

TORO CO  
Form 10-Q  
September 08, 2017  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended August 4, 2017

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

THE TORO COMPANY

(Exact name of registrant as specified in its charter)

Delaware 1-8649 41-0580470  
(State of Incorporation) (Commission File Number) (I.R.S. Employer Identification Number)

8111 Lyndale Avenue South  
Bloomington, Minnesota 55420  
Telephone Number: (952) 888-8801  
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Edgar Filing: TORO CO - Form 10-Q

Exchange Act.

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

The number of shares of the registrant's common stock outstanding as of August 31, 2017 was 107,768,170.

---

Table of Contents

THE TORO COMPANY  
INDEX TO FORM 10-Q

	Page Number
<u>PART I. FINANCIAL INFORMATION:</u>	
<u>Item 1. Financial Statements</u>	
<u>Condensed Consolidated Statements of Earnings (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>6</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>18</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>28</u>
<u>Item 4. Controls and Procedures</u>	<u>30</u>
<u>PART II. OTHER INFORMATION:</u>	
<u>Item 1. Legal Proceedings</u>	<u>30</u>
<u>Item 1A. Risk Factors</u>	<u>30</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>31</u>
<u>Item 5. Other Information</u>	<u>31</u>
<u>Item 6. Exhibits</u>	<u>32</u>
<u>Signatures</u>	<u>33</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## THE TORO COMPANY AND SUBSIDIARIES

## Condensed Consolidated Statements of Earnings (Unaudited)

(Dollars and shares in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	August 4, 2017	July 29, 2016	August 4, 2017	July 29, 2016
Net sales	\$627,943	\$600,980	\$2,016,549	\$1,923,819
Cost of sales	401,158	384,363	1,279,970	1,221,361
Gross profit	226,785	216,617	736,579	702,458
Selling, general, and administrative expense	139,001	134,664	428,929	411,576
Operating earnings	87,784	81,953	307,650	290,882
Interest expense	(4,750 )	(4,646 )	(14,309 )	(14,021 )
Other income, net	5,349	3,480	12,916	11,865
Earnings before income taxes	88,383	80,787	306,257	288,726
Provision for income taxes	19,979	24,965	72,388	87,962
Net earnings	\$68,404	\$55,822	\$233,869	\$200,764
Basic net earnings per share of common stock	\$0.63	\$0.51	\$2.16	\$1.83
Diluted net earnings per share of common stock	\$0.61	\$0.50	\$2.10	\$1.79
Weighted-average number of shares of common stock outstanding — Basic	108,456	109,966	108,434	109,946
Weighted-average number of shares of common stock outstanding — Diluted	111,457	112,112	111,460	112,154

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective September 16, 2016.

See accompanying Notes to Condensed Consolidated Financial Statements.

## THE TORO COMPANY AND SUBSIDIARIES

## Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)

	Three Months Ended		Nine Months Ended	
	August 4, 2017	July 29, 2016	August 4, 2017	July 29, 2016
Net earnings	\$68,404	\$55,822	\$233,869	\$200,764
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	12,300	(5,753 )	13,017	(4,803 )
Cash flow derivative instruments, net of tax of \$(2,262), \$652, \$(2,236), and \$(1,000), respectively	(3,062 )	667	(1,100 )	(1,925 )

Edgar Filing: TORO CO - Form 10-Q

Other comprehensive income (loss)	9,238	(5,086 )	11,917	(6,728 )
Comprehensive income	\$77,642	\$50,736	\$245,786	\$194,036

See accompanying Notes to Condensed Consolidated Financial Statements.

3

---

Table of Contents

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

	August 4, 2017	July 29, 2016	October 31, 2016
<b>ASSETS</b>			
Cash and cash equivalents	\$335,026	\$277,243	\$273,555
Receivables, net	221,551	202,389	163,265
Inventories, net	349,022	327,114	307,034
Prepaid expenses and other current assets	42,550	39,658	35,155
Total current assets	948,149	846,404	779,009
Property, plant, and equipment, gross	890,585	833,664	838,036
Less accumulated depreciation	663,659	612,788	615,998
Property, plant, and equipment, net	226,926	220,876	222,038
Long-term deferred income taxes	59,754	65,216	57,228
Other assets	25,779	26,148	23,422
Goodwill	202,678	195,016	194,782
Other intangible assets, net	106,258	110,785	108,093
Total assets	\$1,569,544	\$1,464,445	\$1,384,572
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
Current portion of long-term debt	\$23,056	\$22,627	\$22,484
Accounts payable	211,453	172,156	174,668
Accrued liabilities	309,385	318,628	266,687
Total current liabilities	543,894	513,411	463,839
Long-term debt, less current portion	308,793	331,641	328,477
Deferred revenue	24,964	11,958	11,830
Other long-term liabilities	31,971	29,585	30,391
Stockholders' equity:			
Preferred stock, par value \$1.00 per share, authorized 1,000,000 voting and 850,000 non-voting shares, none issued and outstanding	—	—	—
Common stock, par value \$1.00 per share, authorized 175,000,000 shares; issued and outstanding 107,883,039 shares as of August 4, 2017, 109,289,956 shares as of July 29, 2016, and 108,427,393 shares as of October 31, 2016	107,883	109,290	108,427
Retained earnings	578,558	505,131	480,044
Accumulated other comprehensive loss	(26,519)	(36,571)	(38,436)
Total stockholders' equity	659,922	577,850	550,035
Total liabilities and stockholders' equity	\$1,569,544	\$1,464,445	\$1,384,572

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective September 16, 2016.

See accompanying Notes to Condensed Consolidated Financial Statements.



Table of Contents

## THE TORO COMPANY AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Nine Months Ended	
	August 4, 2017	July 29, 2016
Cash flows from operating activities:		
Net earnings	\$233,869	\$200,764
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Non-cash income from finance affiliate	(7,566 )	(7,302 )
Provision for depreciation, amortization, and impairment loss	47,713	46,332
Stock-based compensation expense	9,691	7,723
Provision for deferred income taxes	(2,121 )	256
Other	71	(464 )
Changes in operating assets and liabilities, net of effect of acquisitions:		
Receivables, net	(54,935 )	(23,699 )
Inventories, net	(34,069 )	3,428
Prepaid expenses and other assets	(7,625 )	(2,108 )
Accounts payable, accrued liabilities, deferred revenue, and other long-term liabilities	86,991	79,055
Net cash provided by operating activities	272,019	303,985
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(36,572 )	(34,601 )
Proceeds from asset disposals	74	232
Distributions from finance affiliate, net	4,617	3,594
Proceeds from sale of a business	—	1,500
Acquisition, net of cash acquired	(24,181 )	—
Net cash used in investing activities	(56,062 )	(29,275 )
Cash flows from financing activities:		
Repayments of short-term debt	—	(1,161 )
Repayments of long-term debt	(19,158 )	(20,713 )
Proceeds from exercise of stock options	9,756	19,691
Purchases of Toro common stock	(96,059 )	(69,189 )
Dividends paid on Toro common stock	(56,926 )	(49,488 )
Net cash used in financing activities	(162,387 )	(120,860 )
Effect of exchange rates on cash and cash equivalents	7,901	(2,882 )
Net increase in cash and cash equivalents	61,471	150,968
Cash and cash equivalents as of the beginning of the fiscal period	273,555	126,275
Cash and cash equivalents as of the end of the fiscal period	\$335,026	\$277,243

See accompanying Notes to Condensed Consolidated Financial Statements.



Table of Contents

THE TORO COMPANY AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

August 4, 2017

Note 1 — Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and do not include all the information and notes required by United States generally accepted accounting principles (“U.S. GAAP”) for complete financial statements. Unless the context indicates otherwise, the terms “company,” “Toro,” “we,” “our” or “us” refer to The Toro Company and its consolidated subsidiaries. All intercompany accounts and transactions have been eliminated from the unaudited Condensed Consolidated Financial Statements.

In the opinion of management, the unaudited Condensed Consolidated Financial Statements include all adjustments, consisting primarily of recurring accruals, considered necessary for the fair presentation of the company's financial position, results of operations, and cash flows for the periods presented. Since the company's business is seasonal, operating results for the nine months ended August 4, 2017 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2017.

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

For further information, refer to the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in the company's Annual Report on Form 10-K for the fiscal year ended October 31, 2016. The policies described in that report are used for preparing quarterly reports.

Accounting Policies

In preparing the Condensed Consolidated Financial Statements in conformity with U.S. GAAP, management must make decisions that impact the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures, including disclosures of contingent assets and liabilities. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. Estimates are used in determining, among other items, sales promotion and incentive accruals, incentive compensation accruals, income tax accruals, inventory valuation, warranty reserves, earn-out liabilities, allowance for doubtful accounts, pension and post-retirement accruals, self-insurance accruals, useful lives for tangible and definite-lived intangible assets, and future cash flows associated with impairment testing for goodwill, indefinite-lived intangible assets and other long-lived assets. These estimates and assumptions are based on management's best estimates and judgments at the time they are made. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances, including the current economic environment. Management adjusts such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with certainty, actual amounts could differ significantly from those estimated at the time the Condensed Consolidated Financial Statements are prepared. Changes in those estimates will be reflected in the Consolidated Financial Statements in future periods.

Note 2 — Acquisition

Effective January 1, 2017, during the first quarter of fiscal 2017, the company completed the acquisition of all the outstanding shares of Regnerbau Calw GmbH ("Perrot"), a privately held manufacturer of professional irrigation equipment. The addition of these products broadens and strengthens the company's irrigation solutions for the sport, agricultural, and industrial markets. The acquisition was funded with existing foreign cash and cash equivalents.

The purchase price of this acquisition was allocated to the identifiable assets acquired and liabilities assumed based on estimates of their fair value, with the excess purchase price recorded as goodwill. As of August 4, 2017, the company has not yet finalized the purchase accounting for the acquisition, but expects to finalize such purchase accounting in the fourth quarter of fiscal 2017. This acquisition was immaterial based on the company's consolidated financial condition and results of operations.

#### Note 3 — Investment in Joint Venture

In fiscal 2009, the company and TCF Inventory Finance, Inc. ("TCFIF"), a subsidiary of TCF National Bank, established Red Iron Acceptance, LLC ("Red Iron"), a joint venture in the form of a Delaware limited liability company that primarily provides

Table of Contents

inventory financing to certain distributors and dealers of the company's products in the United States. On November 29, 2016, during the first quarter of fiscal 2017, the company entered into amended agreements for its Red Iron joint venture with TCFIF. As a result, the amended term of Red Iron will continue until October 31, 2024, subject to two-year extensions thereafter. Either the company or TCFIF may elect not to extend the amended term, or any subsequent term, by giving one-year written notice to the other party.

The company owns 45 percent of Red Iron and TCFIF owns 55 percent of Red Iron. The company accounts for its investment in Red Iron under the equity method of accounting. The company and TCFIF each contributed a specified amount of the estimated cash required to enable Red Iron to purchase the company's inventory financing receivables and to provide financial support for Red Iron's inventory financing programs. Red Iron borrows the remaining requisite estimated cash utilizing a \$550 million secured revolving credit facility established under a credit agreement between Red Iron and TCFIF. The company's total investment in Red Iron as of August 4, 2017 was \$21.7 million. The company has not guaranteed the outstanding indebtedness of Red Iron. The company has agreed to repurchase products repossessed by Red Iron and the TCFIF Canadian affiliate, up to a maximum aggregate amount of \$7.5 million in a calendar year.

Under the repurchase agreement between Red Iron and the company, Red Iron provides financing for certain dealers and distributors. These transactions are structured as an advance in the form of a payment by Red Iron to the company on behalf of a distributor or dealer with respect to invoices financed by Red Iron. These payments extinguish the obligation of the dealer or distributor to make payment to the company under the terms of the applicable invoice. Under separate agreements between Red Iron and the dealers and distributors, Red Iron provides loans to the dealers and distributors for the advances paid by Red Iron to the company. The net amount of receivables financed for dealers and distributors under this arrangement for the nine months ended August 4, 2017 and July 29, 2016 were \$1,466.5 million and \$1,389.5 million, respectively.

As of July 31, 2017, Red Iron's total assets were \$428.9 million and total liabilities were \$380.8 million.

## Note 4 — Inventories

Inventories are valued at the lower of cost or net realizable value, with cost determined by the last-in, first-out ("LIFO") method for most inventories and first-in, first-out ("FIFO") method for all other inventories. The company establishes a reserve for excess, slow-moving, and obsolete inventory that is equal to the difference between the cost and estimated net realizable value for that inventory. These reserves are based on a review and comparison of current inventory levels to the planned production, as well as planned and historical sales of the inventory.

Inventories were as follows:

	August 4, July 29,		October 31,
(Dollars in thousands)	2017	2016	2016
Raw materials and work in process	\$88,440	\$88,581	\$ 90,463
Finished goods and service parts	318,940	302,573	274,929
Total FIFO value	407,380	391,154	365,392
Less: Adjustment to LIFO value	58,358	64,040	58,358
Total inventories, net	\$349,022	\$327,114	\$ 307,034

## Note 5 — Goodwill and Other Intangible Assets

The changes in the net carrying amount of goodwill for the first nine months of fiscal 2017 were as follows:

(Dollars in thousands)	Professional Segment	Residential Segment	Total
------------------------	----------------------	---------------------	-------

Edgar Filing: TORO CO - Form 10-Q

Balance as of October 31, 2016	\$ 184,338	\$ 10,444	\$ 194,782
Goodwill acquired	6,678	—	6,678
Translation adjustments	1,080	138	1,218
Balance as of August 4, 2017	\$ 192,096	\$ 10,582	\$ 202,678

7

---

Table of Contents

The components of other intangible assets as of August 4, 2017 were as follows:

(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$ 15,155	\$ (11,419 )	\$ 3,736
Non-compete agreements	6,890	(6,764 )	126
Customer-related	87,507	(17,812 )	69,695
Developed technology	30,232	(26,180 )	4,052
Trade names	30,096	(5,889 )	24,207
Other	800	(800 )	—
Total amortizable	170,680	(68,864 )	101,816
Non-amortizable - trade names	4,442	—	4,442
Total other intangible assets, net	\$ 175,122	\$ (68,864 )	\$ 106,258

The components of other intangible assets as of October 31, 2016 were as follows:

(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$ 15,151	\$ (10,866 )	\$ 4,285
Non-compete agreements	6,886	(6,681 )	205
Customer-related	84,353	(14,434 )	69,919
Developed technology	28,648	(23,712 )	4,936
Trade names	28,715	(4,235 )	24,480
Other	800	(800 )	—
Total amortizable	164,553	(60,728 )	103,825
Non-amortizable - trade names	4,268	—	4,268
Total other intangible assets, net	\$ 168,821	\$ (60,728 )	\$ 108,093

Amortization expense for intangible assets during the third quarter of fiscal 2017 was \$2.5 million, compared to \$2.5 million for the same period last fiscal year. Amortization expense for intangible assets during the first nine months of fiscal 2017 was \$7.4 million, compared to \$8.1 million for the same period last fiscal year. Estimated amortization expense for the remainder of fiscal 2017 and succeeding fiscal years is as follows: fiscal 2017 (remainder), \$2.4 million; fiscal 2018, \$8.0 million; fiscal 2019, \$7.1 million; fiscal 2020, \$6.6 million; fiscal 2021, \$6.2 million; fiscal 2022, \$6.1 million; and after fiscal 2022, \$65.4 million.

#### Note 6 — Stockholders' Equity

##### Accumulated Other Comprehensive Loss

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

(Dollars in thousands)	August 4, 2017	July 29, 2016	October 31, 2016
Foreign currency translation adjustments	\$ 18,089	\$ 29,636	\$ 31,430
Pension and post-retirement benefits	6,683	4,881	6,359
Cash flow derivative instruments	1,747	2,054	647
Total accumulated other comprehensive loss	\$ 26,519	\$ 36,571	\$ 38,436



Table of Contents

The components and activity of AOCL for the first nine months of fiscal 2017 are as follows:

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Post-retirement Benefits	Cash Flow Derivative Instruments	Total
Balance as of October 31, 2016	\$ 31,430	\$ 6,359	\$ 647	\$38,436
Other comprehensive loss (income) before reclassifications	(13,341 )	324	2,092	(10,925 )
Amounts reclassified from AOCL	—	—	(992 )	(992 )
Net current period other comprehensive loss (income)	(13,341 )	324	1,100	(11,917 )
Balance as of August 4, 2017	\$ 18,089	\$ 6,683	\$ 1,747	\$26,519

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

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

For additional information on the components reclassified from AOCL refer to Note 12, Derivative Instruments and Hedging Activities.

#### Note 7 — Stock-Based Compensation

##### Stock Option Awards

Under The Toro Company Amended and Restated 2010 Equity and Incentive Plan, as amended and restated (the “2010 plan”), stock options are granted with an exercise price equal to the closing price of the company’s common stock on the date of grant, as reported by the New York Stock Exchange. Options are generally granted to executive officers, other employees, and non-employee members of the company’s Board of Directors on an annual basis in the first quarter of the company’s fiscal year. Options generally vest one-third each year over a three-year period and have a ten-year term. Other options granted to certain employees vest in full on the three-year anniversary of the date of grant and have a ten-year term. Compensation expense equal to the grant date fair value is generally recognized for these awards over the vesting period. Stock options granted to executive officers and other employees are subject to accelerated expensing if the option holder meets the retirement definition set forth in the 2010 plan. In that case, the fair value of the options is expensed in the fiscal year of grant because generally the option holder must be employed as of the end of the fiscal year in which the options are granted in order for the options to continue to vest following retirement. Similarly, if a non-employee director has served on the company’s Board of Directors for ten full fiscal years or more, the awards vest immediately upon retirement, and therefore, the fair value of the options granted is fully expensed on the date of the grant.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes valuation method with the assumptions noted in the table below. The expected life is a significant assumption as it determines the period for which the risk-free interest rate, volatility, and dividend yield must be applied. The expected life is the average length of time in which executive officers, other employees, and non-employee directors are expected to exercise their stock options, which is primarily based on historical experience. Separate groups of employees and non-employee directors that have similar historical exercise behavior are considered separately for valuation purposes. Expected volatilities are based on the movement of the company’s common stock over the most recent historical period equivalent to the

expected life of the option. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate over the expected life at the time of grant. Dividend yield is estimated over the expected life based on the company's historical cash dividends paid, expected future cash dividends and dividend yield, and expected changes in the company's stock price.



Table of Contents

The following table illustrates the weighted-average valuation assumptions for options granted in the following fiscal periods:

	Fiscal 2017	Fiscal 2016
Expected life of option in years	6.02	5.97
Expected stock price volatility	22.15%	24.04%
Risk-free interest rate	2.03%	1.80%
Expected dividend yield	1.01%	1.24%
Weighted-average fair value at date of grant	\$12.55	\$8.79

## Performance Share Awards

Under the 2010 Plan, the company grants performance share awards to executive officers and other employees under which they are entitled to receive shares of the company's common stock contingent on the achievement of performance goals of the company and businesses of the company, which are generally measured over a three-year period. The number of shares of common stock a participant receives will be increased (up to 200 percent of target levels) or reduced (down to zero) based on the level of achievement of performance goals and vest at the end of a three-year period. Performance share awards are generally granted on an annual basis in the first quarter of the company's fiscal year. Compensation expense is recognized for these awards on a straight-line basis over the vesting period based on the per share fair value as of the date of grant and the probability of achieving each performance goal. The per share fair value of performance share awards granted during the first quarter of fiscal 2017 and 2016 was \$54.52 and \$38.89, respectively. No performance shares awards were granted during the second or third quarter of fiscal 2017 or 2016.

## Restricted Stock and Restricted Stock Unit Awards

Under the 2010 plan, restricted stock and restricted stock unit awards are generally granted to certain employees that are not executive officers. Occasionally, restricted stock or restricted stock unit awards may be granted, including to executive officers, in connection with hiring, mid-year promotions, leadership transition, or retention. Restricted stock and restricted stock unit awards generally vest one-third each year over a three-year period, or vest in full on the three-year anniversary of the date of grant. Such awards may have performance-based rather than time-based vesting requirements. Compensation expense equal to the grant date fair value, which is equal to the closing price of the company's common stock on the date of grant multiplied by the number of shares subject to the restricted stock and restricted stock unit awards, is recognized for these awards over the vesting period. The per share weighted-average fair value of restricted stock unit awards granted during the first nine months of fiscal 2017 and 2016 was \$65.86 and \$41.84, respectively.

## Note 8 — Per Share Data

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

(Shares in thousands)	Three Months Ended		Nine Months Ended	
	August 4, 2017	July 29, 2016	August 4, 2017	July 29, 2016
Basic				
Weighted-average number of shares of common stock	108,456	109,966	108,417	109,910
Assumed issuance of contingent shares	—	—	17	36
Weighted-average number of shares of common stock and assumed issuance of contingent shares	108,456	109,966	108,434	109,946
Diluted				

Edgar Filing: TORO CO - Form 10-Q

Weighted-average number of shares of common stock and assumed issuance of contingent shares	108,456	109,966	108,434	109,946
Effect of dilutive securities	3,001	2,146	3,026	2,208
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	111,457	112,112	111,460	112,154

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective September 16, 2016.

Table of Contents

Incremental shares from options and restricted stock units are computed by the treasury stock method. For the third quarter of fiscal 2017, there were no options to purchase shares of common stock that were excluded from diluted earnings per share because they were anti-dilutive. Options to purchase 33,536 shares of common stock during the third quarter of fiscal 2016 were excluded from diluted net earnings per share because they were anti-dilutive. Options to purchase 443,003 and 487,742 shares of common stock during the first nine months of fiscal 2017 and 2016, respectively, were excluded from diluted net earnings per share because they were anti-dilutive.

## Note 9 — Segment Data

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

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

(Dollars in thousands)

Three months ended August 4, 2017	Professional	Residential	Other	Total
Net sales	\$ 468,564	\$ 152,127	\$ 7,252	\$ 627,943
Intersegment gross sales	6,577	78	(6,655 )	—
Earnings (loss) before income taxes	\$ 97,368	\$ 11,360	\$(20,345)	\$ 88,383

(Dollars in thousands)

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

(Dollars in thousands)

Nine months ended August 4, 2017	Professional	Residential	Other	Total
Net sales	\$ 1,451,269	\$ 550,651	\$ 14,629	\$ 2,016,549
Intersegment gross sales	23,767	270	(24,037 )	—
Earnings (loss) before income taxes	314,545	62,965	(71,253 )	306,257
Total assets	\$ 852,919	\$ 207,452	\$ 509,173	\$ 1,569,544

(Dollars in thousands)

Nine months ended July 29, 2016	Professional	Residential	Other	Total
Net sales	\$ 1,361,829	\$ 550,330	\$ 11,660	\$ 1,923,819
Intersegment gross sales	24,100	289	(24,389 )	—
Earnings (loss) before income taxes	292,311	64,494	(68,079 )	288,726
Total assets	\$ 803,414	\$ 215,509	\$ 445,522	\$ 1,464,445

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

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	August 4, 2017	July 29, 2016	August 4, 2017	July 29, 2016
Corporate expenses	\$(22,174)	\$(19,903)	\$(72,385)	\$(68,270)
Interest expense, net	(4,750 )	(4,646 )	(14,309 )	(14,021 )
Other	6,579	3,473	15,441	14,212
Total Other loss before income taxes	\$(20,345)	\$(21,076)	\$(71,253)	\$(68,079)



Table of Contents

## Note 10 — Contingencies — Litigation

The company is party to litigation in the ordinary course of business. Such matters are generally subject to uncertainties and to outcomes that are not predictable with assurance and that may not be known for extended periods of time. Litigation occasionally involves claims for punitive, as well as compensatory, damages arising out of the use of the company's products. Although the company is self-insured to some extent, the company maintains insurance against certain product liability losses. The company is also subject to litigation and administrative and judicial proceedings with respect to claims involving asbestos and the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for personal injury, remedial investigations or clean up and other costs and damages. The company is also typically involved in commercial disputes, employment disputes, and patent litigation cases in which it is asserting or defending against patent infringement claims. To prevent possible infringement of the company's patents by others, the company periodically reviews competitors' products. To avoid potential liability with respect to others' patents, the company regularly reviews certain patents issued by the United States Patent and Trademark Office and foreign patent offices. Management believes these activities help minimize its risk of being a defendant in patent infringement litigation. The company is currently involved in patent litigation cases, including cases by or against competitors, where it is asserting and defending against claims of patent infringement. Such cases are at varying stages in the litigation process. The company records a liability in its Condensed Consolidated Financial Statements for costs related to claims, including future legal costs, settlements and judgments, where the company has assessed that a loss is probable and an amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, the company records the most probable estimate of the loss or the minimum amount when no amount within the range is a better estimate than any other amount. The company discloses a contingent liability even if the liability is not probable or the amount is not estimable, or both, if there is a reasonable possibility that a material loss may have been incurred. In the opinion of management, the amount of liability, if any, with respect to these matters, individually or in the aggregate, will not materially affect its consolidated results of operations, financial position, or cash flows.

## Note 11 — Warranty Guarantees

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

The changes in accrued warranties were as follows:

	Three Months Ended August 4, July 29, 2017		Nine Months Ended August 4, July 29, 2017	
(Dollars in thousands)	2017	2016	2017	2016
Beginning balance	\$81,993	\$79,658	\$72,158	\$70,734
Warranty provisions	11,208	10,869	38,003	36,673
Warranty claims	(11,381)	(11,894)	(29,682)	(28,596)

Edgar Filing: TORO CO - Form 10-Q

Changes in estimates	(662	) 2,780	679	2,602
Ending balance	\$81,158	\$81,413	\$81,158	\$81,413

12

---

## Table of Contents

### Note 12 — 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's primary currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the British pound, the Mexican peso, the Japanese yen, the Chinese Renminbi, and the Romanian New Leu against the U.S. dollar, as well as the Romanian New Leu against the Euro.

To reduce its exposure to foreign currency exchange rate risk, the company actively manages the exposure of its foreign currency exchange rate risk by entering into various derivative instruments, authorized under company policies that place controls on these hedging activities, with counterparties that are highly rated financial institutions. The company's policy does not allow the use of derivative instruments for trading or speculative purposes. The company also made an accounting policy election to use the portfolio exception with respect to measuring counterparty credit risk for derivative instruments, and to measure the fair value of a portfolio of financial assets and financial liabilities on the basis of the net open risk position with each counterparty.

The company's hedging activities primarily involve the use of forward currency contracts to hedge most foreign currency transactions, including forecasted sales and purchases denominated in foreign currencies. The company may also utilize forward currency contracts or cross currency swaps 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 fluctuations. Decisions on whether to use such derivative instruments are primarily based on the amount of exposure to the currency involved and an assessment of the near-term market value for each currency.

### Cash Flow Hedging Instruments

The company recognizes all derivative instruments as either assets or liabilities at fair value on the Condensed Consolidated Balance Sheets and formally documents relationships between cash flow hedging instruments and the related hedged transactions, as well as its risk-management objective and strategy for undertaking cash flow hedging instruments. This process includes linking all cash flow hedging instruments to the forecasted transactions, such as sales to third parties, foreign plant operations, and purchases from suppliers. Changes in fair values of outstanding cash flow hedging instruments, except the ineffective portion, are recorded in other comprehensive income within accumulated other comprehensive loss ("AOCL") on the Condensed Consolidated Balance Sheets, until net earnings is affected by the variability of the cash flows of the hedged transaction. Gains and losses on the cash flow hedging instrument representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in net earnings. The Condensed Consolidated Statements of Earnings classification of effective cash flow hedge results is the same as that of the underlying exposure. Results of cash flow hedges of sales and foreign plant operations are recorded in net sales and cost of sales, respectively, when the underlying hedged transaction affects net earnings. The maximum amount of time the company hedges its exposure to the variability in future cash flows for forecasted trade sales and purchases is two years. Results of cash flow hedges of intercompany loans are recorded in other income, net as an offset to the remeasurement of the foreign loan balance.

The company formally assesses, at the cash flow hedge's inception, and on an ongoing basis, whether the cash flow hedging instruments have been highly effective in offsetting changes in the cash flows of the hedged transactions and whether those cash flow hedging instruments 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 cash flow hedge, the company discontinues cash flow hedge accounting prospectively. When the company discontinues cash flow hedge accounting because it is no longer probable, but it is still reasonably possible that the forecasted transaction will occur by the end of the originally expected period or within an additional two-month period of time thereafter, the gain or loss on the

derivative remains in AOCL and is reclassified to net earnings when the forecasted transaction affects net earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were in AOCL are recognized immediately in net earnings. In all situations in which cash flow hedge accounting is discontinued and the derivative remains outstanding, the company carries the derivative at its fair value on the Condensed Consolidated Balance Sheets, recognizing future changes in the fair value in other income, net. For the third quarter of fiscal 2017, the company did not discontinue cash flow hedge accounting on any forward currency contracts designated as cash flow hedging instruments. For the nine months ended August 4, 2017, the company recognized immaterial gains on forward currency contracts reclassified into earnings as a result of the discontinuance of cash flow hedge accounting. As of August 4, 2017, the notional amount outstanding of forward contracts designated as cash flow hedging instruments was \$125.8 million.



Table of Contents

## Derivatives Not Designated as Cash Flow Hedging Instruments

The company also enters into foreign currency contracts that include forward currency contracts to mitigate the remeasurement of specific assets and liabilities on the Condensed Consolidated Balance Sheets. These contracts are not designated as cash flow hedging instruments. Accordingly, changes in the fair value of hedges of recorded balance sheet positions, such as cash, receivables, payables, intercompany notes, and other various contractual claims to pay or receive foreign currencies other than the functional currency, are recognized immediately in other income, net, on the Condensed 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 derivative instruments and Condensed Consolidated Balance Sheets location:

(Dollars in thousands)	Fair Value at August 4, 2017	Fair Value at July 29, 2016	Fair Value at October 31, 2016
Derivative assets:			
Derivatives designated as cash flow hedging instruments			
Prepaid expenses and other current assets			
Forward currency contracts	\$ 1,998	\$ 114	\$ 1,535
Derivatives not designated as cash flow hedging instruments			
Prepaid expenses and other current assets			
Forward currency contracts	166	532	432
Total assets	\$ 2,164	\$ 646	\$ 1,967
Derivative liabilities:			
Derivatives designated as cash flow hedging instruments			
Accrued liabilities			
Forward currency contracts	\$ 5,173	\$ 2,070	\$ 973
Derivatives not designated as cash flow hedging instruments			
Accrued liabilities			
Forward currency contracts	1,481	402	792
Total liabilities	\$ 6,654	\$ 2,472	\$ 1,765

The following tables present the impact of derivative instruments on the Condensed Consolidated Statements of Earnings for the company's derivatives designated as cash flow hedging instruments for the three and nine months ended August 4, 2017 and July 29, 2016, respectively:

	Effective Portion		Location of Gain (Loss)	Ineffective Portion and Excluded from Effectiveness Testing		Location of Gain	Gain (Loss) Recognized		
	Gain (Loss) Recognized in OCI	Recognized in Derivatives		Gain (Loss) Recognized in OCI	Recognized in Derivatives		in Income on Derivatives	in Income on Derivatives	
(Dollars in thousands)	August 4, 2017	July 29, 2016		August 4, 2017	July 29, 2016		August 4, 2017	July 29, 2016	
Forward currency contracts	\$(3,531)	\$983	Net sales	\$ 153	\$(192)	)	Other income, net	\$(179)	\$(69)
Forward currency contracts	469	(317)	Cost of sales	96	(931)	)			
	\$(3,062)	\$666	Total	\$ 249	\$(1,123)	)	Total	\$(179)	\$(69)

Total derivatives  
designated as cash  
flow hedging  
instruments

14

---

Table of Contents

	Effective Portion		Location of Gain (Loss) Reclassified from AOCL into Income	Gain (Loss) Reclassified from AOCL into Income		Ineffective Portion and Excluded from Effectiveness Testing Location of Gain (Loss) Recognized in Income on Derivatives		Gain (Loss) Recognized in Income on Derivatives	
	Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives		Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives	Gain (Loss) Recognized in OCI Derivatives
(Dollars in thousands)	August 4, 2017	July 29, 2016		August 4, 2017	July 29, 2016		August 4, 2017	July 29, 2016	
Forward currency contracts	\$(3,685)	\$(1,647)	Net sales	\$2,219	\$1,809	Other income, net	\$190	\$162	
Forward currency contracts	2,585	(537)	Cost of sales	(1,227)	(1,930)				
Cross currency contracts	—	255	Other income, net	—	(94)				
Total derivatives designated as cash flow hedging instruments	\$(1,100)	\$(1,929)	Total	\$992	\$(215)	Total	\$190	\$162	

As of August 4, 2017, the company expects to reclassify approximately \$2.4 million of losses from AOCL to earnings during the next twelve months.

The following table presents the gain/(loss) of derivative instruments on the Condensed Consolidated Statements of Earnings for the company's derivatives not designated as cash flow hedging instruments:

	Location of Gain (Loss)	Three Months Ended		Nine Months Ended	
		August 4, 2017	July 29, 2016	August 4, 2017	July 29, 2016
(Dollars in thousands)					
Forward currency contracts	Other income, net	\$(4,513)	\$788	\$(3,959)	\$(553)
Cross currency contracts	Other income, net	—	(8)	—	(191)
Total derivatives not designated as cash flow hedging instruments		\$(4,513)	\$780	\$(3,959)	\$(744)

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

The following table shows the effects of the master netting arrangements on the fair value of the company's derivative contracts that are recorded in the Condensed Consolidated Balance Sheets:

(Dollars in thousands)	August 4, 2017	July 29, 2016	October 31, 2016
Derivative assets:			
Forward currency contracts			

Edgar Filing: TORO CO - Form 10-Q

Gross amounts of recognized assets	\$2,164	\$885	\$2,264
Gross liabilities offset in the balance sheets	—	(239 )	(297 )
Net amounts of assets presented in the Consolidated Balance Sheets	\$2,164	\$646	\$1,967
Derivative liabilities:			
Forward currency contracts			
Gross amounts of recognized liabilities	\$(6,654 )	\$(2,475 )	\$(1,765 )
Gross assets offset in the balance sheets	—	3	—
Net amounts of liabilities presented in the Consolidated Balance Sheets	\$(6,654 )	\$(2,472 )	\$(1,765 )

Table of Contents

## Note 13 — 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 flows), 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 balances are valued at their carrying amounts in the Condensed Consolidated Balance Sheets, which are reasonable estimates of their fair value due to their short-term nature. Forward currency contracts are valued based on observable market transactions of forward currency prices and spot currency rates as of the reporting date. The unfunded deferred compensation liability is primarily subject to changes in fixed-income investment contracts based on current yields.

Assets and liabilities measured at fair value on a recurring basis, as of August 4, 2017, July 29, 2016, and October 31, 2016 are summarized below:

(Dollars in thousands)	Fair Value Measurements Using Inputs Considered as:			
	Fair Value	Level 1	Level 2	Level 3
August 4, 2017				
Assets:				
Cash and cash equivalents	\$ 335,026	\$ 335,026	\$ —	\$ —
Forward currency contracts	2,164	—	2,164	—
Total assets	\$ 337,190	\$ 335,026	\$ 2,164	\$ —
Liabilities:				
Forward currency contracts	\$ 6,654	\$ —	\$ 6,654	\$ —
Deferred compensation liabilities	760	—	760	—
Total liabilities	\$ 7,414	\$ —	\$ 7,414	\$ —
(Dollars in thousands)				
July 29, 2016				
Assets:				
Cash and cash equivalents	\$ 277,243	\$ 277,243	\$ —	\$ —
Forward currency contracts	646	—	646	—
Total assets	\$ 277,889	\$ 277,243	\$ 646	\$ —
Liabilities:				
Forward currency contracts	\$ 2,472	\$ —	\$ 2,472	\$ —
Deferred compensation liabilities	1,275	—	1,275	—
Total liabilities	\$ 3,747	\$ —	\$ 3,747	\$ —



Table of Contents

(Dollars in thousands) October 31, 2016	Fair Value Measurements Using Inputs Considered as:			
	Fair Value	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 273,555	\$ 273,555	\$ —	\$ —
Forward currency contracts	1,967	—	1,967	—
Total assets	\$ 275,522	\$ 273,555	\$ 1,967	\$ —
Liabilities:				
Forward currency contracts	\$ 1,765	\$ —	\$ 1,765	\$ —
Deferred compensation liabilities	1,149	—	1,149	—
Total liabilities	\$ 2,914	\$ —	\$ 2,914	\$ —

The company measures certain assets and liabilities at fair value on a non-recurring basis. Assets acquired and liabilities assumed as part of acquisitions are measured at fair value. There were no transfers between Level 1 and Level 2 during the three and nine months ended August 4, 2017 and July 29, 2016, or the twelve months ended October 31, 2016.

## Note 14 — Subsequent Events

The company has evaluated all subsequent events and concluded that no subsequent events have occurred that would require recognition in the Condensed Consolidated Financial Statements or disclosure in the Notes to the Condensed Consolidated Financial Statements.

Table of Contents

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

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

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

This MD&A should be read in conjunction with the MD&A included in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended October 31, 2016. This discussion contains various "Forward-Looking Statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and we refer readers to the section titled "Forward-Looking Information" located at the end of Part I, Item 2 of this report for more information.

COMPANY OVERVIEW

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

We strive to provide innovative, well-built, and dependable products supported by an extensive service network. A significant portion of our revenues has historically been, and we expect will continue to be, attributable to new and enhanced products. We define new products as those introduced in the current and previous two fiscal years.

Shares and per share data have been adjusted for all periods presented to reflect a two-for-one stock split effective September 16, 2016.

RESULTS OF OPERATIONS

Overview

For the third quarter of fiscal 2017, our net sales increased 4.5 percent with a net earnings increase of 22.5 percent, as compared to the third quarter of fiscal 2016. Year-to-date fiscal 2017 net earnings increased 16.5 percent compared to the same period in the prior fiscal year on a net sales increase of 4.8 percent. Professional segment net sales increased



9.5 percent for the third quarter comparison, primarily due to strong demand for our landscape contractor zero-turn radius riding mowers, continued growth in our golf and grounds business, and increased irrigation sales due to our Perrot acquisition that closed in the first quarter of fiscal 2017. Professional segment net sales increased 6.6 percent for the year-to-date comparison, primarily due to increased demand for golf and grounds products, new product releases in our landscape contractor business, increased shipments of our professional snow and ice management products, and growth in our rental and specialty construction business. Residential segment net sales were down 9.3 percent for the third quarter comparison, mainly due to a transition in the timing of our Toro Days sales promotion to the second quarter of fiscal 2017, increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage, and weakened demand for our steering wheel zero-turn radius riding mowers. Residential segment net sales increased 0.1 percent for the year-to-date comparison, primarily due to higher sales of our residential snow products due to favorable snowfalls in the first quarter of fiscal 2017 and strong demand for our walk-power mowers, primarily offset by decreased sales of our zero-turn radius riding mowers due to weakened demand for our steering wheel zero-turn radius riding mowers and increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage.

## Table of Contents

Changes in foreign currency exchange rates resulted in a reduction of our net sales of approximately \$0.5 million and \$6.5 million for the third quarter and year-to-date periods of fiscal 2017, respectively.

Our net earnings growth in the third quarter and year-to-date periods of fiscal 2017 was primarily attributable to increased sales while leveraging selling, general & administrative expenses ("SG&A"), as well as a lower effective tax rate, mainly driven by the adoption of ASU No. 2016-09, Stock-based Compensation ("ASU 2016-09"), in the first quarter of fiscal 2017. We currently expect the adoption of ASU 2016-09 to continue to benefit our effective tax rate for the remainder of fiscal 2017 such that the effective tax rate is anticipated to be lower than the effective tax rate we experienced during fiscal 2016. The adoption of ASU 2016-09 can add variability to our provision for income taxes, mainly due to the timing of stock option exercises, vesting of restricted stock units, and the trading price of our common stock.

We increased our cash dividend for the third quarter of fiscal 2017 by 16.7 percent to \$0.175 per share compared to the \$0.15 per share cash dividend paid in the third quarter of fiscal 2016.

Inventory levels increased \$21.9 million, or 6.7 percent, as of the end of the third quarter of fiscal 2017 due primarily to inventory increases to support strong forecasted Professional segment sales, as well as increases due to the acquisition of Perrot that closed in the first quarter of fiscal 2017. Accounts receivable increased \$19.2 million, or 9.5 percent, largely due to increased sales and the acquisition of Perrot that closed in the first quarter of fiscal 2017. As of the end of the third quarter of fiscal 2017, field inventory levels were lower for both the Professional and Residential segments when compared to the prior fiscal year period.

Our current multi-year employee initiative, "Destination PRIME," which began with our 2015 fiscal year, continues our journey into our second century. This is our final year of this three-year initiative, which is intended to help us drive revenue and earnings growth and further improve productivity, while also continuing our century-long commitment to innovation, relationships, and excellence. Through our Destination PRIME initiative, we strive to achieve our goals by pursuing a progression of annual milestones. Our organic revenue growth goal is to achieve five percent or more of organic revenue growth each fiscal year during this initiative. We define organic revenue growth as the increase in net sales, less net sales from acquisitions that occurred in the current fiscal year. Our operating earnings goal is to raise operating earnings as a percentage of net sales to more than 13 percent by the end of fiscal 2017. Additionally, our working capital goal is to drive down average net working capital as a percentage of net sales to 13 percent or less by the end of fiscal 2017. We define average net working capital as net accounts receivable plus net inventory less accounts payable as a percentage of net sales for a twelve month period.

### Net Sales

Worldwide consolidated net sales for the third quarter of fiscal 2017 were \$627.9 million, up 4.5 percent compared to \$601.0 million in the third quarter of fiscal 2016. The net sales increase for the quarter comparison was primarily due to strong demand for our Professional segment landscape contractor zero-turn radius riding mowers, strong sales of our golf and grounds mowers, and increased irrigation sales due to our acquisition of Perrot that closed in the first quarter of fiscal 2017, partially offset by lower sales of Residential segment walk-power and zero-turn radius riding mowers mainly due to a transition in the timing of our Toro Days sales promotion to the second quarter of fiscal 2017, increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage, and weakened demand for our steering wheel zero-turn radius riding mowers. For the year-to-date period of fiscal 2017, net sales were \$2,016.5 million, up 4.8 percent from the same period in the prior fiscal year. The year-to-date increase was primarily due to strong demand for products in our golf and grounds business, well-received new product releases in our Professional segment landscape contractor businesses, increased shipments of professional and residential snow and ice management products, continued growth in our rental and specialty construction businesses, and high demand

for our Residential segment walk-power mowers, partially offset by decreased sales of our zero-turn radius riding mowers due to weakened demand for our steering wheel zero-turn radius riding mowers and increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage.

International net sales were up 9.8 percent and 4.8 percent for the third quarter and year-to-date periods of fiscal 2017, respectively. The net sales increase for the third quarter comparison was primarily due to sales from our Perrot acquisition that closed in the first quarter of fiscal 2017, increased sales of our Professional segment landscape contractor and Residential segment zero-turn radius riding mowers, and growth of our golf and grounds business, partially offset by lower sales of Residential segment walk-power mowers. The net sales increase for the year-to-date period comparison was mainly due to increased irrigation sales from our Perrot acquisition, along with increased Pope-branded irrigation product sales due to favorable weather conditions in Australia, growth of our golf and grounds business, and increased shipments of Professional segment landscape contractor equipment, partially offset by lower sales of our Residential segment walk-power and zero-turn radius riding mowers. Both periods of fiscal 2017 were negatively impacted by changes in foreign currency exchange rates.

Table of Contents

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

	Three Months		Nine Months	
	Ended		Ended	
	August 4	July 29,	August 4	July 29,
	2017	2016	2017	2016
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	63.9	64.0	63.5	63.5
Gross profit	36.1	36.0	36.5	36.5
Selling, general, and administrative expense	22.1	22.4	21.2	21.4
Operating earnings	14.0	13.6	15.3	15.1
Interest expense	(0.8 )	(0.8 )	(0.7 )	(0.7 )
Other income, net	0.9	0.6	0.6	0.6
Provision for income taxes	3.2	4.1	3.6	4.6
Net earnings	10.9 %	9.3 %	11.6 %	10.4 %

## Gross Profit

As a percentage of net sales, gross profit for the third quarter of fiscal 2017 was 36.1 percent, up 10 basis points when compared to the third quarter of fiscal 2016. The third quarter comparison results were up primarily due to the impact of segment mix and productivity improvements, which were partially offset by higher commodity and freight costs. Gross profit as a percentage of net sales for the fiscal 2017 year-to-date period was 36.5 percent, consistent with the same period last fiscal year. The year-to-date comparison results were also primarily due to productivity improvements and the impact of segment mix, offset by higher commodity and freight costs, as well as unfavorable foreign currency exchange rates.

## Selling, General, and Administrative Expense

SG&A expense increased \$4.3 million, or 3.2 percent, for the third quarter of fiscal 2017 and increased \$17.4 million, or 4.2 percent, for the year-to-date period of fiscal 2017. As a percentage of net sales, SG&A expense decreased 30 basis points and 20 basis points for the third quarter and year-to-date periods of fiscal 2017, respectively. The decrease as a percentage of net sales for the third quarter comparison was primarily due to lower warranty and direct marketing expenses, partially offset by higher incentive expense attributable to improved expected company performance in fiscal 2017. SG&A expense as a percentage of net sales for the year-to-date comparison was down compared to the prior fiscal year, mainly due to lower administrative and direct marketing expenses, partially offset by higher incentive expense as mentioned in the quarter comparison.

## Interest Expense

Interest expense for the third quarter and year-to-date periods of fiscal 2017 increased by 2.2 percent and by 2.1 percent, respectively, when compared to the prior fiscal year comparative periods.

## Other Income, Net

Other income, net for the third quarter and year-to-date periods of fiscal 2017 increased by \$1.9 million and by \$1.1 million, respectively, compared to the same periods last fiscal year. The increase in the third quarter comparison was driven by foreign currency exchange rate gains. The increase in the year-to-date period of fiscal 2017 was mainly due to foreign currency exchange rate gains, partially offset by a litigation recovery and the sale of our Northwestern U.S. distribution company, both of which occurred in the first quarter of fiscal 2016 and did not repeat in fiscal 2017.

Provision for Income Taxes

The effective tax rate for the third quarter of fiscal 2017 was 22.6 percent compared to 30.9 percent in the third quarter of 2016. The effective tax rate for the year-to-date period of fiscal 2017 was 23.6 percent compared to 30.5 percent in the same period of fiscal 2016. The decrease in the third quarter of fiscal 2017 was primarily driven by discrete tax items, including favorable one-time adjustments related to prior years and a \$2.9 million benefit related to share-based compensation due to the adoption of ASU 2016-09 in the first quarter of fiscal 2017. The decrease in the year-to-date period of fiscal 2017 was primarily driven by a discrete tax benefit of \$18.9 million, related to share-based compensation. The adoption of ASU 2016-09 can add variability to our provision for income taxes, mainly due to the timing of stock option exercises, vesting of restricted stock units, and the trading price of our common stock.

Table of Contents

## Net Earnings

Net earnings for the third quarter of fiscal 2017 were \$68.4 million, or \$0.61 per diluted share, compared to \$55.8 million, or \$0.50 per diluted share, for the third quarter of fiscal 2016, resulting in a net earnings per diluted share increase of 22.0 percent. Year-to-date net earnings in fiscal 2017 were \$233.9 million, or \$2.10 per diluted share, compared to \$200.8 million, or \$1.79 per diluted share, in the prior fiscal year comparative period, resulting in a net earnings per diluted share increase of 17.3 percent. The primary factors contributing to the net earnings increase for the third quarter and year-to-date comparative periods included leveraging SG&A expense over higher sales volumes and a lower effective tax rate, mainly driven by the adoption of ASU 2016-09 in the first quarter of fiscal 2017.

## BUSINESS SEGMENTS

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

The following table summarizes net sales by segment:

(Dollars in thousands)	Three Months Ended			
	August 4, 2017	July 29, 2016	\$ Change	% Change
Professional	\$468,564	\$427,784	\$40,780	9.5 %
Residential	152,127	167,815	(15,688 )	(9.3 )%
Other	7,252	5,381	1,871	34.8 %
Total net sales*	\$627,943	\$600,980	\$26,963	4.5 %

\* Includes international net sales of: \$139,434 \$126,975 \$12,459 9.8 %

(Dollars in thousands)	Nine Months Ended			
	August 4, 2017	July 29, 2016	\$ Change	% Change
Professional	\$1,451,269	\$1,361,829	\$89,440	6.6 %
Residential	550,651	550,330	321	0.1 %
Other	14,629	11,660	2,969	25.5 %
Total net sales*	\$2,016,549	\$1,923,819	\$92,730	4.8 %

\* Includes international net sales of: \$472,317 \$450,577 \$21,740 4.8 %

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

(Dollars in thousands)	Three Months Ended			
	August 4, 2017	July 29, 2016	\$ Change	% Change
Professional	\$97,368	\$89,096	\$8,272	9.3 %
Residential	11,360	12,767	(1,407 )	(11.0 )%
Other	(20,345 )	(21,076 )	731	3.5 %
Total earnings before income taxes	\$88,383	\$80,787	\$7,596	9.4 %

(Dollars in thousands)	Nine Months Ended			
	\$ Change % Change			

Edgar Filing: TORO CO - Form 10-Q

	August 4, 2017	July 29, 2016			
Professional	\$314,545	\$292,311	\$22,234	7.6	%
Residential	62,965	64,494	(1,529 )	(2.4 )	%
Other	(71,253 )	(68,079 )	(3,174 )	(4.7 )	%
Total earnings before income taxes	\$306,257	\$288,726	\$17,531	6.1	%

Table of Contents

## Professional Segment

Net Sales. Worldwide net sales for our Professional segment in the third quarter and year-to-date periods of fiscal 2017 increased 9.5 percent and 6.6 percent, respectively. The Professional segment net sales increase for the third quarter comparison of fiscal 2017 was primarily due to strong demand for zero-turn radius riding mowers in our landscape contractor businesses, continued growth in our golf and grounds business with increased shipments of our Groundsmaster® and Greensmaster® series mowers, and increased irrigation sales due to our acquisition of Perrot that closed in the first quarter of fiscal 2017. Professional segment net sales growth for the year-to-date comparison of fiscal 2017 was largely due to strong demand for our innovative golf and grounds products, including the Workman® GTX utility vehicle, the introduction of new products in our landscape contractor businesses, including the Exmark-branded Radius® and the Toro-branded TITAN® HD zero-turn radius riding mowers, increased shipments of our BOSS® snow and ice management products impacted by favorable snowfalls in the first quarter of fiscal 2017, and continued demand for our rental and specialty construction compact utility loaders and tracked Mud Buggy™.

Operating Earnings. Operating earnings for the Professional segment in the third quarter of fiscal 2017 increased by 9.3 percent compared to the third quarter of fiscal 2016, and when expressed as a percentage of net sales, remained consistent at 20.8 percent in the third quarter of fiscal 2017, compared to the same period in the prior fiscal year. As a percentage of net sales, the third quarter comparison of Professional segment operating earnings was impacted by lower gross margins primarily due to higher commodity costs and the impact of segment product mix, partially offset by productivity improvements and lower freight costs, as well as leveraging SG&A expense over higher sales volumes. For the year-to-date period of fiscal 2017, Professional segment operating earnings increased by 7.6 percent compared to the same period in the prior fiscal year and increased to 21.7 percent as a percentage of net sales for the year-to-date period of fiscal 2017, compared to 21.5 percent in the same period last fiscal year. As a percentage of net sales, the year-to-date comparison of the Professional segment operating earnings increase was driven primarily by leveraging SG&A expense over higher sales volumes and consistent gross margins when compared to the prior fiscal year comparative period, primarily due to higher commodity costs offset by productivity improvements.

## Residential Segment

Net Sales. Worldwide net sales for our Residential segment in the third quarter of fiscal 2017 decreased 9.3 percent compared to the prior fiscal year period. Worldwide net sales for our Residential segment in the year-to-date period of fiscal 2017 increased 0.1 percent compared to the prior fiscal year period. The Residential segment net sales decrease in the third quarter comparison was primarily due to a transition in the timing of our Toro Days sales promotion to the second quarter of fiscal 2017, increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage, and weakened demand for our steering wheel zero-turn radius riding mower, partially offset by higher shipments of Residential segment snow products in anticipation of the upcoming selling season. The year-to-date net sales increase was primarily due to increased shipments of our Residential segment snow products due to favorable snowfalls in the first quarter of fiscal 2017 and increased demand of for walk-power mowers, primarily offset by decreased sales of our zero-turn radius riding mowers due to weakened demand for our steering wheel zero-turn radius riding mowers and increased sales of our professional grade zero-turn radius riding mowers to homeowners with acreage.

Operating Earnings. Operating earnings for the Residential segment in the third quarter of fiscal 2017 decreased 11.0 percent, or expressed as a percentage of net sales, decreased to 7.5 percent from 7.6 percent when compared to the third quarter of fiscal 2016. As a percentage of net sales, the third quarter comparison of the Residential segment operating earnings decrease was driven by lower gross margins primarily due to higher commodity and freight costs, partially offset by productivity improvements, as well as decreased SG&A expense mainly due to lower warranty expense. For the year-to-date period of fiscal 2017, Residential segment operating earnings decreased 2.4 percent, or expressed as a percentage of net sales, decreased to 11.4 percent from 11.7 percent when compared to the same period



last fiscal year. As a percentage of net sales, the year-to-date comparison of the Residential segment operating earnings decrease was primarily driven by an increase in SG&A expense mainly due to increased engineering and warranty expense, as well as gross margins that were consistent with the prior fiscal year comparative period, primarily due to higher commodity and freight costs, offset by productivity improvements.

#### Other Segment

Net Sales. Net sales for the Other segment include sales from our wholly owned domestic distribution company less sales from the Professional and Residential segments to the distribution company. The Other segment net sales in the third quarter and year-to-date periods of fiscal 2017 increased by \$1.9 million and \$3.0 million, respectively, compared to the same period last fiscal year, mainly due to strong demand for our golf and grounds equipment that was sold through our wholly owned domestic distribution company.

## Table of Contents

Operating Loss. Operating loss for the Other segment decreased \$0.7 million for the third quarter comparison primarily due to foreign currency exchange rate derivative instrument gains. Operating loss for the Other segment increased \$3.2 million for the year-to-date period of fiscal 2017, compared to the same period last fiscal year, primarily attributable to higher incentive expense due to improved expected company performance in fiscal 2017, as well as the sale of our Northwestern U.S. distribution company in the first quarter of fiscal 2016 that was not repeated in fiscal 2017. The year-to-date operating loss increase was partially offset by foreign currency exchange rate derivative instrument gains.

## FINANCIAL POSITION

### Working Capital

During the remainder of fiscal 2017, we plan to continue to place emphasis on improving asset utilization with a focus on reducing the amount of working capital in the supply chain, adjusting production plans, and maintaining or improving order replenishment and service levels to end users. Our average net working capital as a percentage of net sales for the twelve months ended August 4, 2017, was 14.0 percent compared to 16.4 percent for the twelve months ended July 29, 2016. We calculate our average net working capital as net receivables plus net inventories, less accounts payable for a twelve month period as percentage of rolling twelve month net sales.

Inventory levels were up \$21.9 million, or 6.7 percent, as of the end of the third quarter of fiscal 2017 compared to the end of the third quarter of fiscal 2016 due primarily to inventory increases to support strong forecasted Professional segment sales, as well as increases due to the acquisition of Perrot that closed in the first quarter of fiscal 2017. Accounts receivable as of the end of the third quarter of fiscal 2017 increased \$19.2 million, or 9.5 percent, compared to the end of the third quarter of fiscal 2016 primarily due to increased sales and the acquisition of Perrot that closed in the first quarter of fiscal 2017. Our average days sales outstanding for receivables decreased to 30.1 days, based on sales for the last twelve months ended August 4, 2017, compared to 31.9 days for the twelve months ended July 29, 2016. In addition, accounts payable increased \$39.3 million, or 22.8 percent, as of the end of our third quarter of fiscal 2017 compared to the end of the third quarter of fiscal 2016, due mainly to continued working capital initiatives.

### Liquidity and Capital Resources

Our businesses are seasonally working capital intensive and require funding for purchases of raw materials used in production, replacement parts inventory, payroll and other administrative costs, capital expenditures, establishment of new facilities, expansion and renovation of existing facilities, as well as for financing receivables from customers that are not financed with Red Iron. We believe that anticipated cash generated from operations, together with our long-term debt, bank credit lines, and cash on hand, will provide us with adequate liquidity to meet our anticipated operating requirements. We believe that the funds available through existing financing arrangements and forecasted cash flows will be sufficient to provide the necessary capital resources for our anticipated working capital needs, capital expenditures, investments, debt repayments, quarterly cash dividend payments, and stock repurchases for at least the next twelve months. As of August 4, 2017, cash and short-term investments held by our foreign subsidiaries were approximately \$111.5 million.

Our Board of Directors approved a cash dividend of \$0.175 per share for the third quarter of fiscal 2017 that was paid on July 12, 2017. This was an increase of 16.7 percent over our cash dividend of \$0.15 per share for the third quarter of fiscal 2016.

Cash Flow. Cash provided by operating activities for the first nine months of fiscal 2017 decreased \$32.0 million compared to the first nine months of fiscal 2016. This nine month comparison change was mainly due to changes in working capital, partially offset by strong net earnings and a Red Iron exclusivity incentive payment. Cash used for

investing activities increased \$26.8 million during the first nine months of fiscal 2017 compared to the first nine months of fiscal 2016, primarily due to cash utilized for the Perrot acquisition that closed in the first quarter of fiscal 2017. Cash used for financing activities for the first nine months of fiscal 2017 increased \$41.5 million compared to the first nine months of fiscal 2016, mainly due to more cash used for common stock repurchases, fewer stock option exercises, and increased common stock dividends paid.

**Credit Lines and Other Capital Resources.** Our businesses are seasonal, with accounts receivable balances historically increasing between January and April as a result of typically higher sales volumes and extended payment terms made available to our customers, and typically decreasing between May and December when payments are received. The seasonality of production and shipments causes our working capital requirements to fluctuate during the year. Seasonal cash requirements are financed from operations, cash on hand, and with short-term financing arrangements, including our \$150.0 million unsecured senior five-year revolving credit facility that expires in October 2019. Included in our \$150.0 million revolving credit facility is a \$20.0 million sublimit for standby letters of credit and a \$20.0 million sublimit for swingline loans. At our election, and with the approval of the named borrowers on the revolving credit facility and the election of the lenders to fund such increase, the aggregate maximum

Table of Contents

principal amount available under the facility may be increased by an amount up to \$100.0 million in aggregate. Funds are available under the revolving credit facility for working capital, capital expenditures, and other lawful purposes, including, but not limited to, acquisitions and stock repurchases. Interest expense on this credit line is determined based on a LIBOR rate (or other rates quoted by the Administrative Agent, Bank of America, N.A.) plus a basis point spread defined in the credit agreement. In addition, our non-U.S. operations maintain short-term lines of credit in the aggregate amount of approximately \$9.6 million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. As of August 4, 2017 and July 29, 2016, we had no outstanding short-term debt under these lines of credit. As of August 4, 2017, we had \$7.5 million of outstanding letters of credit and \$152.1 million of unutilized availability under our credit agreements.

As of August 4, 2017, we had \$331.8 million outstanding in long-term debt that includes \$100.0 million of 7.8% debentures due June 15, 2027, \$123.8 million of 6.625% senior notes due May 1, 2037, a \$100.7 million term loan, a \$10.0 million note due to the former owners of the BOSS business, and partially offsetting debt issuance costs and deferred charges of \$2.7 million related to our outstanding long-term debt. The term loan bears interest based on a LIBOR rate (or other rates quoted by the Administrative Agent, Bank of America, N.A.) plus a basis point spread defined in the credit agreement. The term loan can be repaid in part or in full at any time without penalty, but in any event must be paid in full by October 2019.

Our revolving and term loan credit facility contains standard covenants, including, without limitation, financial covenants, such as the maintenance of minimum interest coverage and maximum debt to earnings before interest, taxes, depreciation, and amortization (“EBITDA”) ratios; and negative covenants, which among other things, limit loans and investments, disposition of assets, consolidations and mergers, transactions with affiliates, restricted payments, contingent obligations, liens, and other matters customarily restricted in such agreements. Most of these restrictions are subject to certain minimum thresholds and exceptions. Under the revolving credit facility, we are not limited in the amount for payments of cash dividends and common stock repurchases as long as our debt to EBITDA ratio from the previous quarter compliance certificate is less than or equal to 3.25, provided that immediately after giving effect of any such proposed action, no default or event of default would exist. As of August 4, 2017, we were not limited in the amount for payments of cash dividends and stock repurchases. We were in compliance with all covenants related to our credit agreement for our revolving credit facility as of August 4, 2017, and we expect to be in compliance with all covenants during the remainder of fiscal 2017. If we were out of compliance with any debt covenant required by this credit agreement following the applicable cure period, the banks could terminate their commitments unless we could negotiate a covenant waiver from the banks. In addition, our long-term senior notes, debentures, term loan, and any amounts outstanding under the revolving credit facility could become due and payable if we were unable to obtain a covenant waiver or refinance our short-term debt under our credit agreement. If our credit rating falls below investment grade and/or our average debt to EBITDA ratio rises above 1.50, the basis point spread over LIBOR (or other rates quoted by the Administrative Agent, Bank of America, N.A.) we currently pay on outstanding debt under the credit agreement would increase. However, the credit commitment could not be cancelled by the banks based solely on a ratings downgrade. Our debt rating for long-term unsecured senior, non-credit enhanced debt was unchanged during the third quarter of fiscal 2017 by Standard and Poor’s Ratings Group at BBB and by Moody’s Investors Service at Baa3.

## Customer Financing Arrangements and Contractual Obligations

Our Red Iron joint venture with TCFIF provides inventory financing to certain distributors and dealers of our products in the U.S. that enables them 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 \$23.2 million of receivables from us during the first nine months of fiscal 2017. As of August 4, 2017, \$10.8 million of receivables financed by a third party financing company, excluding Red Iron, were outstanding. See our most recently filed Annual Report on Form 10-K for further details regarding our customer financing

arrangements and contractual obligations.

#### Inflation

We are subject to the effects of inflation, deflation, and changing prices. In the first nine months of fiscal 2017, average prices paid for commodities and components we purchase were slightly higher compared to the average prices paid for commodities and components in the first nine months of fiscal 2016. We intend to continue to closely follow prices of commodities and components that affect our product lines, and we anticipate average prices paid for some commodities and components to be slightly higher for the remainder of fiscal 2017, as compared to fiscal 2016. Historically, we have mitigated, and we currently expect to continue to mitigate, commodity price increases, in part, by collaborating with suppliers, reviewing alternative sourcing options, substituting materials, engaging in internal cost reduction efforts, and increasing prices on some of our products, all as appropriate.

Table of Contents

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

See our most recent Annual Report on Form 10-K for the fiscal year ended October 31, 2016 for a discussion of our critical accounting policies.

New Accounting Pronouncements to be Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Updates ("ASU") No. 2014-09, Revenue from Contracts with Customers that updates the principles for recognizing revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. The guidance also requires enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from an entity's contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606), which deferred the effective date of this standard by one year. We expect to adopt this guidance on November 1, 2018, as required, based on the new effective date. The guidance permits the use of either a retrospective or cumulative effect transition method. We have not yet selected a transition method but plan to select a transition method in the fourth quarter of fiscal 2017. We are currently assessing our contracts with customers and developing related financial disclosures to evaluate the impact of the amended guidance on our existing revenue recognition policies and procedures. The majority of our revenue arrangements generally consist of a single performance obligation to transfer promised goods or services. While we have not identified any material differences in the amount and timing of revenue recognition related to ASU 2014-09, our evaluation is not complete and, accordingly, we have not yet reached a conclusion on the overall impacts of adopting ASU 2014-09.

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

In February 2016, the FASB issued ASU No. 2016-02, Leases, which, among other things, requires lessees to recognize most leases on-balance sheet. The standard requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The amended guidance will become effective for us commencing in the first quarter of fiscal 2020. Entities are required to use a modified retrospective approach, with early adoption permitted. We are currently reviewing the revised guidance, assessing our leases, and related impact on our Consolidated Financial Statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which amends guidance on the classification of certain cash receipts and payments in the statement of cash flows. The amended guidance will become effective for us commencing in the first quarter of fiscal 2019. Early adoption is permitted. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which clarifies the definition of a business in Accounting Standards Codification 805. The amended guidance will become effective for us commencing in the first quarter of fiscal 2019. Early adoption is permitted. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. The amended guidance will become effective for us commencing in the first quarter of fiscal 2021. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. The amended guidance will become effective for us commencing in the first quarter of fiscal 2019. Early adoption is permitted. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements.

We believe that all other recently issued accounting pronouncements from the FASB that we have not noted above, will not have a material impact on our Consolidated Financial Statements or do not apply to our operations.

Table of Contents

FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (“Securities Act”), and Section 21E under the Securities Exchange Act of 1934, as amended (“Exchange Act”), and that are subject to the safe harbor created by those sections. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or web casts open to the public, in press releases or reports, on our web sites or otherwise. Statements that are not historical are forward-looking and reflect expectations and assumptions. Forward-looking statements are based on our current expectations of future events, and often can be identified in this report and elsewhere by using words such as “expect,” “strive,” “looking ahead,” “outlook,” “guidance,” “forecast,” “goal,” “optimistic,” “anticipate,” “continue,” “plan,” “estimate,” “project,” “believe,” “should,” “could,” “will,” “v,” “may,” “likely,” “intend,” “can,” “seek,” “potential,” “pro forma,” or the negative thereof and similar expressions or future data. Forward-looking statements generally relate to our future performance, including our anticipated operating results, liquidity requirements, and financial condition; our business strategies and goals; and the effect of laws, rules, regulations, new accounting pronouncements, and outstanding litigation on our business and future performance.

Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or implied. The following are some of the factors known to us that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements:

Adverse economic conditions and outlook in the United States and in other countries in which we conduct business could adversely affect our net sales and earnings, which include but are not limited to recessionary conditions; slow or negative economic growth rates; the impact of U.S. federal debt, state debt and sovereign debt defaults and austerity measures by certain European countries; slow down or reductions in levels of golf course development, renovation, and improvement; golf course closures; reduced levels of home ownership, construction, and sales; home foreclosures; negative consumer confidence; reduced consumer spending levels resulting from tax increases or other factors; prolonged high unemployment rates; higher commodity and component costs and fuel prices; inflationary or deflationary pressures; reduced credit availability or unfavorable credit terms for our distributors, dealers, and end-user customers; higher short-term, mortgage, and other interest rates; and general economic and political conditions and expectations.

Weather conditions, including unfavorable weather conditions exacerbated by global climate changes or otherwise, may reduce demand for some of our products and adversely affect our net sales and operating results, or may affect the timing of demand for some of our products and may adversely affect net sales and operating results in subsequent periods.

Fluctuations in foreign currency exchange rates have affected our operating results and could continue to result in declines in our reported net sales and net earnings.

Increases in the cost, or disruption in the availability, of raw materials, components, and parts containing various commodities that we purchase, such as steel, aluminum, petroleum and natural gas-based resins, linerboard, copper, lead, rubber, engines, transmissions, transaxles, hydraulics, electric motors, and other commodities and components, and increases in our other costs of doing business, such as transportation costs or increased tariffs, duties or other charges as a result of changes to international trade agreements may adversely affect our profit margins and business. Our Professional segment net sales are dependent upon certain factors, including golf course revenues and the amount of investment in golf course renovations and improvements; the level of new golf course development and golf course closures; the level of property owners who outsource their lawn care and snow and ice removal activities; the level of residential and commercial construction; continued acceptance of and demand for micro-irrigation solutions for agricultural markets; the timing and occurrence of winter weather conditions; demand for our products in the rental and specialty construction market; availability of cash or credit to Professional segment customers on acceptable terms to finance new product purchases; and the amount of government revenues, budget, and spending levels for grounds maintenance equipment.



Our Residential segment net sales are dependent upon consumers buying our products at dealers, mass retailers, and home centers, such as The Home Depot, Inc.; the amount of product placement at mass retailers and home centers; consumer confidence and spending levels, changing buying patterns of customers, and timing of sales incentive programs.

Changes in our product mix impact our financial performance, including profit margins and net earnings, as our Professional segment products generally have higher profit margins than our Residential segment products.

We intend to grow our business in part through acquisitions and alliances, strong customer relations, and new joint ventures and partnerships, which could be risky and harm our business reputation, financial condition, and operating results, particularly if we are not able to successfully integrate such acquisitions and alliances, joint ventures, and partnerships. If previous or future acquisitions do not produce the expected results or integration into our operations takes more time than expected, our business could be harmed. We cannot guarantee previous or future acquisitions, alliances, joint ventures or partnerships will in fact produce any benefits.

Table of Contents

Our ability to manage our inventory levels to meet our customers' demand for our products is important for our business. If we underestimate or overestimate demand for our products and do not maintain appropriate inventory levels, our net sales and/or working capital could be negatively impacted.

Our business and operating results are subject to the inventory management decisions of our distribution channel customers. Any adjustments in the carrying amount of inventories by our distribution channel customers may impact our inventory management and working capital goals as well as operating results.

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

A significant percentage of our consolidated net sales are generated outside of the United States, and we intend to continue to expand our international operations. Our international operations also require significant management attention and financial resources; expose us to difficulties presented by international economic, political, legal, regulatory, accounting, and business factors, including implications of withdrawal by the U.S. from, or revision to, international trade agreements, foreign policy changes between the U.S. and other countries, weakened international economic conditions, or the United Kingdom's process for exiting the European Union; and may not be successful or produce desired levels of net sales. In addition, a portion of our international net sales are financed by third parties.

The termination of our agreements with these third parties, any material change to the terms of our agreements with these third parties or in the availability or terms of credit offered to our international customers by these third parties, or any delay in securing replacement credit sources, could adversely affect our sales and operating results.

If we are unable to continue to enhance existing products and develop and market new products that respond to customer needs and preferences and achieve market acceptance, or if we experience unforeseen product quality or other problems in the development, production, or use of new and existing products, we may experience a decrease in demand for our products, and our net sales and business could suffer.

We manufacture our products at and distribute our products from several locations in the United States and internationally. Any disruption at any of these facilities or our inability to cost-effectively expand existing facilities, open and manage new facilities, and/or move production between manufacturing facilities could adversely affect our business and operating results.

Our production labor needs fluctuate throughout the year, with a sharp increase in the number of production staff, some of which may be new to our manufacturing processes and safety protocols, during periods of peak manufacturing activity and any failure by our production labor force to adequately and safely perform their jobs could adversely affect our business, operating results, and reputation.

Management information systems are critical to our business. If our information systems or those of our business partners or third party service providers fail to adequately perform, or if we, our business partners or third party service providers experience an interruption in their operation, including by theft, loss or damage from unauthorized access, security breaches, natural or man-made disasters, cyber attacks, computer viruses, phishing, power loss or other disruptive events, our business, reputation, financial condition, and operating results could be adversely affected.

Our reliance upon patents, trademark laws, and contractual provisions to protect our proprietary rights may not be sufficient to protect our intellectual property from others who may sell similar products. Our products may infringe the proprietary rights of others.

Our business, properties, and products are subject to governmental regulation with which compliance may require us to incur expenses or modify our products or operations and non-compliance may result in harm to our reputation and/or expose us to penalties. Governmental regulation may also adversely affect the demand for some of our products and our operating results. In addition, changes in laws and regulations in the U.S. or other countries in which we conduct business also may adversely affect our operating results, including, (i) taxation and tax policy changes, tax rate changes, new tax laws, revised tax law interpretations, which individually or in combination may cause our effective tax rate to increase, (ii) healthcare laws or regulations, which may cause us to incur higher employee healthcare and other costs, or (iii) changes to international trade agreements that could result in additional duties or other charges on raw materials, whole goods or components we import.

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

Costs of complying with the various environmental laws related to our ownership and/or lease of real property, such as clean-up costs and liability that may be associated with certain hazardous waste disposal activities, could adversely affect our financial condition and operating results.

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

We operate in many different jurisdictions and we could be adversely affected by violations of the U.S. Foreign Corrupt Practices Act and similar worldwide anti-corruption laws. The continued expansion of our international operations could increase the risk of violations of these laws in the future.

We are required to comply with “conflict minerals” rules promulgated by the SEC, which has imposed costs on us and could raise reputational and other risks. We have, and we expect that we will continue to, incur additional costs and expenses, which may be significant in order to comply with these rules. Since our supply chain is complex, ultimately

## Table of Contents

we may not be able to sufficiently verify the origin of the conflict minerals used in our products through the due diligence procedures that we implement or we may identify through our due diligence procedures that some or all of the conflict minerals in our products are sourced from covered regions, which may adversely affect our reputation with our customers, shareholders, and other stakeholders.

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

If we are unable to retain our executive officers or other key employees, attract and retain other qualified personnel, or successfully implement executive officer, key employee or other qualified personnel transitions, we may not be able to meet strategic objectives and our business could suffer.

As a result of our Red Iron joint venture, we are dependent upon the joint venture to provide competitive inventory financing programs to certain distributors and dealers of our products. Any material change in the availability or terms of credit offered to our customers by the joint venture, challenges or delays in transferring new distributors and dealers from any business we might acquire to this financing platform, any termination or disruption of our joint venture relationship or any delay in securing replacement credit sources could adversely affect our net sales and operating results.

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

• We are expanding and renovating our corporate facilities and could experience disruptions to our operations in connection with such efforts.

Our business is subject to a number of other factors that may adversely affect our operating results, financial condition, or business, such as: our ability to achieve the revenue growth, operating earnings, and working capital goals of our “Destination PRIME” initiative or any quarterly financial guidance; man-made or natural disasters, such as Hurricane Harvey or Hurricane Irma, or global pandemics that may result in shortages of raw materials and components, higher fuel and commodity costs, delays in shipments to customers, and increases in insurance premiums; financial viability of our distributors and dealers, changes in distributor ownership, changes in channel distribution of our products, relationships with our distribution channel partners, our success in partnering with new dealers, and our customers’ ability to pay amounts owed to us; a decline in retail sales or financial difficulties of our distributors or dealers, which would cause us to repurchase financed product; new or revised accounting standards, including standards related to stock-based compensation and revenue recognition; and the threat of terrorist acts and war that may result in heightened security and higher costs for import and export shipments of components or finished goods, reduced leisure travel, and contraction of the U.S. and world economies.

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

All forward-looking statements included in this report are expressly qualified in their entirety by the foregoing cautionary statements. We caution readers not to place undue reliance on any forward-looking statement which speaks only as of the date made and to recognize that forward-looking statements are predictions of future results, which may not occur as anticipated. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the risks and uncertainties described above, the risks described in our most recent Annual Report on Form 10-K, Part I, Item 1A, “Risk Factors,” as well as others that we may consider immaterial or do not anticipate at this time. The foregoing risks and uncertainties are not exclusive and further information concerning the company and our businesses, including factors that potentially could materially affect our

financial results or condition, may emerge from time to time. We make no commitment to revise or update any forward-looking statements in order to reflect actual results, events or circumstances occurring or existing after the date any forward-looking statement is made, or changes in factors or assumptions affecting such forward-looking statements. We advise you, however, to consult any further disclosures we make on related subjects in our future Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K we file with or furnish to the Securities and Exchange Commission.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk stemming from changes in foreign currency exchange rates, interest rates, and commodity prices. We are also exposed to equity market risk pertaining to the trading price of our common stock. Changes in these factors could cause fluctuations in our earnings and cash flows. See further discussion on these market risks below and refer to our most recent Annual Report on Form 10-K for discussion on equity market risk.

Table of Contents

**Foreign Currency Exchange Rate Risk.** 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. Our primary foreign currency exchange rate exposures are with the Euro, the Australian dollar, the Canadian dollar, the British pound, the Mexican peso, the Japanese yen, the Chinese Renminbi, the Romanian New Leu against the U.S. dollar, and the Romanian New Leu against the Euro, including exposure as a result of the volatility and uncertainty that may arise as a result of the United Kingdom's process for exiting the European Union. 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 U.S. dollar and Mexican peso generally have a positive effect.

To reduce our exposure to foreign currency exchange rate risk, we actively manage the exposure of our foreign currency exchange rate risk by entering into various derivative instruments, authorized under company policies that place controls on these hedging activities, with counterparties that are highly rated financial institutions. Our policy does not allow the use of derivative instruments for trading or speculative purposes. We use 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 fluctuations.

Our hedging activities primarily involve the use of forward currency contracts to hedge most foreign currency transactions, including existing foreign currency assets, liabilities and probable commitments and forecasted sales and purchases denominated in foreign currencies. We may also utilize forward currency contracts or cross currency swaps to offset intercompany loan exposures. Decisions on whether to use such derivative instruments are primarily based on the amount of exposure to the currency involved and an assessment of the near-term market value for each currency. Our worldwide foreign currency exchange rate exposures are reviewed monthly. The gains and losses on our derivative instruments offset changes in values of the related exposures. Therefore, changes in the values of our derivative instruments are highly correlated with changes in the market values of underlying hedged items both at inception and over the life of the derivative instrument. For additional information regarding gains and losses on our derivative instruments, see Note 12 in our Notes to Condensed Consolidated Financial Statements under the heading "Derivative Instruments and Hedging Activities" included in Item 1 of this Quarterly Report on Form 10-Q.

The following foreign currency exchange contracts have maturity dates in fiscal 2017 through fiscal 2019. All items are non-trading and stated in U.S. dollars. Certain derivative instruments we hold do not meet the cash flow hedge accounting criteria; therefore, changes in their 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, August 4, 2017 were as follows:

(Dollars in thousands, except average contracted rate)	Average Contracted Rate	Notional Amount	Pre-tax Value in Accumulated Other Comprehensive Loss	Fair Value Impact (Loss) Gain
Buy US dollar/Sell Australian dollar	0.7644	60,830.9	(1,646.1	) (1,321.1 )
Buy US dollar/Sell Canadian dollar	1.3118	9,468.2	(443.2	) 216.0
Buy US dollar/Sell Euro	1.1461	70,634.0	(2,752.3	) 1,211.2
Buy US dollar/Sell British pound	1.3109	24,960.1	(388.3	) 449.2
Buy Mexican peso/Sell US dollar	20.9055	15,522.7	1,700.0	(633.1 )

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 on the Consolidated Balance Sheets, and would not impact net earnings.

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

**Commodity Price Risk.** Some raw materials used in our products are exposed to commodity price changes. The primary commodity price exposures are with steel, aluminum, petroleum and natural gas-based resins, and linerboard. In addition, we are a purchaser of components and parts containing various commodities, including steel, aluminum, copper, lead, rubber, and others that are

## Table of Contents

integrated into our end products. Further information regarding changing prices for commodities is presented in Item 2 of this Quarterly Report on Form 10-Q, in the section titled “Inflation.”

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

### ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) that are designed to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and we are required to apply our judgment in evaluating the cost-benefit relationship of possible internal controls. Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered in this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of such period to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure. There was no change in our internal control over financial reporting that occurred during our third quarter ended August 4, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are a party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive, as well as compensatory, damages arising out of the use of our products. Although we are self-insured to some extent, we maintain insurance against certain product liability losses. We are also subject to litigation and administrative and judicial proceedings with respect to claims involving asbestos and the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for personal injury, remedial investigations or clean-up, and other costs and damages. We are also typically involved in commercial disputes, employment disputes, and patent litigation cases in the ordinary course of business. To prevent possible infringement of our patents by others, we periodically review competitors’ products. To avoid potential liability with respect to others’ patents, we regularly review certain patents issued by the United States Patent and Trademark Office 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, including cases by or against competitors, where we are asserting and defending against claims of patent infringement. Such cases are at varying stages in the litigation process.

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



ITEM 1A. RISK FACTORS

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

Table of Contents

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

The following table shows our third quarter of fiscal 2017 stock repurchase activity.

Period	Total Number of Shares (or Units) Purchased (1) (2)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased As Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
May 6, 2017 through June 2, 2017	—	\$ —	—	6,169,162
June 3, 2017 through June 30, 2017	—	—	—	6,169,162
July 1, 2017 through August 4, 2017	144,201	70.44	143,010	6,026,152
Total	144,201	\$ 70.44	143,010	

(1) On December 3, 2015, the company's Board of Directors authorized the repurchase of 8,000,000 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 143,010 shares during the period indicated above under this program and 6,026,152 shares remain available to repurchase under this program.

(2) Includes 1,191 units (shares) of the company's common stock purchased in open-market transactions at an average price of \$71.16 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 1,191 shares were not repurchased under the company's repurchase program described in footnote 1 above.

## ITEM 5. OTHER INFORMATION

As disclosed in our Current Report on Form 8-K dated August 29, 2017, effective as of November 3, 2017 (i) our current Chairman of the Board, Michael J. Hoffman, will retire as Chairman of the Board and as a director, (ii) our current President and Chief Executive Officer, Richard M. Olson, will become Chairman of the Board, and (iii) our Board size will decrease from 11 to 10 directors.

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibit No. Description

- 3.1 and 4.1 Restated Certificate of Incorporation of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated June 17, 2008, Commission File No. 1-8649).
- 3.2 and 4.2 Certificate of Amendment to Restated Certificate of Incorporation of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated March 12, 2013, Commission File No. 1-8649).
- 3.3 and 4.3 Amended and Restated Bylaws of The Toro Company (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K dated July 19, 2016, Commission File No. 1-8649).
- 4.4 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). (Filed on paper - hyperlink is not required pursuant to Rule 105 of Regulation S-T)
- 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).
- 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 August 4, 2017, filed with the SEC on September 7, 2017, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Earnings for the three and nine-month periods ended August 4, 2017 and July 29, 2016, (ii) Condensed Consolidated Statements of Comprehensive Income for the three and nine-month periods ended August 4, 2017 and July 29, 2016, (iii) Condensed Consolidated Balance Sheets as of August 4, 2017, July 29, 2016, and October 31, 2016, (iv) Condensed Consolidated Statement of Cash Flows for the nine-month periods ended August 4, 2017 and July 29, 2016, and (v) Notes to Condensed Consolidated

Financial Statements (filed herewith).

Table of Contents

SIGNATURES

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

THE TORO COMPANY  
(Registrant)

Date: September 7, 2017 By: /s/ Renee J.  
Peterson  
Renee J.  
Peterson  
Vice  
President,  
Treasurer  
and Chief  
Financial  
Officer  
(duly  
authorized  
officer,  
principal  
financial  
officer, and  
principal  
accounting  
officer)