value of forward foreign exchange contracts entered into to offset foreign currency exposure to Indian rupee denominated net monetary assets. As of September 30, 2009, the notional value of these undesignated hedges is $275.0 million. The $0.7 million decrease in interest income is due to lower average short-term interest rates during the third quarter of 2009 compared to the third quarter of 2008. The increase in other income (expense), net primarily relates to gains on redemptions of certain auction rate securities offset by the net change in fair value of our auction-rate securities and the related UBS Right.

Provision for Income Taxes. The provision for income taxes increased from approximately $20.4 million during the three months ended September 30, 2008 to approximately $27.1 million during the three months ended September 30, 2009. The effective income tax rate of 15.3% (15.9% excluding discrete items) for the three months ended September 30, 2008 increased to 16.6% for the three months ended September 30, 2009. The increase in the effective income tax rate in 2009 is primarily attributed to a shift in geographic mix of our income.

Net Income. Net income increased from approximately $112.8 million for the three months ended September 30, 2008 to approximately $136.6 million for the three months ended September 30, 2009, representing 15.4% and 16.0% of revenues, respectively. The increase in net income as a percentage of revenues is primarily attributed to the decrease in operating margins described above offset by non-operating foreign currency exchange gains.

Table of Contents

Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008

The following table sets forth, for the periods indicated, certain financial data expressed for the nine months ended September 30:

(Dollars in thousands)

	2009	% of Revenues	2008	% of Revenues	Increase	% Increase
Revenues	$ 2,375,942	100.0%	$ 2,063,259	100.0%	$ 312,683	15.2%
Cost of revenues(1)	1,328,647	55.9	1,153,068	55.9	175,579	15.2
Selling, general and administrative expenses(2)	530,681	22.3	482,643	23.4	48,038	10.0
Depreciation and amortization expense	65,032	2.7	53,544	2.6	11,488	21.5
Income from operations	451,582	19.0	374,004	18.1	77,578	20.7
Other income (expense), net	16,772		5,120		11,652	227.6
Provision for income taxes	77,395		60,567		16,828	27.8
Net income	$ 390,959	16.5%	$ 318,557	15.4%	$ 72,402	22.7%

(1) Includes stock-based compensation expense of $11,473 in 2009 and $14,688 in 2008, and stock-based Indian fringe benefit tax expense of $187 in 2009 and $2,709 in 2008 and is exclusive of depreciation and amortization expense.

(2) Includes stock-based compensation expense of $20,532 in 2009 and $18,269 in 2008, and stock-based Indian fringe benefit tax expense of $758 in 2009 and $4,783 in 2008 and is exclusive of depreciation and amortization expense.

The following table includes non-GAAP income from operations, excluding stock-based compensation and applicable stock-based Indian fringe benefit tax expense, a measure defined by the Securities and Exchange Commission as a non-GAAP financial measure. This non-GAAP financial measure is not based on any comprehensive set of accounting rules or principles and should not be considered a substitute for, or superior to, financial measures calculated in accordance with GAAP, and may be different from non-GAAP measures used by other companies. In addition, this non-GAAP measure, the financial statements prepared in accordance with GAAP and reconciliations of our GAAP financial statements to such non-GAAP measure should be carefully evaluated.

We seek to manage the Company to a targeted operating margin, excluding stock-based compensation costs and applicable stock-based Indian fringe benefit tax, of 19% to 20% of revenues. Accordingly, we believe that non-GAAP income from operations, excluding stock-based compensation costs and applicable stock-based Indian fringe benefit tax, is a meaningful measure for investors to evaluate our financial performance. For our internal management reporting and budgeting purposes, we use financial statements that do not include stock-based compensation expense and applicable stock-based Indian fringe benefit tax for financial and operational decision making, to evaluate period-to-period comparisons and for making comparisons of our operating results to those of our competitors. Moreover, because of varying available valuation methodologies and the variety of award types that companies can use to account for stock-based compensation, we believe that providing a non-GAAP financial measure that excludes stock-based compensation expense and applicable stock-based Indian fringe benefit tax allows investors to make additional comparisons between our operating results and those of other companies. Accordingly, we believe that the presentation of non-GAAP income from operations when read in conjunction with our reported GAAP income from operations can provide useful supplemental information to our management and to investors regarding financial and business trends relating to our financial condition and results of operations.

A limitation of using non-GAAP income from operations versus income from operations reported in accordance with GAAP is that non-GAAP income from operations, excludes costs, namely, stock-based compensation that is recurring and applicable stock-based Indian fringe benefit tax that was repealed during the third quarter of 2009 retroactive to April 1, 2009. Stock-based compensation expense will continue to be for the foreseeable future a significant recurring expense in our business. In addition, other companies may calculate non-GAAP financial measures differently than us, thereby limiting the usefulness of this non-GAAP financial measure as a comparative tool. We compensate for these limitations by providing specific information regarding the GAAP amounts excluded from non-GAAP income from operations and evaluating such non-GAAP financial measures with financial measures calculated in accordance with GAAP.

Table of Contents

A reconciliation of income from operations as reported and non-GAAP income from operations, excluding stock-based compensation expense and the applicable stock-based Indian fringe benefit tax expense incurred through March 31, 2009 is as follows for the nine months ended September 30:

(Dollars in thousands)

	2009	% of Revenues	2008	% of Revenues
Income from operations, as reported	$ 451,582	19.0%	$ 374,004	18.1%
Add: stock-based compensation expense	32,005	1.3	32,957	1.6
Add: stock-based Indian fringe benefit tax expense	945	0.1	7,492	0.4
Non-GAAP income from operations, excluding stock-based compensation expense and stock-based Indian fringe benefit tax expense	$ 484,532	20.4%	$ 414,453	20.1%

The fringe benefit tax regulation in India obligated us to pay, upon exercise or distribution of shares under a stock-based compensation award, a non-income related tax on the appreciation of the award from date of grant to date of vest. There was no cash cost to us as we recovered the cost of the Indian fringe benefit tax from the employee s proceeds from the award. Under U.S. GAAP, the stock-based Indian fringe benefit tax expense is required to be recorded as an operating expense and the related recovery of such tax from our employee is required to be recorded to stockholders equity as proceeds from a stock-based compensation award. During the third quarter of 2009, the Indian government repealed the fringe benefit tax effective retroactive to April 1, 2009.

Revenue. Revenue increased by 15.2%, or approximately $312.7 million, from approximately $2,063.3 million during the nine months ended September 30, 2008 to approximately $2,375.9 million during the nine months ended September 30, 2009. This increase is primarily attributed to greater acceptance of the on-site/offshore delivery model among an increasing number of industries, continued interest in using the on-site/offshore delivery model as a means to reduce overall IT costs, continued growth in North America and Europe and greater penetration in the Asian market. Revenue from customers existing as of September 30, 2008 increased by approximately $245.4 million and revenue from new customers added since September 30, 2008 was approximately $67.3 million or approximately 21.5% of the period over period revenue increase and 2.8% of total revenues for the nine months ended September 30, 2009.

In addition, revenue from North American and European customers for the nine months ended September 30, 2009 increased by $255.4 million and $33.9 million, respectively, over the comparable 2008 period. We had approximately 570 active clients as of September 30, 2009 as compared to 551 active clients as of September 30, 2008. In addition, we experienced growth across all of our business segments for an increasingly broad range of services. Our Financial Services and Healthcare business segments accounted for approximately $82.5 million and $121.8 million, respectively, of the $312.7 million increase in revenue. Additionally, our IT consulting and technology services and IT outsourcing revenues increased by approximately 8.0% and 21.7%, respectively, compared to the nine months ended September 30, 2008 and represented approximately 44.5% and 55.5%, respectively, of total revenues for the nine months ended September 30, 2009. No customer accounted for sales in excess of 10% of revenues during the nine months ended September 30, 2009 and 2008.

Cost of Revenues (Exclusive of Depreciation and Amortization Expense). Our cost of revenues consists primarily of the cost of salaries, incentive-based compensation, stock-based compensation expense and related stock-based Indian fringe benefit tax expense, payroll taxes, benefits, immigration and project-related travel for technical personnel, the cost of subcontracting and the cost of sales commissions related to revenues. Our cost of revenues increased by 15.2%, or approximately $175.6 million, from approximately $1,153.1 million during the nine months ended September 30, 2008 to approximately $1,328.6 million during the nine months ended September 30, 2009. The increase was due primarily to higher compensation and benefits costs of approximately $173.0 million, inclusive of the depreciation of the Indian rupee, resulting from the increase in the number of our technical personnel and incentive-based compensation offset by continued improvements in operational efficiencies.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist primarily of salaries, incentive-based compensation, stock-based compensation expense and the related stock-based Indian fringe benefit tax expense, employee benefits, travel, promotion, communications, management, finance, administrative and occupancy costs. Selling, general and administrative expenses, including depreciation and amortization, increased by 11.1%, or approximately $59.5 million, from approximately $536.2 million during the nine months ended September 30, 2008 to approximately $595.7 million during the nine months ended September 30, 2009, and decreased as a percentage of revenue from 26.0% to 25.1%. The decrease as a percentage of revenue was due primarily to the favorable impact of the depreciation of the Indian rupee versus the U.S. dollar, economies of scale driven by increased revenues that resulted from our expanded sales and marketing activities in the current and prior years that allowed us to leverage our cost structure over a larger organization, reductions in discretionary spending partially offset by an increase in compensation and benefit costs, including incentive-based compensation, depreciation and amortization expense and expenses related to the expansion of our infrastructure to support our revenue growth.

Table of Contents

Income from Operations. Income from operations increased 20.7%, or approximately $77.6 million, from approximately $374.0 million during the nine months ended September 30, 2008 to approximately $451.6 million during the nine months ended September 30, 2009, representing operating margins of 18.1% and 19.0% of revenues, respectively. The operating margin increase was primarily due to the favorable impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies as a result of revenue growth outpacing our headcount growth partially offset by an increase in compensation and benefit costs, including incentive-based compensation costs, and investments to grow our business. Excluding stock-based compensation expense and stock-based Indian fringe benefit tax expense of $33.0 million and $40.4 million, operating margin for the nine months ended September 30, 2009 and September 30, 2008 was 20.4% and 20.1% of revenues, respectively.

Excluding the impact of applicable designated cash flow hedges, the depreciation of the Indian rupee against the U.S. dollar favorably impacted our operating margin by approximately 271 basis points or 2.71 percentage points and was partially offset by compensation increases and investments to grow our business. We entered into forward foreign exchange contracts to hedge certain salary payments in India. These hedges are intended to mitigate the volatility of the changes in the exchange rate between the U.S. dollar and the Indian rupee. At September 30, 2009, the notional value of these contracts was $478.0 million and the contracts are scheduled to mature over the next fifteen months.

Other Income (Expense), Net. Other income (expense), net consists primarily of foreign currency gains and (losses) and interest income. The following table sets forth, for the periods indicated, Other income (expense), net for the nine months ended September 30:

(Dollars in thousands)

	2009	2008	Increase/ (Decrease)
Foreign currency exchange gains (losses)	$ 15,673	$ (11,411)	$ 27,084
Gains (losses) on forward foreign exchange contracts not designated as hedging instruments	(9,477)		(9,477)
Interest income	9,756	16,428	(6,672)
Other income (expense), net	820	103	717
Total Other income (expense), net	$ 16,772	$ 5,120	$ 11,652

The foreign currency exchange gains of approximately $15.7 million are primarily attributed to (i) U.S. dollar denominated intercompany payables from our European subsidiaries to Cognizant India for services performed by Cognizant India on behalf of our European customers, and (ii) the remeasurement of the Indian rupee net monetary assets on Cognizant India s books to the U.S. dollar functional currency. The $9.5 million of losses on forward foreign exchange contracts are related to the change in fair value of forward foreign exchange contracts entered into to offset foreign currency exposure to Indian rupee denominated net monetary assets. At September 30, 2009 the notional value of these undesignated hedges is $275.0 million. The $6.7 million decrease in interest income is due to lower average short-term interest rates during 2009 compared to 2008. The increase in other income (expense), net of $0.7 million primarily relates to gains on redemptions of certain auction-rate securities offset by the net change in fair value of our auction-rate securities and the related UBS Right.

Provision for Income Taxes. The provision for income taxes increased from approximately $60.6 million during the nine months ended September 30, 2008 to approximately $77.4 million during the nine months ended September 30, 2009. The effective income tax rate of 16.0% for the nine months ended September 30, 2008 increased to 16.5% for the nine months ended September 30, 2009. The increase in the effective income tax rate in 2009 is primarily attributed to a shift in geographic mix of our income.

Net Income. Net income increased from approximately $318.6 million for the nine months ended September 30, 2008 to approximately $391.0 million for the nine months ended September 30, 2009, representing 15.4% and 16.5% of revenues, respectively. The increase in net income as a percentage of revenues in 2009 is primarily attributed to a higher operating margin and foreign currency exchange gains partially offset by lower interest income.

Results by Business Segment

Our reportable segments are: Financial Services, which includes customers providing banking/transaction processing, capital markets and insurance services; Healthcare, which includes healthcare providers and payers as well as life sciences customers; Manufacturing/Retail/Logistics, which includes manufacturers, retailers, travel and other hospitality customers, as well as customers providing logistics services; and Other, which is an aggregation of industry operating segments which, individually, are less than 10% of consolidated revenues and segment operating profit. The Other segment includes media and information services, communications and high technology operating segments. Our sales managers, account executives, account managers and project teams are aligned in accordance with the specific industries they serve.

Table of Contents

Our chief operating decision maker evaluates Cognizant s performance and allocates resources based on segment revenues and operating profit. Segment operating profit is defined as income from operations before unallocated costs. Generally, operating expenses for each operating segment have similar characteristics and are subject to the same factors, pressures and challenges. However, the economic environment and its effects on industries served by our operating groups may affect revenue and operating expenses to differing degrees. Expenses included in segment operating profit consist principally of direct selling and delivery costs as well as a per seat charge for use of the development centers. Certain expenses, such as general and administrative, and a portion of depreciation and amortization, are not specifically allocated to specific segments as management does not believe it is practical to allocate such costs to individual segments because they are not directly attributable to any specific segment. Further, stock-based compensation expense and the related stock-based India fringe benefit tax are not allocated to individual segments in internal management reports used by the chief operating decision maker. Accordingly, these expenses are separately disclosed as unallocated and are adjusted only against the total income from operations.

As of September 30, 2009, we had 570 active customers. Accordingly, we provide a significant volume of services to many customers in each of our business segments. Therefore, a loss of a significant customer or a few significant customers in a particular segment could materially reduce revenues for such segment. However, no individual customer exceeded 10% of our consolidated revenues for the periods ended September 30, 2009 and 2008, respectively. In addition, the services we provide to our larger customers are often critical to the operations of such customers and a termination of our services would require an extended transition period with gradual declining revenues.

Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics and Other segments for the three months ended September 30, 2009 and 2008 are as follows:

(Dollars in thousands)

	September 30, 2009	September 30, 2008	Increase	%
Revenues:				
Financial Services	$ 364,196	$ 339,004	$ 25,192	7.4%
Healthcare	226,435	174,183	52,252	30.0
Manufacturing/Retail/Logistics	146,642	115,395	31,247	27.1
Other	116,215	106,144	10,071	9.5
Total Revenues	$ 853,488	$ 734,726	$ 118,762	16.2%
Segment Operating Profit:				
Financial Services	$ 139,777	$ 113,981	$ 25,796	22.6%
Healthcare	94,863	66,783	28,080	42.0
Manufacturing/Retail/Logistics	52,175	32,955	19,220	58.3
Other	40,222	33,885	6,337	18.7
Total Segment Operating Profit	$ 327,037	$ 247,604	$ 79,433	32.1%

Financial Services Segment

Revenue. Revenue increased by 7.4 %, or approximately $25.2 million, from approximately $339.0 million during the three months ended September 30, 2008 to approximately $364.2 million during the three months ended September 30, 2009. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $16.2 million and approximately $9.0 million, respectively. Within the segment, growth among our insurance customers increased revenue by approximately $14.2 million over the third quarter of last year. Overall, the period-over-period increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 22.6%, or approximately $25.8 million, from approximately $114.0 million during the three months ended September 30, 2008 to approximately $139.8 million during the three months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues, the impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies, including continued leverage on prior sales and marketing investments, partially offset by additional headcount to support our revenue growth and continued investment in sales and marketing.

Table of Contents

Healthcare Segment

Revenue. Revenue increased by 30.0%, or approximately $52.2 million, from approximately $174.2 million during the three months ended September 30, 2008 to approximately $226.4 million during the three months ended September 30, 2009. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $45.2 million and approximately $7.0 million, respectively. Within the segment, growth was particularly strong among both of our life sciences and healthcare customers, where revenue increased by approximately $26.2 million and $26.1 million, respectively, over the third quarter of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 42.0%, or approximately $28.1 million, from approximately $66.8 million during the three months ended September 30, 2008 to approximately $94.9 million during the three months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues, the impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies, including continued leverage on prior sales and marketing investments, partially offset by additional headcount to support our revenue growth and continued investment in sales and marketing.

Manufacturing/Retail/Logistics Segment

Revenue. Revenue increased by 27.1%, or approximately $31.2 million, from approximately $115.4 million during the three months ended September 30, 2008 to approximately $146.6 million during the three months ended September 30, 2009. The increase in revenue was driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $19.4 million and approximately $11.8 million, respectively. Within the segment, growth was particularly strong among our retail/hospitality customers, where revenue increased approximately $26.9 million over the third quarter of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 58.3%, or approximately $19.2 million, from approximately $33.0 million during the three months ended September 30, 2008 to approximately $52.2 million during the three months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues, the impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies, including continued leverage on prior sales and marketing investments, partially offset by additional headcount to support our revenue growth and continued investment in sales and marketing.

Other Segment

Revenue. Revenue increased by 9.5%, or approximately $10.1 million, from approximately $106.1 million during the three months ended September 30, 2008 to approximately $116.2 million during the three months ended September 30, 2009. The increase in revenue was driven by continued expansion of customer relationships added since September 30, 2008 of $10.3 million and was partially offset by a decline of revenue from several of our existing customers. Accordingly, revenue from existing customers as of September 30, 2008 decreased by $0.2 million. Within the Other segment, growth was particularly strong among our media and information services customers, where revenue increased by approximately $8.3 million over the third quarter of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 18.7%, or approximately $6.3 million, from approximately $33.9 million during the three months ended September 30, 2008 to approximately $40.2 million during the three months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues, the impact of the depreciation of the Indian rupee versus the U.S. dollar and achieving operating efficiencies, including continued leverage on prior sales and marketing investments, partially offset by additional headcount to support our revenue growth and continued investment in sales and marketing.

Table of Contents

Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008

Revenues from external customers and segment operating profit, before unallocated expenses, for the Financial Services, Healthcare, Manufacturing/Retail/Logistics and Other segments for the nine months ended September 30, 2009 and 2008 are as follows:

(Dollars in thousands)

	September 30, 2009	September 30, 2008	Increase	%
Revenues:				
Financial Services	$ 1,028,086	$ 945,545	$ 82,541	8.7%
Healthcare	620,137	498,335	121,802	24.4
Manufacturing/Retail/Logistics	402,173	319,752	82,421	25.8
Other	325,546	299,627	25,919	8.7
Total Revenues	$ 2,375,942	$ 2,063,259	$ 312,683	15.2%
Segment Operating Profit:				
Financial Services	$ 368,460	$ 327,162	$ 41,298	12.6%
Healthcare	241,613	197,847	43,766	22.1
Manufacturing/Retail/Logistics	134,751	104,551	30,200	28.9
Other	110,329	103,216	7,113	6.9
Total Segment Operating Profit	$ 855,153	$ 732,776	$ 122,377	16.7%

Financial Services Segment

Revenue. Revenue increased by 8.7%, or approximately $82.5 million, from approximately $945.6 million during the nine months ended September 30, 2008 to approximately $1,028.1 million during the nine months ended September 30, 2009. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $60.8 million and approximately $21.7 million, respectively. Within the segment, growth was strong among our insurance customers where revenue increased by approximately $51.1 million over the first nine months of last year. Overall, the year-over-year increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 12.6%, or approximately $41.3 million, from approximately $327.2 million during the nine months ended September 30, 2008 to approximately $368.5 million during the nine months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues and the impact of the depreciation of the Indian rupee versus the U.S. dollar, partially offset by additional headcount to support our revenue growth, continued investment in sales and marketing, and wage inflation, primarily in India.

Healthcare Segment

Revenue. Revenue increased by 24.4%, or approximately $121.8 million, from approximately $498.3 million during the nine months ended September 30, 2008 to approximately $620.1 million during the nine months ended September 30, 2009. The increase in revenue was primarily driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $109.8 million and approximately $12.0 million, respectively. Within the segment, growth was particularly strong among both our life sciences and healthcare customers, where revenue increased by approximately $67.6 million and $54.2 million, respectively, over the first nine months of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 22.1%, or approximately $43.8 million, from approximately $197.8 million during the nine months ended September 30, 2008 to approximately $241.6 million during the nine months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues and the impact of the depreciation of the Indian rupee versus the U.S. dollar, partially offset by additional headcount to support our revenue growth, continued investment in sales and marketing, and wage inflation, primarily in India.

Manufacturing/Retail/Logistics Segment

Revenue. Revenue increased by 25.8%, or approximately $82.4 million, from approximately $319.8 million during the nine months ended September 30, 2008 to approximately $402.2 million during the nine months ended September 30, 2009. The increase in revenue was driven by continued expansion of existing customer relationships as well as revenue contributed by new customers. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $66.1 million and approximately $16.3 million, respectively. Within the segment, growth was particularly strong among our retail and hospitality customers, where revenue increased by approximately $60.7 million over the first nine months of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 28.9%, or approximately $30.2 million, from approximately $104.6 million during the nine months ended September 30, 2008 to approximately $134.8 million during the nine months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues and the impact of the depreciation of the Indian rupee versus the U.S. dollar, partially offset by additional headcount to support our revenue growth, continued investment in sales and marketing, and wage inflation, primarily in India.

Other Segment

Revenue. Revenue increased by 8.7%, or approximately $25.9 million, from approximately $299.6 million during the nine months ended September 30, 2008 to approximately $325.5 million during the nine months ended September 30, 2009. The increase in revenue from customers existing as of September 30, 2008 and customers added since such date was approximately $8.5 million and $17.4 million, respectively. Within the Other segment, growth was particularly strong among our media and information services customers, where revenue increased by approximately $27.2 million over the third quarter of last year. The increase can also be attributed to leveraging sales and marketing investments in this business segment as well as greater acceptance of the on-site/offshore IT services delivery model.

Segment Operating Profit. Segment operating profit increased 6.9%, or approximately $7.1 million, from approximately $103.2 million during the nine months ended September 30, 2008 to approximately $110.3 million during the nine months ended September 30, 2009. The increase in segment operating profit was attributable primarily to increased revenues and the impact of the depreciation of the Indian rupee versus the U.S. dollar, partially offset by additional headcount to support our revenue growth, continued investment in sales and marketing, and wage inflation, primarily in India.

Liquidity and Capital Resources

At September 30, 2009, we had cash and cash equivalents and short-term investments of $1,182.7 million. We have used, and plan to use, such cash for: (i) expansion of existing operations, including our offshore IT development centers; (ii) continued development of new service lines; (iii) possible acquisitions of related businesses; (iv) possible formation of joint ventures; (v) stock repurchases and (vi) general corporate purposes, including working capital. As of September 30, 2009, we had working capital of approximately $1,508.5 million. Accordingly, we do not anticipate any near-term liquidity issues.

Net cash provided by operating activities was approximately $434.8 million during the nine months ended September 30, 2009 as compared to approximately $236.8 million during the nine months ended September 30, 2008. The increase is primarily attributed to the increase in net income in 2009 and efficiencies in the deployment of working capital required to support our revenue growth. Trade accounts receivable increased from approximately $517.5 million at December 31, 2008 to approximately $586.9 million at September 30, 2009. Unbilled accounts receivable increased from approximately $62.2 million at December 31, 2008 to approximately $97.8 million at September 30, 2009. The increase in trade accounts receivable and unbilled receivables as of September 30, 2009 as compared to December 31, 2008 was primarily due to increased revenues and a higher number of days of sales outstanding. We monitor turnover, aging and the collection of accounts receivable through the use of management reports that are prepared on a customer basis and evaluated by our finance staff. At September 30, 2009, our days of sales outstanding, including unbilled receivables, were approximately 73.8 days as compared to 70.8 days at December 31, 2008 and 75.1 days as of September 30, 2008.

Our investing activities used net cash of approximately $219.7 million during the nine months ended September 30, 2009 as compared to a net use of cash of approximately $33.5 million during the nine months ended September 30, 2008. The increase in net cash used in investing activities primarily relates to a decrease in net redemptions of investments and an increase in additional investments made in 2009 partially offset by decreased capital expenditure spending and decreased payments for acquisitions.

Our financing activities provided net cash of approximately $31.6 million during the nine months ended September 30, 2009 as compared to providing approximately $37.2 million during the nine months ended September 30, 2008. The decrease relates to lower levels of proceeds from employee stock-based compensation arrangements offset by lower levels of repurchases of our common stock during 2009.

Table of Contents

As of September 30, 2009, our short-term and long-term investments totaled $346.8 million and included $0.5 million in short-term and $136.1 million in long-term of AAA/A3-rated auction-rate municipal debt securities that are collateralized by debt obligations supported by student loans, substantially backed by the FFELP. In addition, the remainder of our long-term investments included $20.9 million of an auction-rate securities related UBS Right discussed below. Since February 14, 2008, auctions failed for all the auction-rate securities still in our portfolio as of September 30, 2009. We believe that the failed auctions experienced to date are not a result of the deterioration of the underlying credit quality of the securities and we continue to earn and receive interest on the auction-rate municipal debt securities at a pre-determined formula with spreads tied to particular interest rate indices. All of the auction-rate municipal debt securities held by us are callable by the issuer at par.

In November 2008, we accepted an offer from UBS AG (UBS) to sell to UBS, at par value, our auction-rate securities at any time during an exercise period from June 30, 2010 to July 2, 2012, which we refer to as the UBS Right. In accepting the UBS Right, we granted UBS the authority to purchase these auction-rate securities or sell them on our behalf at par any time after the execution of the UBS Right through July 2, 2012. The offer is non-transferable. During the first nine months of 2009, approximately $10.8 million of the auction-rate securities were redeemed at par value. At September 30, 2009, the par value of the auction-rate securities held by us was $157.8 million.

Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute current and planned operations and needs for at least the next 12 months. If a liquidity event does not occur prior to the exercise period under the UBS Right, we expect to obtain liquidity through the UBS Right. If UBS is unable to honor its obligations under the UBS Right, we believe we will be able to ultimately recover our investment in auction-rate municipal debt securities due to: (i) the strength of the underlying collateral substantially backed by FFELP, and (ii) the AAA/A3 credit rating of the securities held by us. However, it could take until the final maturity of the underlying security (up to 32 years) to realize our investments recorded value.

Our ability to expand and grow our business in accordance with current plans, to make acquisitions and form joint ventures and to meet our long-term capital requirements beyond a 12-month period will depend on many factors, including the rate, if any, at which our cash flow increases, our ability and willingness to accomplish acquisitions and joint ventures with capital stock, our continued intent not to repatriate earnings from India, and the availability of public and private debt and equity financing. We cannot be certain that additional financing, if required, will be available on terms favorable to us, if at all. We expect our operating cash flow and cash and cash equivalents to be sufficient to meet our operating requirements for the next twelve months.

Commitments and Contingencies

Our current India real estate development program now includes planned construction of approximately 4.5 million square feet of new space. The expanded program, which commenced during the quarter ended March 31, 2007, includes the expenditure of approximately $330.0 million on land acquisition, facilities construction and furnishings to build new state-of-the-art IT development centers in regions primarily designated as SEZs located in India. As of September 30, 2009, we had outstanding fixed capital commitments of approximately $44.2 million related to our India development center expansion program.

On October 15, 2009, we entered into a definitive agreement with UBS AG to acquire UBS Service Centre (India) Private Limited (UBS ISC) for a purchase price of approximately $75.0 million. Subject to the satisfaction of certain closing conditions, we expect to close the transaction near the end of December 2009.

During December 2008, our Board of Directors authorized a program to repurchase $50.0 million of our Class A common stock. This authorization expires in December 2009 and we purchased $12.4 million of shares during the nine montder:none;padding:0in 0in 0in 0in;width:1.3%;">

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(41,191

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(37,788

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Interest expense, net	(4,165)	(4,186)	(8,593)	(8,302)
Other	3,059	908	2,344	(389)
Total	$ (22,827)	$ (21,645)		

$

(47,440

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$

(46,479

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11

Table of Contents

Treasury Share Retirement

On November 30, 2011, the company s Board of Directors authorized the retirement of 15 million treasury shares.

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 and 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 has made an accounting policy election to use the portfolio exception permitted in ASU No. 2011-04 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 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 Yuan, the Romanian New Lei against the U.S. dollar, as well as the Romanian New Lei 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 items, 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 statement of earnings classification of effective hedge results is the same as that of the underlying exposure. Results of hedges of sales and foreign plant operations are recorded in net sales and cost of sales, respectively, when the underlying hedged transaction affects net earnings. The maximum amount of time the company hedges its exposure to the variability in future cash flows for forecasted trade sales and purchases is two years.

The company formally assesses, at a hedge s inception and on an ongoing basis, whether the derivatives that are used in the hedging transaction have been highly effective in offsetting changes in the cash flows of the hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not, or has ceased to be, highly effective as a hedge, the company discontinues hedge accounting prospectively. When the company discontinues hedge accounting because it is no longer probable, but it is still reasonably possible that the forecasted transaction will occur by the end of the originally expected period or within an additional two-month period of time thereafter, the gain or loss on the derivative remains in accumulated other comprehensive loss (AOCL) and is reclassified to net earnings when the forecasted transaction affects net earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were 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 sheet, recognizing future changes in the fair value in other income, net. For the second quarter of fiscal 2012, there were no gains or losses on contracts reclassified into earnings as a result of the discontinuance of cash flow hedges. As of May 4, 2012, the notional amount outstanding of forward contracts designated as cash flow hedges was $56.5

million.

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 change in fair value of specific assets and liabilities on the consolidated balance sheet. These contracts are not designated as hedging instruments. Accordingly, changes in the fair value of hedges of recorded balance sheet positions, such as cash, receivables, payables, intercompany notes, and other various contractual claims to pay or receive foreign currencies other than the functional currency, are recognized immediately in other

Table of Contents

income, net, on the consolidated statements of earnings together with the transaction gain or loss from the hedged balance sheet position.

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

	Asset Derivatives				Liability Derivatives			
	May 4, 2012		April 29, 2011		May 4, 2012		April 29, 2011	
(Dollars in thousands)	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Designated as Hedging Instruments								
Foreign exchange contracts	Prepaid expenses	$ 759	Prepaid expenses	$	Accrued liabilities	$	Accrued liabilities	$ 3,151
Derivatives Not Designated as Hedging Instruments								
Foreign exchange contracts	Prepaid expenses	1,318	Prepaid expenses		Accrued liabilities	339	Accrued liabilities	4,803
Total Derivatives		$ 2,077		$		$ 339		$ 7,954

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 six months ended May 4, 2012 and April 29, 2011, respectively.

	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)	
(Dollars in thousands) **For the three months ended**	**May 4, 2012**	**April 29, 2011**		**May 4, 2012**	**April 29, 2011**		**May 4, 2012**	**April 29, 2011**
Foreign exchange contracts	$ (870)	$ (2,859)	Net sales	$ 1,265	$ (1,847)	Other income, net	$ 281	$ (46)
Foreign exchange contracts	120	261	Cost of sales	(214)	231			
Total	$ (750)	$ (2,598)		$ 1,051	$ (1,616)			
For the six months ended	**May 4, 2012**	**April 29, 2011**		**May 4, 2012**	**April 29, 2011**		**May 4, 2012**	**April 29, 2011**
Foreign exchange contracts	$ 241	$ (7,119)	Net sales	$ 1,705	$ (2,590)	Other income, net	$ 203	$ (358)
Foreign exchange contracts	692	1,228	Cost of sales	(646)	374			
Total	$ 933	$ (5,891)		$ 1,059	$ (2,216)			

As of May 4, 2012, the company expects to reclassify approximately $1.5 million of gains from AOCL to earnings during the next 12 months.

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

		Gain (Loss) Recognized in Net Earnings			
		Three Months Ended		Six Months Ended	
(Dollars in thousands)	**Location of Gain (Loss) Recognized in Net Earnings**	**May 4, 2012**	**April 29, 2011**	**May 4, 2012**	**April 29, 2011**
Foreign exchange contracts	Other income, net	$ 158	$ (8,016)	$ 4,506	$ (9,509)

13

Table of Contents

Fair Value Measurements

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

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

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

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

Cash and cash equivalents are valued at their carrying amounts in the consolidated balance sheets, which are reasonable estimates of their fair value due to their short-term maturities. Foreign currency forward exchange contracts are valued at fair market value using the market approach based on exchange rates as of the reporting date, which is the amount the company would receive or pay to terminate the contracts. The unfunded deferred compensation liability is primarily subject to changes in fixed-income investment contracts based on current yields. For accounts receivable and accounts payable, carrying amounts are a reasonable estimate of fair value given their short-term nature.

Assets and liabilities measured at fair value on a recurring basis, as of May 4, 2012, April 29, 2011, and October 31, 2011 are summarized below:

(Dollars in thousands)

May 4, 2012	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents	$ 82,572	$ 82,572	$	
Foreign exchange contracts	2,077		2,077	
Total Assets	$ 84,649	$ 82,572	$ 2,077	
Liabilities:				
Foreign exchange contracts	$ 339		$ 339	
Deferred compensation liabilities	3,928		3,928	
Total Liabilities	$ 4,267		$ 4,267	

April 29, 2011	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents	$ 106,862	$ 106,862		
Total Assets	$ 106,862	$ 106,862		
Liabilities:				
Foreign exchange contracts	$ 7,954		$ 7,954	
Deferred compensation liabilities	4,654		4,654	
Total Liabilities	$ 12,608		$ 12,608	

October 31, 2011	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents	$ 80,886	$ 80,886		
Total Assets	$ 80,886	$ 80,886		
Liabilities:				
Foreign exchange contracts	$ 3,150		$ 3,150	
Deferred compensation liabilities	4,297		4,297	
Total Liabilities	$ 7,447		$ 7,447	

Contingencies

Litigation

General. The company is party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive as well as compensatory damages arising out of use of the company s products. Although the company is self-insured to some extent, the company maintains insurance against certain product liability losses. The company is also subject to 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 (USPTO) and foreign patent offices. Management believes these activities help minimize its risk of being a defendant in patent infringement litigation.

Lawnmower Engine Horsepower Marketing and Sales Practices Litigation. Beginning in June 2004, various plaintiffs filed class action lawsuits in state and federal courts throughout the country against the company and other defendants alleging that the horsepower labels on the products the plaintiffs purchased were inaccurate. The plaintiffs (i) asserted statutory and common law claims, and (ii) sought an injunction, unspecified compensatory and punitive damages, treble damages, and attorneys fees. In December 2008, all lawsuits were transferred to the United States District Court for the Eastern District of Wisconsin (the Court) for coordinated or consolidated pretrial proceedings.

The company and certain other defendants entered into a settlement agreement with plaintiffs in February 2010, the Court approved the company s settlement and certified the settlement class in August 2010, and the company s settlement agreement became final in February 2011. The settlement class consists of all persons in the United States who, beginning January 1, 1994 and through April 12, 2010, purchased a lawnmower containing a two-stroke or four-stroke gas combustible engine up to 30 horsepower that was manufactured or sold by the company and other defendants, and the company s settlement agreement provides for, among other things, (i) a monetary settlement, (ii) an additional warranty period for certain engines that are subject to the litigation, and (iii) injunctive relief relating to power rating labeling practices. The expected costs of the company s performance of its settlement obligations are consistent with accruals established in prior periods and, as such, management does not currently expect that the settlement will have a material adverse effect on the company s consolidated operating results or financial condition.

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

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

Subsequent Events

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

Table of Contents

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

Nature of Operations

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

This Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the MD&A included in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended October 31, 2011.

RESULTS OF OPERATIONS

Overview

Our results for the second quarter of fiscal 2012 were positive with a net sales growth rate of 9.5 percent and a net earnings growth rate of 14.2 percent, each as compared to the second quarter of fiscal 2011. Year-to-date net earnings increased 14.5 percent in fiscal 2012 compared to the same period in the prior fiscal year on a year-to-date net sales growth rate of 9.9 percent. Sales for most professional segment businesses increased due to strong demand for domestic golf equipment as customers replaced aging equipment, favorable early spring weather that accelerated shipments and demand for landscape contractor equipment, the successful introduction of new products, higher demand resulting from improved domestic economic conditions in our markets, and price increases on some products. Worldwide sales for our micro-irrigation products also increased due to continued acceptance of drip irrigation solutions for agricultural markets. Additionally, for the first six months of fiscal 2012, $7.5 million of incremental net sales from acquisitions completed during the past twelve months also contributed to the sales growth for our professional segment. During the second quarter of fiscal 2012, we completed the acquisitions of two professional product lines that increase our product offering and presence in the rental and light construction markets. Residential segment sales also were up primarily from favorable early spring weather conditions that drove strong demand for walk power mowers and riders, positive customer response to newly introduced products, and higher sales of Pope products in Australia due to more favorable weather conditions. However, shipments of snow thrower products and service parts were down, mainly for the year-to-date comparison, due to reduced demand resulting from the lack of snowfall during the 2011/2012 winter season. International net sales decreased slightly for the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011 primarily from a slowdown in shipments of golf and grounds equipment in Europe. Our net earnings growth of 14.2 percent and 14.5 percent in the second quarter and year-to-date periods of fiscal 2012, respectively, compared to the same periods in fiscal 2011, resulted primarily from higher sales volumes and leveraging of our selling, general, and administrative (SG&A) expense over higher sales volumes. Our gross margin rate increased 20 basis points in the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011. However, for the year-to-date period of fiscal 2012, our gross margin rate decreased 20 basis points compared to the same period in the prior fiscal year. Additionally, our net earnings growth was hampered by an increase in our tax rate due to the expiration of the domestic research tax credit on December 31, 2011.

We continued to focus on asset management and our financial condition remained strong. Our receivables decreased slightly, by 2.0 percent, as of the end of the second quarter of fiscal 2012 compared to the end of the second quarter of fiscal 2011 on a sales increase of nearly 10 percent. Our inventory levels also declined by 3.5 percent as of the end of the second quarter of fiscal 2012 compared to the end of the second quarter of fiscal 2011. Our second quarter cash dividend increased by 10 percent from $0.20 to $0.22 per share compared to the quarterly cash dividend paid in the second quarter of fiscal 2011.

Our multi-year initiative, Destination 2014 will take us to our centennial in 2014 and into our second century. This four-year initiative is intended to focus our efforts on driving our legacy of excellence through building caring relationships and engaging in innovation. Through our Destination 2014 initiative financial goals, we will strive to achieve a minimum of $100 million in organic revenue growth each fiscal year and 12 percent operating earnings as a percentage of net sales by the end of fiscal 2014. We define organic revenue growth as the increase in net sales, less net sales from acquisitions that occurred in the prior twelve-month period.

Table of Contents

Our first half of fiscal 2012 financial results were solid, and we are optimistic that our results for the full fiscal year of 2012 will end positively. Our continued focus is on generating customer demand and aggressively driving retail sales for our innovative products, while keeping production closely aligned with expected shipment volumes. We will continue to keep a cautionary eye on the global economic environment, particularly Europe, retail demand, field inventory levels, commodity prices, weather conditions, competitive actions, expenses, and other factors identified below under the heading Forward-Looking Information, which could cause our actual results to differ from our anticipated outlook.

Net Earnings

Net earnings for the second quarter of fiscal 2012 were $68.8 million, or $2.26 per diluted share, compared to $60.3 million, or $1.88 per diluted share, for the second quarter of fiscal 2011, resulting in a net earnings per diluted share increase of 20.2 percent. Year-to-date net earnings in fiscal 2012 were $88.7 million, or $2.91 per diluted share, compared to $77.5 million, or $2.41 per diluted share, in the last fiscal year, resulting in a net earnings per diluted share increase of 20.7 percent. The primary factors contributing to our earnings improvements were higher sales volumes and the leveraging of fixed SG&A costs over higher sales volumes, somewhat offset by a higher effective tax rate. In addition, second quarter and year-to-date fiscal 2012 net earnings per diluted share were benefited by approximately $0.11 per share and $0.16 per share, respectively, compared to the same periods in fiscal 2011, 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		**Six Months Ended**	
	May 4, 2012	**April 29, 2011**	**May 4, 2012**	**April 29, 2011**
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	(66.0)	(66.2)	(65.7)	(65.5)
Gross margin	34.0	33.8	34.3	34.5
SG&A expense	(18.6)	(19.0)	(21.7)	(22.6)
Operating earnings	15.4	14.8	12.6	11.9
Interest expense	(0.6)	(0.7)	(0.7)	(0.8)
Other income, net	0.3	0.2	0.2	0.2
Provision for income taxes	(5.1)	(4.8)	(4.1)	(3.7)
Net earnings	10.0%	9.5%	8.0%	7.6%

Net Sales

Worldwide consolidated net sales for the second quarter and year-to-date periods of fiscal 2012 were up 9.5 percent and 9.9 percent, respectively, from the same periods in the prior fiscal year. Worldwide professional segment net sales were up 9.0 percent and 9.3 percent for the second quarter and year-to-date periods of fiscal 2012, respectively, compared to the same periods in the prior fiscal year. Sales for most professional segment businesses increased due to strong demand for domestic golf equipment as customers replaced aging equipment, favorable early spring weather that accelerated shipments and demand for landscape contractor equipment, the successful introduction of new products, higher demand resulting from improved domestic economic conditions in our markets, and price increases on some products. However, shipments of golf and grounds equipment in Europe were down due to economic uncertainty in some European countries. Worldwide sales for our micro-irrigation products increased due to continued acceptance of drip irrigation solutions for agricultural markets. Additionally, for the first six months of fiscal 2012, $7.5 million of incremental net sales from acquisitions completed during the past twelve months also contributed to the sales growth for our professional segment. Residential segment net sales were up 10.6 percent and 11.0 percent for the second quarter and year-to-date periods of fiscal 2012, respectively, compared to the same periods in the prior fiscal year. Favorable early spring weather drove strong demand for walk power mowers and riders, and positive customer response to new products we introduced also increased net sales for our residential segment. Sales of Pope products in Australia were also up due to more favorable weather conditions in fiscal 2012 compared to fiscal 2011. However, shipments of snow thrower products and service parts were down, mainly for the year-to-date comparison, due to reduced demand resulting from the lack of snowfall during the 2011/2012 winter season. International net sales for the second quarter of fiscal 2012 were slightly down by 2.2 percent compared to the second quarter of fiscal 2011; however, for the year-to-date period of fiscal 2012, international net sales slightly increased by 1.8 percent from the same period in the prior fiscal year. A weaker U.S. dollar compared to other currencies in which we transact business accounted for approximately $2.3 million and $4.8 million of additional net sales for the second quarter and year-to-date periods of fiscal 2012, respectively. Field inventory levels were up as of the end of the second quarter of fiscal 2012 compared to the same period in the prior fiscal year due to increased orders

Table of Contents

from strong preseason demand as a result of early spring weather conditions, and higher field inventory levels of snow throwers as a result of decreased demand due to the lack of snowfall during the 2011/2012 winter season.

Gross Profit

As a percentage of net sales, gross profit for the second quarter of fiscal 2012 increased 20 basis points to 34.0 percent compared to 33.8 percent in the second quarter of fiscal 2011. This improvement was due mainly to manufacturing efficiencies from increased production and demand for our products, price increases on some products, somewhat offset by higher commodity costs. Gross profit as a percent of net sales for the year-to-date period of fiscal 2012 decreased 20 basis points to 34.3 percent compared to 34.5 percent for the year-to-date period of fiscal 2011. This decline mainly was due to a lower proportionate share of product sales that carry higher average gross margins and higher commodity prices, somewhat offset by price increases on some products and manufacturing efficiencies from increased production and demand for our products.

Selling, General, and Administrative Expense

SG&A expense increased $8.7 million, or 7.3 percent, for the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011 and increased $11.9 million, or 5.2 percent, for the year-to-date period of fiscal 2012 compared to the year-to-date period of fiscal 2011. As a percentage of net sales, SG&A expense decreased 40 basis points and 90 basis points for the second quarter and year-to-date periods of fiscal 2012, respectively, compared to the same periods in the prior fiscal year. Those decreases were primarily attributable to the leveraging of SG&A costs over higher sales volumes.

Interest Expense

Interest expense for the second quarter of fiscal 2012 decreased slightly, by 0.5 percent, compared to the second quarter of fiscal 2011. For the year-to-date period of fiscal 2012, interest expense increased 3.5 percent compared to the same period in the prior fiscal year as a result of higher average debt levels.

Other Income, Net

Other income, net for the second quarter of fiscal 2012 increased $0.7 million compared to the second quarter of fiscal 2011 due primarily to an increase in income from our equity investment. Other income, net for the year-to-date period of fiscal 2012 decreased slightly by $0.1 million compared to the same period in the prior fiscal year.

Provision for Income Taxes

The effective tax rate for the second quarter of fiscal 2012 was 34.1 percent compared to 33.4 percent for the second quarter of fiscal 2011. The effective tax rate for the year-to-date periods of fiscal 2012 and 2011 was 34.0 percent and 32.6 percent, respectively. The increases in the effective tax rates were primarily the result of the expiration of the Federal Research and Development Tax Credit on December 31, 2011, whereas our tax rate in the first quarter of fiscal 2011 was benefited by the reinstatement and retroactive credit.

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.

Table of Contents

The following table summarizes net sales by segment:

	Three Months Ended			
(Dollars in thousands)	**May 4, 2012**	**April 29, 2011**	**$ Change**	**% Change**
Professional	$ 455,945	$ 418,284	$ 37,661	9.0%
Residential	231,897	209,632	22,265	10.6
Other	3,643	3,685	(42)	(1.1)
Total*	$ 691,485	$ 631,601	$ 59,884	9.5%

* Includes international sales of: $ 197,516 $ 201,896 $ (4,380) (2.2)%

	Six Months Ended			
(Dollars in thousands)	**May 4, 2012**	**April 29, 2011**	**$ Change**	**% Change**
Professional	$ 739,779	$ 676,564	$ 63,215	9.3%
Residential	369,505	332,925	36,580	11.0
Other	6,036	5,324	712	13.4
Total*	$ 1,115,320	$ 1,014,813	$ 100,507	9.9%

* Includes international sales of: $ 346,670 $ 340,647 $ 6,023 1.8%

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

	Three Months Ended			
(Dollars in thousands)	**May 4, 2012**	**April 29, 2011**	**$ Change**	**% Change**
Professional	$ 98,701	$ 85,606	$ 13,095	15.3%
Residential	28,518	26,539	1,979	7.5
Other	(22,827)	(21,645)	(1,182)	(5.5)
Total	$ 104,392	$ 90,500	$ 13,892	15.4%

	Six Months Ended			
(Dollars in thousands)	**May 4, 2012**	**April 29, 2011**	**$ Change**	**% Change**
Professional	$ 140,792	$ 123,525	$ 17,267	14.0%
Residential	41,126	37,907	3,219	8.5
Other	(47,440)	(46,479)	(961)	(2.1)
Total	$ 134,478	$ 114,953	$ 19,525	17.0%

Professional

Net Sales. Worldwide net sales for the professional segment in the second quarter and year-to-date periods of fiscal 2012 increased 9.0 percent and 9.3 percent, respectively, compared to the same periods in the prior fiscal year. Sales for most professional segment businesses increased due to strong demand for domestic golf equipment as customers replaced aging equipment, favorable early spring weather that accelerated shipments and demand for landscape contractor equipment, the successful introduction of new products, higher demand resulting from improved domestic economic conditions in our markets, and price increases on some products. However, shipments of golf and grounds equipment in Europe were down due to economic uncertainty in some European countries. Worldwide sales for our micro-irrigation products increased due to continued acceptance of drip irrigation solutions for agricultural markets. Additionally, for the first six months of fiscal 2012, $7.5 million of incremental net sales from acquisitions completed during the past twelve months also contributed to the sales growth for our professional segment.

Table of Contents

Operating Earnings. Operating earnings for the professional segment in the second quarter and year-to-date periods of fiscal 2012 increased 15.3 percent and 14.0 percent, respectively, compared to the same periods in the last fiscal year. Expressed as a percentage of net sales, professional segment operating margin increased to 21.6 percent compared to 20.5 percent in the second quarter of fiscal 2011, and fiscal 2012 year-to-date professional segment operating margin also increased to 19.0 percent compared to 18.3 percent compared to the same period in the last fiscal year. These profit improvements were attributable to higher sales volumes, an increase in gross margins primarily from manufacturing efficiencies from increased production and demand, and lower SG&A expenses as a percentage of net sales due to the leveraging of fixed SG&A costs over higher sales volumes.

Residential

Net Sales. Worldwide net sales for the residential segment in the second quarter and year-to-date periods of fiscal 2012 increased 10.6 percent and 11.0 percent, respectively, compared to the same periods in the prior fiscal year. Favorable early spring weather drove strong demand for walk power mowers and riders, as well as positive customer response to new products we introduced also contributed to the net sales increase for our residential segment. Sales of Pope products in Australia also were up due to more favorable weather conditions in fiscal 2012 compared to fiscal 2011. However, shipments of snow thrower products and service parts were down, mainly for the year-to-date comparison, due to decreased demand resulting from the lack of snowfall during the 2011/2012 winter season. As a result of the aforementioned lack of snowfall during the 2011/2012 winter season, coupled with higher snow thrower field inventory levels, anticipated lower demand is expected to result in an adverse effect on our shipments of snow thrower products for the second half of fiscal 2012.

Operating Earnings. Operating earnings for the residential segment in the second quarter and year-to-date periods of fiscal 2012 increased 7.5 percent and 8.5 percent, respectively, compared to the same periods in the prior fiscal year due to higher sales volumes. However, expressed as a percentage of net sales, residential segment operating margin decreased to 12.3 percent in the second quarter of fiscal 2012 compared to 12.7 percent in the second quarter of fiscal 2011, and fiscal 2012 year-to-date residential segment operating margin also decreased to 11.1 percent compared to 11.4 percent compared to the same period in the last fiscal year. These decreases in operating margins were primarily attributable to lower gross margins due to higher commodity prices and a lower proportionate share of product sales that carry higher average gross margins, somewhat offset by lower SG&A expenses as a percentage of net sales due to the leveraging of fixed SG&A costs over higher sales volumes.

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 second quarter of fiscal 2012 decreased slightly, by 1.1 percent, compared to the second quarter of fiscal 2011. For the year-to-date period of fiscal 2012, the other segment net sales increased $0.7 million, or 13.4 percent, compared to the same period in the prior fiscal year due to favorable early spring weather that drove strong demand for products at our company-owned Midwestern distribution company.

Operating Losses. Operating losses for the other segment increased for the second quarter and year-to-date periods of fiscal 2012 by $1.2 million, or 5.5 percent, and $1.0 million, or 2.1 percent, respectively, compared to the same periods in the prior fiscal year. These loss increases were due primarily to an increase in self-insured health insurance expense and higher currency exchange rate losses, somewhat offset by an increase in income from our equity investment.

20

Table of Contents

FINANCIAL POSITION

Working Capital

In fiscal 2012, we have placed and intend to continue to place additional emphasis on asset utilization and limiting inventory build up, with a focus on minimizing the amount of working capital in the supply chain, adjusting production plans, and maintaining or improving order replenishment and service levels to end users.

Receivables as of the end of the second quarter of fiscal 2012 decreased by 2.0 percent compared to the end of the second quarter of fiscal 2011 due mainly to strong cash collections the last week of our quarter primarily due to the change in timing of our second quarter end date in fiscal 2012, which was five days later then the end of the second quarter in fiscal 2011. Our average days sales outstanding for receivables improved to 34.5 days based on sales for the twelve months ended May 4, 2012, compared to 36.3 days for the twelve months ended April 29, 2011. Inventory levels as of the end of the second quarter of fiscal 2012 also decreased by 3.5 percent compared to the end of the second quarter of fiscal 2011. Last fiscal year we prebuilt inventory, mainly residential turf products, in anticipation of then expected higher demand for our products that did not occur as planned, whereas this fiscal year we experienced strong preseason demand as a result of favorable early spring weather conditions. In addition, accounts payable decreased as of the end of our second quarter of fiscal 2012 by $6.2 million, or 3.1 percent, driven by lower levels of inventory. Our average net working capital as a percentage of net sales for the twelve months ended May 4, 2012 increased to 14.9 percent compared to 13.6 percent for the twelve months ended April 29, 2011. This increase was due mainly to higher average inventory levels for the twelve-month period ended May 4, 2012 as compared to the twelve-month period ended April 29, 2011. 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.

Liquidity and Capital Resources

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

Our Board of Directors approved a cash dividend of $0.22 per share for the second quarter of fiscal 2012 paid on April 16, 2012, which was an increase of 10 percent over our cash dividend of $0.20 per share for the second quarter of fiscal 2011. Our Board of Directors also declared a two-for-one split of our common stock, which will be effected in the form of a 100 percent stock dividend, and will be distributed June 29, 2012 to shareholders of record as of June 15, 2012.

Cash Flow. We historically use more operating cash in the first half of the fiscal year than the second half of our fiscal year due to the seasonality of our business. Cash provided by operating activities for the first six months of fiscal 2012 increased $71.6 million compared to the first six months of fiscal 2011, mainly as a result of lower inventory levels and a higher increase in accounts payable and accrued liabilities for the first half of fiscal 2012 as compared to the first half of fiscal 2011, as well as higher net earnings. Cash used for investing activities was down by $7.4 million compared to the first six months of fiscal 2011, due mainly to lower levels of cash used for purchases of property, plant and equipment and cash utilized for acquisitions in the first half of fiscal 2012 compared to the first half of fiscal 2011. Cash used for financing activities for the first six months of fiscal 2012 was up by $4.0 million due to higher amounts of funds used to repurchase our common stock during the first half of fiscal 2012 compared to the first half of fiscal 2011.

Credit Lines and Other Capital Resources. Our businesses are seasonal, with accounts receivable balances historically increasing between January and April as a result of higher sales volumes and extended payment terms made available to our customers, and decreasing between May and December when payments are received. The seasonality of production and shipments causes our working capital requirements to fluctuate during the year. Seasonal cash requirements are financed from operations, cash on hand, and with short-term financing arrangements, including our $150.0 million unsecured senior revolving credit facility that expires in July 2015. Included in our $150.0 million revolving credit facility is a sublimit for standby letters of credit and a 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 unsecured short-term lines of credit in the aggregate amount of approximately $6.3 million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. As of May 4, 2012, we had no outstanding short-term debt under our credit facilities and an aggregate of $9.4 million of outstanding letters of credit. As of May 4, 2012, we had an aggregate of $146.8 million of unutilized availability under our credit agreements.

The revolving credit facility contains standard covenants, including, without limitation, financial covenants, such as the maintenance of minimum interest coverage and maximum debt to earnings ratios; and negative covenants, which among other things, limit loans and investments, disposition of assets, consolidations and mergers, transactions with affiliates, restricted payments, contingent obligations, liens and other matters customarily restricted in such agreements. Most of these restrictions are subject to certain minimum thresholds and exceptions. Under the revolving credit facility, we are not limited to 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 2.75; however, we are limited to $50 million per fiscal year if our debt to EBITDA ratio from the previous quarter compliance certificate is greater than 2.75. As of May 4, 2012, we were not limited to payments of cash dividends and stock repurchases as our debt to EBITDA ratio was below 2.75. We were also in compliance with all covenants related to our credit agreement for our revolving credit facility as of May 4, 2012, and we expect to be in compliance with all covenants during the remainder of fiscal 2012. If we were out of compliance with any debt covenant required by this credit agreement following the applicable cure period, the banks could terminate their commitments unless we could negotiate a covenant waiver from the banks. In addition, our long-term senior notes and debentures could become due and payable if we were unable to obtain a covenant waiver or refinance our short-term debt under our credit agreement. If our credit rating falls below investment grade and/or our average debt to EBITDA ratio rises above 2.00, the basis point spread over LIBOR (or other rates quoted by the Administrative Agent, Bank of America, N.A.) we currently pay on our outstanding short-term debt under the credit agreement would increase. However, the credit commitment could not be cancelled by the banks based solely on a ratings downgrade. Our debt rating for long-term unsecured senior, non-credit enhanced debt was unchanged during the second quarter of fiscal 2012 by Moody s Investors Service at Baa3. On April 30, 2012, Standard and Poor s Ratings Group raised our credit and senior unsecured debt rating from BBB- to BBB.

Customer Financing Arrangements and Contractual Obligations

In fiscal 2009, we established our Red Iron joint venture with TCFIF. The purpose of Red Iron is to provide inventory financing, including floor plan and open account receivable financing, to distributors and dealers of our products in the U.S. and to select distributors of our products in Canada to enable our distributors and dealers to carry representative inventories of our products. Some independent international dealers continue to finance their products with a third party finance company. This third party financing company purchased $12.9 million of receivables from us during the first six months of fiscal 2012. As of May 4, 2012, $8.0 million of receivables financed by the third party financing company, excluding Red Iron, were outstanding, and also includes outstanding receivables that were financed by third party sources before the establishment of Red Iron. See our most recently filed Annual Report on Form 10-K for further details regarding our customer financing arrangements and contractual obligations.

Inflation

We are subject to the effects of inflation, deflation, and changing prices. In the first six months of fiscal 2012, average prices paid for commodities and components we purchase were higher compared to the average prices paid for commodities and components in the first six months of fiscal 2011, which hampered our gross margin rate in the first half of fiscal 2012 compared to the first half of fiscal 2011. We will continue to closely follow the commodities and components that affect our product lines, and we anticipate average prices paid for commodities and components to be higher for the remainder of fiscal 2012 as compared to fiscal 2011. We expect to mitigate the impact of inflationary pressures by engaging in proactive vendor negotiations, reviewing alternative sourcing options, substituting materials, engaging in internal cost reduction efforts, and increasing prices on some of our products, all as appropriate.

Critical Accounting Policies and Estimates

See our most recent Annual Report on Form 10-K for the fiscal year ended October 31, 2011 for a discussion of our critical accounting policies.

Table of Contents

New Accounting Pronouncements to be Adopted

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. ASU No. 2011-05 guidance amended the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and is to be applied retrospectively. We will adopt this guidance at the beginning of our fiscal 2013 first quarter, as required. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. ASU No. 2011-11 requires entities to disclose gross and net information about both instruments and transactions eligible for offset in the statement of financial position and those subject to an agreement similar to a master netting arrangement. This would include derivatives and other financial securities arrangements. We will adopt this guidance in our first quarter of fiscal year 2014, as required. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. ASU No. 2011-12 defers the changes in ASU No. 2011-05 of the requirement to present separate line items on the income statement for reclassification adjustments of items out of AOCI into net income. The effective dates for ASU No. 2011-12 are consistent with the effective dates for ASU No. 2011-05 and, similar to our expectations for the adoption of ASU No. 2011-05, we do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

No other new accounting pronouncement that has been issued but not yet effective for us during the second quarter of fiscal 2012 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, and Section 21E of the Securities Exchange Act of 1934, as amended, and that are subject to the safe harbor created by those sections. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or web casts open to the public, in press releases or reports, on our web sites, or otherwise. Statements that are not historical are forward-looking and reflect expectations and assumptions. We try to identify forward-looking statements in this report and elsewhere by using words such as expect, strive, looking ahead, outlook, forecast, optimistic, plan, anticipate, continue, estimate, believe, could, should, will, would, may, possible, likely, intend, and similar expressions and by using future dates. Our forward-looking statements generally relate to our future performance, including our anticipated operating results, 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. These risks and uncertainties include factors that affect all businesses operating in a global market as well as matters specific to Toro. The following are some of the factors known to us that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements:

- Economic conditions and outlook in the United States and 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 state debt and sovereign debt defaults 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; 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 may reduce demand for some of our products and adversely affect our net sales and operating results, or affect the timing of demand for some of our products and may adversely affect net sales and operating results in subsequent periods.

Table of Contents

- 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, fuel, 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 our profit margins and business.

- Our professional segment net sales are dependent upon golf course revenues and the amount of investment in golf course renovations and improvements; the level of new golf course development and golf course closures; the level of homeowners who outsource their lawn care; the level of residential and commercial construction; availability of credit to professional segment customers on acceptable terms to finance new product purchases; and the amount of government revenues, budget, and spending levels for grounds maintenance equipment; and other factors.

- Our residential segment net sales are dependent upon mass retailers and home centers, such as The Home Depot, Inc. as a major customer, the amount of product placement at retailers, consumer confidence and spending levels, and changing buying patterns of customers.

- 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. For example, late in fiscal 2011, we completed the construction of our new manufacturing facility in Romania. Our international operations also require significant management attention and financial resources, expose us to difficulties presented by international economic, political, legal, accounting, and business factors; including political, economic and/or social instability in the countries in which we sell products resulting in contraction or disruption of such markets; and may not be successful or produce desired levels of net sales. 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.

- Fluctuations in foreign currency exchange rates could result in declines in our reported net sales and net earnings.

- Our business, properties, and products are subject to governmental regulation with which compliance may require us to incur expenses or modify our products or operations and non-compliance may expose us to penalties. Governmental regulation may also adversely affect the demand for some of our products and our operating results. The United States Environmental Protection Agency has adopted increasingly stringent engine emission regulations, including Tier 4 emission requirements, that beginning in 2012, are applicable to diesel engines in a specified horsepower range that are used in some of our products. Although we have developed plans to achieve substantial compliance with Tier 4 requirements, these plans are subject to many variables including, among others, the inability of our suppliers to provide compliant engines on a timely basis or our inability to complete the necessary engineering and testing 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 are able to pass along costs we incurred related to research, development, engineering, and other costs to design Tier 4 compliant products in the form of prices increases to our customers and/or our competitors implement different strategies with respect to compliance with Tier 4 requirements, we may experience lower market demand for our products that may, ultimately, adversely affect our profit margins, net sales, and overall financial results. Additionally, if our customers buying patterns change to purchasing our products in advance of price increases on compliant products, we may experience abnormal fluctuation in sales and our financial results of any one period may not be representative of expected financial results in subsequent periods.

- 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.

- 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, open and manage new facilities, including our new distribution facility near Des Moines, Iowa, and/or move production between manufacturing facilities could adversely affect our business and operating results. In late fiscal 2011, we completed the construction of our new manufacturing facility in Romania for micro-irrigation products. If this facility does not produce the anticipated manufacturing or operational efficiencies, or if the micro-irrigation products to be produced at this facility are not accepted into the new

Table of Contents

geographic markets at expected levels, we may not recover the costs of the new facility and our operating results may be adversely affected.

- We intend to grow our business in part through additional acquisitions and alliances, stronger customer relations, and new joint ventures and partnerships, 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.

- We rely on our management information systems for inventory management, distribution, and other key functions. If our information systems fail to adequately perform these functions, or if we experience an interruption in their operation, our business and operating results could be adversely affected.

- We face intense competition in all of our product lines with numerous manufacturers, including from some competitors that have larger operations and greater financial resources than us. We may not be able to compete effectively against competitors actions, which could harm our business and operating results.

- We are subject to product liability claims, product quality issues, and other litigation from time to time that could adversely affect our operating results or financial condition.

- If we are unable to retain our key employees, and attract and retain other qualified personnel, we may not be able to meet strategic objectives and our business could suffer.

- As a result of our financing joint venture with TCFIF, we are dependent upon the joint venture to provide competitive inventory financing programs, including floor plan and open account receivable financing, to certain distributors and dealers of our products. Any material change in the availability or terms of credit offered to our customers by the joint venture, any termination or disruption of our joint venture relationship or any delay in securing replacement credit sources could adversely affect our net sales and operating results.

- The terms of our credit arrangements and the indentures governing our senior notes and debentures could limit our ability to conduct our business, take advantage of business opportunities, and respond to changing business, market, and economic conditions. Additionally, we are subject to counterparty risk in our credit arrangements. If we are unable to comply with the terms of our credit arrangements and indentures, especially the financial covenants, our credit arrangements could be terminated and our senior notes and debentures could become due and payable.

- Legislative enactments could impact the competitive landscape within our markets and affect demand for our products.

- Our business is subject to a number of other factors that may adversely affect our operating results, financial condition, or business, such as: our ability to achieve the revenue growth, operating earnings, and employee engagement goals of our multi-year employee initiative called Destination 2014 ; natural or man-made disasters or global pandemics that may result in shortages of raw materials and components, higher fuel and commodity costs, and an increase in insurance premiums; financial difficulties and viability of our distributors and dealers, changes in distributor ownership, changes in channel distribution of our products, relationships with our distribution channel partners, our success in partnering with new dealers, and our customers ability to pay amounts owed to us; ability of management to adapt to unplanned events; drug cartel-related violence, which may disrupt our production activities and maquiladora operations based in Juarez, Mexico; and continued threat of terrorist acts and war that may result in heightened security and higher costs for import and export shipments of components or finished goods, reduced leisure travel, and contraction of the U.S. and world economies.

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

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

Table of Contents

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Rate Risk. In the normal course of business, we actively manage the exposure of our foreign currency exchange rate market risk by entering into various hedging instruments, authorized under company policies that place controls on these activities, with counterparties that are highly rated financial institutions. Our hedging activities involve the primary use of forward currency contracts. We 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 Yuan, the Romanian New Lei against the U.S. dollar, as well as the Romanian New Lei against the Euro.

We enter into various contracts, principally forward contracts that change in value as foreign currency exchange rates change, to protect the value of existing foreign currency assets, liabilities, anticipated sales, and probable commitments. Decisions on 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 2012 and 2013. All items are non-trading and stated in U.S. dollars. Some derivative instruments we enter into do not meet the cash flow hedging criteria; therefore, changes in fair value are recorded in other income, net. The average contracted rate, notional amount, pre-tax value of derivative instruments in accumulated other comprehensive loss, and fair value impact of derivative instruments in other income, net as of and for the fiscal period ended May 4, 2012 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	1.0064	$ 35,507.2	$ 103.3	$ (1,599.1)
Buy US dollar/Sell Canadian dollar	0.9700	5,051.5	169.0	143.6
Buy US dollar/Sell Euro	1.3707	60,995.9	1,578.2	3,209.8
Buy US dollar/Sell British pound	1.6188	5,827.5		(4.2)
Buy Euro/Sell US dollar	1.3158	6,460.0		118.8
Buy Mexican peso/Sell US dollar	13.1153	25,390.2	(316.8)	(348.3)

Buy Euro/Sell Romanian New Lei	4.4281	22,206.0	(325.8)
Buy British pound/Sell Euro	0.8121	9,078.8	2.8

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

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

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

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

Item 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we are required to apply our judgment in evaluating the cost-benefit relationship of possible internal controls. Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered in this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of such period to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. There was no change in our internal control over financial reporting that occurred during our fiscal quarter ended May 4, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are a party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive as well as compensatory damages arising out of use of our products. Although we are self-insured to some extent, we maintain insurance against certain product liability losses. We are also subject to 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 patent infringement.

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

Table of Contents

Item 1A. RISK FACTORS

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

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table shows our second quarter of fiscal 2012 stock repurchase activity.

Period	Total Number of Shares (or Units) Purchased (1,2,3)		Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased As Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
February 4, 2012 through March 2, 2012	25,702	$	67.00	25,702	1,917,699
March 3, 2012 through March 30, 2012	137,304		69.91	137,304	1,780,395
March 31, 2012 through May 4, 2012	564,204		70.75	563,700	1,216,695
Total	727,210	$	70.46	726,706	

(1) On December 1, 2010, the company s Board of Directors authorized the repurchase of 3,000,000 shares of the company s common stock in open-market or in privately negotiated transactions. This program has no expiration date but may be terminated by the company s Board of Directors at any time. The company repurchased an aggregate of 726,706 shares during the period indicated above under this program.

(2) Includes five 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 equity and incentive plan. These five shares were not repurchased under the company s repurchase program described in footnote 1 above.

(3) Includes 499 units (shares) of the company s common stock purchased in open-market transactions at an average price of $71.13 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 499 shares were not repurchased under the company s repurchase program described in footnote 1 above.

Item 5. OTHER INFORMATION

On June 6, 2012, we (and/or one or more of our wholly owned subsidiaries), TCFIF (and/or one or more of its wholly owned subsidiaries) and Red Iron entered into amendments to certain of the agreements pertaining to our Red Iron joint venture, including: (i) a First Amendment to Agreement to Form Joint Venture between us and TCFIF; (ii) a Second Amendment to Limited Liability Company Agreement of Red Iron between Red Iron Holding Corporation, a Delaware corporation and our wholly-owned subsidiary, and TCFIF Joint Venture I, LLC, a Minnesota limited liability company and wholly owned subsidiary of TCFIF; (iii) a First Amendment to Credit and Security Agreement between TCFIF, as lender, and Red Iron, as borrower; and (iv) a Second Amendment to Second Amended and Restated Repurchase Agreement (Two Step) between us and Red Iron.

The purpose of these amendments is, among other things, to: (i) extend the initial term of Red Iron from October 31, 2014 to October 31, 2017, subject to unlimited automatic two-year extensions thereafter; (ii) provide for an additional incentive payment by TCFIF to us; (iii) remove the restriction that TCFIF and its affiliates may not enter into any joint venture or similar jointly

Table of Contents

owned business relationship for the purpose of operating a wholesale finance business in the United States or Canada to support the financing of certain lawn and garden products, or otherwise providing financing, working capital or similar loan facilities to dealers or distributors of any manufacturer of certain lawn and garden products in the United States or Canada; and (iv) require that TCFIF and its affiliates will not, during the term of Red Iron, provide financing to any entity owned in part by TCFIF or its affiliates for the purpose of operating a wholesale finance business in the United States or Canada to support the financing of certain lawn and garden products at a non-default interest rate that is lower than the rate provided by TCFIF to Red Iron.

The foregoing description is a summary of the material terms of the amendments, does not purport to be complete and is qualified in its entirety by reference to the complete text of the amendments, copies of which are filed as Exhibits 2.1, 2.2, 2.3 and 10.1 to this Quarterly Report on Form 10-Q and are incorporated herein by reference.

Item 6. EXHIBITS

(a) Exhibits

2.1 (1)	First Amendment to Agreement to Form Joint Venture, dated June 6, 2012, by and between The Toro Company and TCF Inventory Finance, Inc. (filed herewith).
2.2	Second Amendment to Limited Liability Company Agreement of Red Iron Acceptance, LLC, dated June 6, 2012, by and between Red Iron Holding Corporation and TCFIF Joint Venture I, LLC (filed herewith).
2.3	Second Amendment to Second Amended and Restated Repurchase Agreement (Two Step), dated June 6, 2012, by and between The Toro Company and Red Iron Acceptance, LLC (filed herewith).
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	Amended and Restated Bylaws of The Toro Company (incorporated by reference to Exhibit 3.2 to Registrant s Current Report on Form 8-K dated June 17, 2008, Commission File No. 1-8649).
4.3	Specimen Form of Common Stock Certificate (incorporated by reference to Exhibit 4(c) to Registrant s Quarterly Report on Form 10-Q for the fiscal quarter ended August 1, 2008, Commission File No. 1-8649).
4.4	Indenture dated as of January 31, 1997, between Registrant and First National Trust Association, as Trustee, relating to The Toro Company s 7.80% Debentures due June 15, 2027 (incorporated by reference to Exhibit 4(a) to Registrant s Current Report on Form 8-K dated June 24, 1997, Commission File No. 1-8649).
4.5	Indenture dated as of April 20, 2007, between Registrant and The Bank of New York Trust Company, N.A., as Trustee, relating to The Toro Company s 6.625% Notes due May 1, 2037 (incorporated by reference to Exhibit 4.3 to Registrant s Registration Statement on Form S-3 filed with the Securities and Exchange Commission on April 23, 2007, Registration No. 333-142282).
4.6	First Supplemental Indenture dated as of April 26, 2007, between Registrant and The Bank of New York Trust Company, N.A., as Trustee, relating to The Toro Company s 6.625% Notes due May 1, 2037 (incorporated by reference to Exhibit 4.1 to Registrant s Current Report on Form 8-K dated April 23, 2007, Commission File No. 1-8649).
4.7	Form of The Toro Company 6.625% Note due May 1, 2037 (incorporated by reference to Exhibit 4.2 to Registrant s Current Report on Form 8-K dated April 23, 2007, Commission File No. 1-8649).

10.1 (1)	First Amendment to Credit and Security Agreement, dated June 6, 2012, by and between Red Iron Acceptance, LLC and TCF Inventory Finance, Inc. (filed herewith).
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 May 4, 2012, filed with the SEC on June 8, 2012, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Earnings for the three and six-month periods ended May 4, 2012 and April 29, 2011, (ii) Condensed Consolidated Balance Sheets as of May 4, 2012, April 29, 2011, and October 31, 2011, (iii) Condensed Consolidated Statement of Cash Flows for the three and six-month periods ended May 4, 2012 and April 29, 2011, and (iv) Notes to Condensed Consolidated Financial Statements.**

(1) Portions of this exhibit have been redacted and are subject to a confidential treatment request filed with the Secretary of the Securities and Exchange Commission Pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended. The redacted material is being filed separately with the Securities and Exchange Commission.

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

Table of Contents

SIGNATURES

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

THE TORO COMPANY
(Registrant)

Date: June 8, 2012	By	/s/ Renee J. Peterson
	Renee J. Peterson Vice President, Finance and Chief Financial Officer (duly authorized officer and principal financial officer)	