TORO CO
Form 10-Q
June 06, 2008

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 May 2, 2008

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 S No £

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

Large accelerated   Accelerated   Non-accelerated   Smaller reporting filer S filer £ filer £ company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes £ No S

The number of shares of Common Stock outstanding as of May 30, 2007 was 37,507,093.

THE TORO COMPANY
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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
THE TORO COMPANY AND SUBSIDIARIES
Condensed Consolidated Statements of Earnings (Unaudited)
(Dollars and shares in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	May 2, 2008	May 4, 2007	May 2, 2008	May 4, 2007
Net sales	$ 638,510	$ 686,653	$ 1,044,309	$ 1,065,741
Cost of sales	410,744	441,937	667,406	680,960
Gross profit	227,766	244,716	376,903	384,781
Selling, general, and administrative expense	124,943	125,843	242,060	238,124
Earnings from operations	102,823	118,873	134,843	146,657
Interest expense	(5,419)	(5,789)	(10,302)	(10,276)
Other (expense) income, net	(798)	1,476	900	3,867
Earnings before income taxes	96,606	114,560	125,441	140,248
Provision for income taxes	33,822	39,594	44,030	46,832
Net earnings	$ 62,784	$ 74,966	$ 81,411	$ 93,416
Basic net earnings per share of common stock	$ 1.64	$ 1.82	$ 2.12	$ 2.27
Diluted net earnings per share of common stock	$ 1.60	$ 1.77	$ 2.07	$ 2.21
Weighted-average number of shares of common stock outstanding – Basic	38,239	41,098	38,313	41,119
Weighted-average number of shares of common stock outstanding – Diluted	39,126	42,253	39,263	42,255

See accompanying notes to condensed consolidated financial statements.

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

	May 2, 2008	May 4, 2007	October 31, 2007
ASSETS			
Cash and cash equivalents	$ 32,053	$ 40,797	$ 62,047
Receivables, net	547,192	577,223	283,115
Inventories, net	265,428	247,906	251,275
Prepaid expenses and other current assets	13,698	12,904	10,677
Deferred income taxes	56,633	58,042	57,814
Total current assets	915,004	936,872	664,928
Property, plant, and equipment	599,189	562,220	577,082
Less accumulated depreciation	426,986	393,097	406,410
	172,203	169,123	170,672
Deferred income taxes	6,508	1,861	5,185
Other assets	7,953	11,057	9,153
Goodwill	86,097	81,665	86,224
Other intangible assets, net	16,122	5,683	14,675
Total assets	$ 1,203,887	$ 1,206,261	$ 950,837
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current portion of long-term debt	$ 2,341	$ 75,000	$ 1,611
Short-term debt	151,500	45,825	372
Accounts payable	117,425	120,642	90,966
Accrued liabilities	275,911	280,069	248,521
Total current liabilities	547,177	521,536	341,470
Long-term debt, less current portion	227,753	223,141	227,598
Deferred revenue and other long-term liabilities	16,813	9,681	11,331
Stockholders' equity:			
Preferred stock, par value $1.00, authorized 1,000,000 voting and 850,000 non-voting shares, none issued and outstanding	-	-	-
Common stock, par value $1.00, authorized 100,000,000 shares, issued and outstanding 37,364,763 shares as of May 2, 2008 (net of 16,667,457 treasury shares), 40,109,017 shares as of May 4, 2007 (net of 13,923,203 treasury shares), and 37,950,831 shares as of October 31, 2007 (net of 16,081,389 treasury shares)	37,365	40,109	37,951
Retained earnings	374,335	416,692	335,384
Accumulated other comprehensive income (loss)	444	(4,898)	(2,897)
Total stockholders' equity	412,144	451,903	370,438
Total liabilities and stockholders' equity	$ 1,203,887	$ 1,206,261	$ 950,837

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended May 2, 2008	Six Months Ended May 4, 2007
Cash flows from operating activities:		
Net earnings	$ 81,411	$ 93,416
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity losses from investments	324	125
Provision for depreciation and amortization	21,836	20,393
Gain on disposal of property, plant, and equipment	(81)	(99)
Gain on sale of a business	(113)	-
Stock-based compensation expense	3,281	3,828
Increase in deferred income taxes	(1,463)	(1,982)
Changes in operating assets and liabilities:		
Receivables, net	(260,988)	(282,982)
Inventories, net	(13,920)	(5,628)
Prepaid expenses and other assets	(2,870)	(2,322)
Accounts payable, accrued liabilities, and deferred revenue and other long-term liabilities	61,291	54,941
Net cash used in operating activities	(111,292)	(120,310)
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(22,479)	(21,752)
Proceeds from asset disposals	871	117
Increase in investment in affiliates	(250)	-
Increase in other assets	(279)	(48)
Proceeds from sale of a business	1,048	-
Acquisitions, net of cash acquired	(1,000)	(1,088)
Net cash used in investing activities	(22,089)	(22,771)
Cash flows from financing activities:		
Increase in short-term debt	151,128	45,455
Issuance of long-term debt, net of costs	-	121,436
Repayments of long-term debt, net of costs	(750)	-
Excess tax benefits from stock-based awards	339	5,464
Proceeds from exercise of stock options	1,718	6,992
Purchases of Toro common stock	(36,906)	(41,912)
Dividends paid on Toro common stock	(11,478)	(9,865)
Net cash provided by financing activities	104,051	127,570
Effect of exchange rate changes on cash	(664)	785
Net decrease in cash and cash equivalents	(29,994)	(14,726)
Cash and cash equivalents as of the beginning of the fiscal period	62,047	55,523
Cash and cash equivalents as of the end of the fiscal period	$ 32,053	$ 40,797

See accompanying notes to condensed consolidated financial statements.

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THE TORO COMPANY AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
May 2, 2008

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 accounting principles generally accepted in the United States of America for complete financial statements. Unless the context indicates otherwise, the terms “company” and “Toro” refer to The Toro Company and its subsidiaries. In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting primarily of recurring accruals, considered necessary for a fair presentation of the financial position and results of operations. Since the company’s business is seasonal, operating results for the six months ended May 2, 2008 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2008. Additional factors that could cause our actual results to differ materially from our expected results, including any forward-looking statements made in this report, are described in our most recently filed Annual Report on Form 10-K (Item 1A) and later in this report under Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations– Forward-Looking Information.

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

For further information, refer to the consolidated financial statements and notes included in the company’s Annual Report on Form 10-K for the fiscal year ended October 31, 2007. The policies described in that report are used for preparing quarterly reports.

Accounting Policies

In preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles, management must make decisions that impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. In reaching such decisions, management applies judgments based on its understanding and analysis of the relevant circumstances, historical experience, and actuarial valuations. Actual amounts could differ from those estimated at the time the consolidated financial statements are prepared. Note 1 to the consolidated financial statements in the company’s most recent Annual Report on Form 10-K provides a summary of the significant accounting policies followed in the preparation of the financial statements. Other footnotes to the consolidated financial statements in the company’s Annual Report on Form 10-K describe various elements of the financial statements and the assumptions made in determining specific amounts.

Comprehensive Income

Comprehensive income and the components of other comprehensive income (loss) were as follows:

	Three Months Ended		Six Months Ended	
(Dollars in thousands)	May 2, 2008	May 4, 2007	May 2, 2008	May 4, 2007
Net earnings	$ 62,784	$ 74,966	$ 81,411	$ 93,416
Other comprehensive income (loss):				
Cumulative translation adjustments	3,052	2,765	1,128	3,324

Minimum pension liability adjustment, net of tax	-	-	175	-
Unrealized gain (loss) on derivative instruments, net of tax	779	(1,274)	2,038	(1,373)
Comprehensive income	$ 66,615	$ 76,457	$ 84,752	$ 95,367

Stock-Based Compensation

The company accounts for stock-based compensation awards in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), “Share-Based Payment.” During the first quarter of fiscal 2008, option awards were 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. No options were granted during the second quarter of fiscal 2008. For certain non-officer employees, the options vest in full two years from the date of grant and have a five-year term. For officers, certain key employees, and members of our Board of Directors, the options vest one-third each year over a three-year period and have a ten-year term. Compensation expense equal to the grant date fair value is recognized for these awards over the vesting period. The company also issues performance share awards to officers and other key employees. The company determines the fair value of these performance share awards as of the date of grant and recognizes the expense over the three-year vesting period. Total compensation expense for option and performance share awards for the second quarter of fiscal 2008 and 2007 was $1.4 million and $1.9 million, respectively. Year-to-date compensation expense for option and performance share awards through the second quarter of fiscal 2008 and 2007 was $3.3 million and $3.8 million, respectively.

The fair value of each share-based option is estimated on the date of grant using a Black-Scholes valuation method that uses the assumptions noted in the table below. The expected life is a significant assumption as it determines the period for which the risk-free interest rate, volatility, and dividend yield must be applied. The expected life is the average length of time over which the employee groups are expected to exercise their options, which is based on historical experience with similar grants. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. Expected volatilities are based on the movement of the company’s common stock over the most recent historical period equivalent to the expected life of the option. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate over the expected life at the time of grant. Dividend yield is estimated over the expected life based on the company’s dividend policy, historical dividends paid, expected increase in future cash dividends, and expected increase in the company’s stock price. The following table illustrates the assumptions for options granted in the following fiscal periods.

	Fiscal 2008	Fiscal 2007
Expected life of option in years	3 – 6.5	3 – 6.5
Expected volatility	24.84% - 25.75%	24.96% - 26.44%
Weighted-average volatility	25.26%	25.65%
Risk-free interest rate	3.10% - 4.08%	4.42% - 4.53%
Expected dividend yield	0.92%- 0.95%	0.78%- 0.90%
Weighted-average dividend yield	0.94%	0.84%

The weighted-average fair value of options granted during the first quarter of fiscal 2008 was $13.90 per share and during the first two quarters of fiscal 2007 was $12.32 per share. The fair value of performance share awards granted during the first quarters of fiscal 2008 and 2007 was $58.96 per share and $44.90 per share, respectively. No performance share awards were granted during the second quarters of fiscal 2008 or fiscal 2007.

Inventories

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

Inventories were as follows:

(Dollars in thousands)	May 2, 2008	May 4, 2007	October 31, 2007
Raw materials and work in process	$ 70,001	$ 67,298	$ 68,367
Finished goods and service parts	255,914	240,531	242,965
	325,915	307,829	311,332
Less: LIFO	42,889	40,860	42,889
Other reserves	17,598	19,063	17,168
Total	$ 265,428	$ 247,906	$ 251,275

Per Share Data

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

(Shares in thousands)	Three Months Ended May 2, 2008	Three Months Ended May 4, 2007	Six Months Ended May 2, 2008	Six Months Ended May 4, 2007
Basic				
Weighted-average number of shares of common stock	38,239	41,098	38,301	41,078
Assumed issuance of contingent shares	-	-	12	41
Weighted-average number of shares of common stock and assumed issuance of contingent shares	38,239	41,098	38,313	41,119
Diluted				
Weighted-average number of shares of common stock and assumed issuance of contingent shares	38,239	41,098	38,313	41,119
Effect of dilutive securities	887	1,155	950	1,136
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	39,126	42,253	39,263	42,255

Options to purchase an aggregate of 715,135 shares of common stock outstanding during the second quarter of fiscal 2008 were excluded from the diluted net earnings per share calculation because their exercise prices were greater than the average market price of the company’s common stock during the second quarter of fiscal 2008. Options to purchase an aggregate of 164,940 and 11,240 shares of common stock outstanding during the year-to-date periods through the second quarter of fiscal 2008 and 2007, respectively, were excluded from the diluted net earnings per share calculations because their exercise prices were greater than the average market price of the company’s common stock during the year-to-date periods through the second quarters of fiscal 2008 and 2007.

Goodwill

The changes in the net carrying amount of goodwill for the first six months of fiscal 2008 were as follows:

(Dollars in thousands)	Professional Segment	Residential Segment	Total
Balance as of October 31, 2007	$ 75,457	$ 10,767	$ 86,224
Translation adjustment	(63)	(64)	(127)
Balance as of May 2, 2008	$ 75,394	$ 10,703	$ 86,097

Other Intangible Assets

The components of other amortizable intangible assets were as follows:

(Dollars in thousands)	May 2, 2008 Gross Carrying Amount	May 2, 2008 Accumulated Amortization	October 31, 2007 Gross Carrying Amount	October 31, 2007 Accumulated Amortization
Patents	$ 6,553	$ (6,223)	$ 6,553	$ (6,155)
Non-compete agreements	1,939			