TORO CO
Form 10-Q
June 06, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended May 4, 2018

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

For the Transition Period from to

THE TORO COMPANY
(Exact name of registrant as specified in its charter)

Delaware	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 ý No o

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 ý No o

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

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

Exchange Act. o

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

The number of shares of the registrant’s common stock outstanding as of June 1, 2018 was 105,193,660.

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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 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Net sales	$875,280	$872,767	$1,423,526	$1,388,606
Cost of sales	551,224	556,453	895,231	878,812
Gross profit	324,056	316,314	528,295	509,794
Selling, general and administrative expense	153,783	157,018	291,100	289,928
Operating earnings	170,273	159,296	237,195	219,866
Interest expense	(4,720)	(4,676)	(9,538)	(9,559)
Other income, net	3,613	3,701	7,894	7,567
Earnings before income taxes	169,166	158,321	235,551	217,874
Provision for income taxes	37,877	37,846	81,658	52,409
Net earnings	$131,289	$120,475	$153,893	$165,465
Basic net earnings per share of common stock	$1.23	$1.11	$1.44	$1.53
Diluted net earnings per share of common stock	$1.21	$1.08	$1.41	$1.48
Weighted-average number of shares of common stock outstanding — Basic	106,423	108,203	106,830	108,419
Weighted-average number of shares of common stock outstanding — Diluted	108,835	111,138	109,353	111,451

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		Six Months Ended	
	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Net earnings	$131,289	$120,475	$153,893	$165,465
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(8,663)	600	2,209	717
Derivative instruments, net of tax of $1,412; $(257); $833; and $29, respectively	3,760	1,741	981	1,962
Pension and retiree medical benefits	331	—	331	—
Other comprehensive income (loss), net of tax	(4,572)	2,341	3,521	2,679
Comprehensive income	$126,717	$122,816	$157,414	$168,144

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	May 4, 2018	May 5, 2017	October 31, 2017
ASSETS			
Cash and cash equivalents	$206,100	$265,191	$310,256
Receivables, net	329,570	328,524	183,073
Inventories, net	394,801	341,576	328,992
Prepaid expenses and other current assets	47,758	41,272	37,565
Total current assets	978,229	976,563	859,886
Property, plant and equipment, gross	901,768	874,910	885,614
Less accumulated depreciation	656,420	650,633	650,384
Property, plant and equipment, net	245,348	224,277	235,230
Deferred income taxes	42,994	57,117	64,083
Goodwill	225,736	201,915	205,029
Other intangible assets, net	109,710	108,268	103,743
Other assets	33,730	30,618	25,816
Total assets	$1,635,747	$1,598,758	$1,493,787
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current portion of long-term debt	$13,000	$23,105	$26,258
Short-term debt	—	832	—
Accounts payable	303,911	273,600	211,752
Accrued liabilities	335,496	324,878	283,786
Total current liabilities	652,407	622,415	521,796
Long-term debt, less current portion	299,302	311,957	305,629
Deferred revenue	24,672	24,948	24,761
Deferred income taxes	1,770	—	1,726
Other long-term liabilities	34,269	31,667	22,783
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 105,456,188 shares as of May 4, 2018, 107,879,717 shares as of May 5, 2017, and 106,882,972 shares as of October 31, 2017	105,456	107,880	106,883
Retained earnings	538,470	535,648	534,329
Accumulated other comprehensive loss	(20,599)	(35,757)	(24,120)
Total stockholders' equity	623,327	607,771	617,092
Total liabilities and stockholders' equity	$1,635,747	$1,598,758	$1,493,787

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended	
	May 4, 2018	May 5, 2017
Cash flows from operating activities:		
Net earnings	$153,893	$165,465
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Non-cash income from finance affiliate	(5,370)	(4,686)
Contributions to finance affiliate, net	(2,959)	(2,708)
Provision for depreciation and amortization	30,141	34,548
Stock-based compensation expense	5,565	6,629
Deferred income taxes	21,121	136
Other	(40)	—
Changes in operating assets and liabilities, net of effect of acquisitions:		
Receivables, net	(143,947)	(164,495)
Inventories, net	(62,575)	(30,100)
Prepaid expenses and other assets	(8,402)	(9,709)
Accounts payable, accrued liabilities, deferred revenue and other long-term liabilities	151,007	172,643
Net cash provided by operating activities	138,434	167,723
Cash flows from investing activities:		
Purchases of property, plant and equipment	(35,365)	(22,273)
Purchase of noncontrolling interest	(333)	—
Acquisitions, net of cash acquired	(31,202)	(24,181)
Net cash used in investing activities	(66,900)	(46,454)
Cash flows from financing activities:		
Increase in short-term debt, net	—	832
Payments on long-term debt	(20,239)	(15,930)
Proceeds from exercise of stock options	5,778	8,222
Payments of withholding taxes for stock awards	(3,212)	(2,723)
Purchases of Toro common stock	(116,490)	(82,239)
Dividends paid on Toro common stock	(42,679)	(37,936)
Net cash used in financing activities	(176,842)	(129,774)
Effect of exchange rates on cash and cash equivalents	1,152	141
Net decrease in cash and cash equivalents	(104,156)	(8,364)
Cash and cash equivalents as of the beginning of the fiscal period	310,256	273,555
Cash and cash equivalents as of the end of the fiscal period	$206,100	$265,191

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 4, 2018

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 Consolidated Financial Position, Results of Operations, and Cash Flows for the periods presented. Since the company’s business is seasonal, operating results for the six months ended May 4, 2018 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2018.

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, 2017. 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.

United States Tax Reform

On December 22, 2017, the United States ("U.S.") enacted Public Law No. 115-97 ("Tax Act"), originally introduced as the Tax Cuts and Jobs Act, to significantly modify the Internal Revenue Code. The Tax Act reduced the U.S. federal corporate tax rate from 35.0 percent to 21.0 percent, created a territorial tax system with an exemption for foreign dividends, and imposed a one-time deemed repatriation tax on a U.S. company's historical undistributed earnings and profits of foreign affiliates. The tax rate change is effective January 1, 2018, resulting in a blended statutory tax rate of 23.3 percent for the fiscal year ended October 31, 2018. Among other provisions, the Tax Act also increased expensing for certain business assets, created new taxes on certain foreign sourced earnings, adopted limitations on business interest expense deductions, repealed deductions for income attributable to domestic production activities, and added other anti-base erosion rules. The effective dates for the provisions set forth in the Tax Act vary as to when the provisions will apply to the company.

In response to the Tax Act, the U.S. Securities and Exchange Commission ("SEC") provided guidance by issuing Staff Accounting Bulletin No. 118 ("SAB 118"). SAB 118 allows companies to record provisional amounts during a measurement period with respect to the impacts of the Tax Act for which the accounting requirements under Accounting Standards Codification ("ASC")

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Topic 740 are not complete, but a reasonable estimate has been determined. The measurement period under SAB 118 ends when a company has obtained, prepared, and analyzed the information that was needed in order to complete the accounting requirements under ASC Topic 740, but cannot exceed one year.

As of May 4, 2018, the company has not completed the accounting for the effects of the Tax Act. However, the company has estimated the impacts of the Tax Act in its annual effective tax rate, and has recorded provisional amounts for the remeasurement of deferred tax assets and liabilities and the deemed repatriation tax.

While we have recorded provisional amounts for the items expected to most significantly impact our financial statements this year, our evaluation is not complete and, accordingly, we have not yet reached a final conclusion on the overall impacts of the Tax Act. The company needs additional time to obtain, prepare, and analyze information related to the applicable provisions of the Tax Act. The actual impact of the Tax Act may differ from the provisional amounts, due to, among other things, changes in interpretations and assumptions the company has made, guidance that may be issued, and changes in the company's structure or business model.

New Accounting Pronouncements Adopted

In February 2018, the Financial Accounting Standards Board issued Accounting Standards Update No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which provides for the reclassification of the stranded tax effect of remeasuring deferred tax balances related to items within accumulated other comprehensive income (“AOCI”) to retained earnings resulting from the Tax Act. The amendment also includes disclosure requirements regarding an entity's accounting policy for releasing income tax effects from AOCI. The company elected to early adopt this guidance as of the beginning of the second quarter of fiscal 2018. The company had $0.1 million of net stranded income tax effects in accumulated other comprehensive loss (“AOCL”) within the Condensed Consolidated Balance Sheets as a result of the lower U.S. federal corporate tax rate due to the enactment of the Tax Act. The net amount of stranded income tax effects within AOCL was determined under the portfolio approach and was derived from the deferred tax balances on the company’s pension and post-retirement benefit plans and cash flow hedging derivative instruments. The adoption of the guidance resulted in the transfer of $0.1 million of net stranded income tax effects out of AOCL and into retained earnings with no impact to total stockholders’ equity or net earnings.

Note 2 — Acquisitions

L.T. Rich Products, Inc.

Effective March 19, 2018, during the second quarter of fiscal 2018, the company completed the acquisition of substantially all of the assets of, and assumed certain liabilities for, L.T. Rich Products, Inc., a manufacturer of professional zero-turn spreader/sprayers, aerators, and snow and ice management equipment. The addition of these products broadens and strengthens the company’s Professional segment solutions for landscape contractors and grounds professionals.

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 May 4, 2018, the company has not yet finalized the purchase accounting for this acquisition, but expects to finalize such purchase accounting within one year from the date of acquisition. Additional purchase accounting disclosures have been omitted given the immateriality of this acquisition in relation to the company's Consolidated Financial Condition and Results of Operations.

Regnerbau Calw GmbH

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 broadened and strengthened 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. This acquisition was immaterial based on the company's Consolidated Financial Condition and Results of Operations.

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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 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 May 4, 2018 was $29.0 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 six months ended May 4, 2018 and May 5, 2017 were $990.4 million and $959.8 million, respectively.

As of April 30, 2018, Red Iron’s total assets were $574.6 million and total liabilities were $510.2 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 a majority of the company's inventories and the 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 4, 2018	May 5, 2017	October 31, 2017
Raw materials and work in process	$112,435	$96,723	$100,077
Finished goods and service parts	349,167	303,211	295,716
Total FIFO value	461,602	399,934	395,793
Less: adjustment to LIFO value	66,801	58,358	66,801
Total inventories, net	$394,801	$341,576	$328,992

Note 5 — Goodwill and Other Intangible Assets

The changes in the net carrying amount of goodwill for the first six months of fiscal 2018 were as follows:

(Dollars in thousands)	Professional Segment	Residential Segment	Total
Balance as of October 31, 2017	$ 194,464	$ 10,565	$205,029
Goodwill acquired	20,393	—	20,393
Translation adjustments	294	20	314
Balance as of May 4, 2018	$ 215,151	$ 10,585	$225,736

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The components of other intangible assets as of May 4, 2018 were as follows:

(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	$18,287	$ (11,937)	$6,350
Non-compete agreements	6,918	(6,806)	112
Customer-related	89,874	(21,284)	68,590
Developed technology	31,180	(27,872)	3,308
Trade names	2,351	(1,724)	627
Other	800	(800)	—
Total amortizable	149,410	(70,423)	78,987
Non-amortizable - trade names	30,723	—	30,723
Total other intangible assets, net	$180,133	$ (70,423)	$109,710

The components of other intangible assets as of October 31, 2017 were as follows:

(Dollars in thousands)	Gross Carrying Amount	Accumulated Amortization	Net
Patents	$15,162	$ (11,599)	$3,563
Non-compete agreements	6,896	(6,775)	121
Customer-related	87,461	(18,940)	68,521
Developed technology	30,212	(26,939)	3,273
Trade names	2,330	(1,637)	693
Other	800	(800)	—
Total amortizable	142,861	(66,690)	76,171
Non-amortizable - trade names	27,572	—	27,572
Total other intangible assets, net	$170,433	$ (66,690)	$103,743

Amortization expense for intangible assets during the second quarter of fiscal 2018 was $1.8 million, compared to $2.5 million for the same period last fiscal year. Amortization expense for intangible assets during the first six months of fiscal 2018 was $3.6 million, compared to $4.9 million for the same period last fiscal year. Estimated amortization expense for the remainder of fiscal 2018 and succeeding fiscal years is as follows: fiscal 2018 (remainder), $3.7 million; fiscal 2019, $6.7 million; fiscal 2020, $6.2 million; fiscal 2021, $5.8 million; fiscal 2022, $5.6 million; fiscal 2023, $5.2 million; and after fiscal 2023, $45.8 million.

Note 6 — Stockholders’ Equity

Accumulated Other Comprehensive Loss

Components of AOCL, net of tax, are as follows:

(Dollars in thousands)	May 4, 2018	May 5, 2017	October 31, 2017
Foreign currency translation adjustments	$19,094	$30,508	$21,303
Pension and post-retirement benefits	1,681	6,564	2,012
Cash flow hedging derivative instruments	(176)	(1,315)	805
Total accumulated other comprehensive loss	$20,599	$35,757	$24,120

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The components and activity of AOCL for the first six months of fiscal 2018 are as follows:

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Post-Retirement Benefits	Cash Flow Hedging Derivative Instruments	Total
Balance as of October 31, 2017	$ 21,303	$ 2,012	$ 805	$24,120
Other comprehensive (income) loss before reclassifications	(2,209)	85	(3,820)	(5,944)
Amounts reclassified from AOCL	—	(416)	2,839	2,423
Net current period other comprehensive income	(2,209)	(331)	(981)	(3,521)
Balance as of May 4, 2018	$ 19,094	$ 1,681	$ (176)	$20,599

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

(Dollars in thousands)	Foreign Currency Translation Adjustments	Pension and Post-Retirement Benefits	Cash Flow Hedging Derivative Instruments	Total
Balance as of October 31, 2016	$ 31,430	$ 6,359	$ 647	$38,436
Other comprehensive (income) loss before reclassifications	(922)	205	(1,219)	(1,936)
Amounts reclassified from AOCL	—	—	(743)	(743)
Net current period other comprehensive (income) loss	(922)	205	(1,962)	(2,679)
Balance as of May 5, 2017	$ 30,508	$ 6,564	$ (1,315)	$35,757

For additional information on the components reclassified from AOCL to the respective line items within net earnings for the company's cash flow hedging derivative instruments, refer to Note 12, Derivative Instruments and Hedging Activities.

Note 7 — Stock-Based Compensation

The compensation costs related to stock-based awards were as follows:

(Dollars in thousands)	Three Months Ended May 4, 2018	Three Months Ended May 5, 2017	Six Months Ended May 4, 2018	Six Months Ended May 5, 2017
Stock option awards	$1,240	$1,377	$2,415	$2,769
Restricted stock units	650	575	1,655	1,151
Performance share awards	551	1,059	965	2,171
Unrestricted common stock awards	—	—	530	538
Total compensation cost for stock-based awards	$2,441	$3,011	$5,565	$6,629

During the first six months of fiscal years 2018 and 2017, 8,388 and 11,412 shares, respectively, of fully vested unrestricted common stock awards were granted to certain members of the company's Board of Directors as a component of their compensation for their service on the board and are recorded in selling, general and administrative expense in the Condensed Consolidated Statements of Earnings. No shares of fully vested unrestricted common stock awards were granted during the second quarter of fiscal years 2018 and 2017.

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

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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 after the last day of the fiscal year in which the stock 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, stock price 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 exercise experience. The company groups executive officers and non-employee directors for valuation purposes based on similar historical exercise behavior. Expected stock price volatilities are based on the daily 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.

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

	Fiscal 2018	Fiscal 2017
Expected life of option in years	6.04	6.02
Expected stock price volatility	20.58%	22.15%
Risk-free interest rate	2.21%	2.03%
Expected dividend yield	0.97%	1.01%
Per share weighted-average fair value at date of grant	$14.25	$12.55

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 weighted-average fair value of performance share awards granted during the first quarter of fiscal 2018 and 2017 was $65.40 and $54.52, respectively. No performance share awards were granted during the second quarter of fiscal 2018 and 2017.

Restricted Stock Unit Awards

Under the 2010 plan, restricted stock unit awards are generally granted to certain employees that are not executive officers. Occasionally, restricted stock unit awards may be granted, including to executive officers, in connection with hiring, mid-year promotions, leadership transition, or retention. 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 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 six months of fiscal 2018 and 2017 was $65.82 and $56.67, respectively.

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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 May 4, 2018	Three Months Ended May 5, 2017	Six Months Ended May 4, 2018	Six Months Ended May 5, 2017
Basic				
Weighted-average number of shares of common stock	106,423	108,203	106,804	108,398
Assumed issuance of contingent shares	—	—	26	21
Weighted-average number of shares of common stock and assumed issuance of contingent shares	106,423	108,203	106,830	108,419
Diluted				
Weighted-average number of shares of common stock and assumed issuance of contingent shares	106,423	108,203	106,830	108,419
Effect of dilutive securities	2,412	2,935	2,523	3,032
Weighted-average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities	108,835	111,138	109,353	111,451

Incremental shares from options and restricted stock units are computed under the treasury stock method. Options to purchase 464,557 and 509,805 shares of common stock during the second quarter of fiscal 2018 and 2017, respectively, were excluded from diluted net earnings per share because they were anti-dilutive. Options to purchase 385,434 and 404,096 shares of common stock during the first six months of fiscal 2018 and 2017, 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 a wholly-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 tables present the summarized financial information concerning the company's reportable segments:

(Dollars in thousands)				
Three Months Ended May 4, 2018	Professional	Residential	Other	Total
Net sales	$ 660,373	$ 212,169	$ 2,738	$ 875,280
Intersegment gross sales	10,664	107	(10,771)	—
Earnings (loss) before income taxes	$ 164,979	$ 26,304	$ (22,117)	$ 169,166

(Dollars in thousands)				
Three Months Ended May 5, 2017	Professional	Residential	Other	Total
Net sales	$ 610,896	$ 258,134	$ 3,737	$ 872,767
Intersegment gross sales	12,634	118	(12,752)	—
Earnings (loss) before income taxes	$ 149,011	$ 35,047	$ (25,737)	$ 158,321

(Dollars in thousands)				
Six Months Ended May 4, 2018	Professional	Residential	Other	Total
Net sales	$ 1,064,042	$ 354,676	$ 4,808	$ 1,423,526
Intersegment gross sales	17,122	163	(17,285)	—

Earnings (loss) before income taxes	240,891	42,017	(47,357)	235,551
Total assets	$ 963,564	$ 288,248	$ 383,935	$ 1,635,747

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(Dollars in thousands) Six Months Ended May 5, 2017	Professional	Residential	Other	Total
Net sales	$ 982,705	$ 398,524	$7,377	$1,388,606
Intersegment gross sales	17,190	192	(17,382)	—
Earnings (loss) before income taxes	217,177	51,605	(50,908)	217,874
Total assets	$ 892,610	$ 265,913	$440,235	$1,598,758

The following table presents the details of the Other segment operating loss before income taxes:

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Corporate expenses	$(21,096)	$(26,250)	$(45,497)	$(50,211)
Interest expense	(4,720)	(4,676)	(9,538)	(9,559)
Other income	3,699	5,189	7,678	8,862
Total Other segment operating loss before income taxes	$(22,117)	$(25,737)	$(47,357)	$(50,908)

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.

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The changes in accrued warranties were as follows:

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Beginning balance	$74,885	$72,573	$74,155	$72,158
Warranty provisions	17,219	17,180	27,789	26,795
Warranty claims	(8,876)	(8,507)	(18,716)	(18,301)
Changes in estimates	1,040	747	1,040	1,341
Ending balance	$84,268	$81,993	$84,268	$81,993

Note 12 — Derivative Instruments and Hedging Activities

Risk Management Objective of Using Derivatives

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 to hedge against such risk, 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 has 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 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.

The company recognizes all derivative instruments at fair value on the Condensed Consolidated Balance Sheets as either assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as a cash flow hedging instrument.

Cash Flow Hedging Instruments

The company 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. At the cash flow hedge's inception and on an ongoing basis, the company formally assesses 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.

Changes in the fair values of the spot rate component of outstanding, highly effective cash flow hedging instruments included in the assessment of hedge effectiveness are recorded in other comprehensive income within AOCL on the Condensed Consolidated Balance Sheets and are subsequently reclassified to net earnings within the Condensed Consolidated Statements of Earnings during the same period in which the cash flows of the underlying hedged transaction affect net earnings. Changes in the fair values of hedge components excluded from the assessment of effectiveness are recognized immediately in net earnings under the mark-to-market approach. The classification of gains or losses recognized on cash flow hedging instruments and excluded components within the Condensed Consolidated Statements of Earnings is the same as that of the underlying exposure. Results of cash flow hedging instruments, and the related excluded components, of sales and foreign plant operations are recorded in net sales and cost of sales, respectively. 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.

When it is determined that a derivative instrument is not, or has ceased to be, highly effective as a cash flow hedge, the company discontinues cash flow hedge accounting prospectively. The gain or loss on the dedesignated derivative instrument remains in AOCL and is reclassified to net earnings within the same Condensed Consolidated Statements of Earnings line item as the underlying exposure when the forecasted transaction affects net earnings. 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 instrument remains in AOCL and is reclassified to net earnings within the same Condensed Consolidated Statements of Earnings line item as the underlying exposure 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 immediately recognized in net earnings within other income, net in the Condensed Consolidated Statements of Earnings. In all situations in which cash flow hedge accounting is discontinued and the derivative instrument remains outstanding, the company carries the derivative instrument at its fair value on the Condensed Consolidated Balance Sheets, recognizing future changes in the fair value within other income, net in the Condensed Consolidated Statements of Earnings.

As of May 4, 2018, the notional amount outstanding of forward contracts designated as cash flow hedging instruments was $70.0 million.

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 and location of the company’s derivative instruments on the Condensed Consolidated Balance Sheets:

(Dollars in thousands)	May 4, 2018	May 5, 2017	October 31, 2017
Derivative assets:			
Derivatives designated as cash flow hedging instruments			
Prepaid expenses and other current assets			
Forward currency contracts	$1,168	$2,008	$1,014
Derivatives not designated as cash flow hedging instruments			
Prepaid expenses and other current assets			
Forward currency contracts	45	823	27
Total assets	$1,213	$2,831	$1,041
Derivative liabilities:			
Derivatives designated as cash flow hedging instruments			

Accrued liabilities			
Forward currency contracts	$ 179	$—	$ 1,563
Derivatives not designated as cash flow hedging instruments			
Accrued liabilities			
Forward currency contracts	1,326	—	703
Total liabilities	$ 1,505	$—	$ 2,266

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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 instruments 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)	May 4, 2018	May 5, 2017	October 31, 2017
Derivative assets:			
Forward currency contracts			
Gross amounts of recognized assets	$1,343	$2,918	$1,055
Gross liabilities offset in the balance sheets	(130)	(87)	(14)
Net amounts of assets presented in the Consolidated Balance Sheets	$1,213	$2,831	$1,041
Derivative liabilities:			
Forward currency contracts			
Gross amounts of recognized liabilities	$(1,726)	$—	$(2,266)
Gross assets offset in the balance sheets	221	—	—
Net amounts of liabilities presented in the Consolidated Balance Sheets	$(1,505)	$—	$(2,266)

The following tables present the impact and location of the amounts reclassified from AOCL into earnings on the Condensed Consolidated Statements of Earnings and the impact of derivative instruments on the Condensed Consolidated Statements of Comprehensive Income for the company's derivatives designated as cash flow hedging instruments for the three and six months ended May 4, 2018 and May 5, 2017:

	Three Months Ended			
	Gain (Loss) Reclassified from AOCL into Earnings		Gain (Loss) Recognized in OCI on Derivatives	
(Dollars in thousands)	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Derivatives designated as cash flow hedging instruments				
Forward currency contracts				
Net sales	$(2,301)	$1,627	$3,868	$(526)
Cost of sales	295	(561)	(108)	2,267
Total derivatives designated as cash flow hedging instruments	$(2,006)	$1,066	$3,760	$1,741

	Six Months Ended			
	Gain (Loss) Reclassified from AOCL into Earnings		Gain (Loss) Recognized in OCI on Derivatives	
(Dollars in thousands)	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Derivatives designated as cash flow hedging instruments				
Forward currency contracts				
Net sales	$(3,312)	$2,066	$1,190	$(154)

Cost of sales	473	(1,323)	(209)	2,116
Total derivatives designated as cash flow hedging instruments	$(2,839)	$743	$981	$1,962

The company recognized immaterial gains within other income, net in net earnings during the second quarter and first six months of fiscal 2018 due to the discontinuance of cash flow hedge accounting on certain forward currency contracts designated as cash flow hedging instruments. For the second quarter and first six months of fiscal 2017, the company did not discontinue cash flow

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hedge accounting on any forward currency contracts designated as cash flow hedging instruments. As of May 4, 2018, the company expects to reclassify approximately $0.7 million of gains from AOCL to earnings during the next twelve months.

The following tables present the impact and location of derivative instruments on the Condensed Consolidated Statements of Earnings for the company's derivatives designated as cash flow hedging instruments and the related components excluded from effectiveness testing:

	Gain (Loss) Recognized in Earnings on Cash Flow Hedging Instruments					
	May 4, 2018			May 5, 2017		
(Dollars in thousands) Three Months Ended	Net Sales	Cost of Sales	Other Income, Net	Net Sales	Cost of Sales	Other Income, Net
Total Consolidated Statements of Earnings income (expense) amounts in which the effects of cash flow hedging instruments are recorded	$875,280	$(551,224)	$ 3,613	$872,767	$(556,453)	$3,701
Gain (loss) on derivatives designated as cash flow hedging instruments:						
Forward currency contracts						
Amount of gain (loss) reclassified from AOCL into earnings	(2,301)	295	—	1,627	(561)	—
Loss on components excluded from effectiveness testing recognized in earnings based on changes in fair value	$(80)	$(93)	$ —	$—	$—	$(28)

	Gain (Loss) Recognized in Earnings on Cash Flow Hedging Instruments					
	May 4, 2018			May 5, 2017		
(Dollars in thousands) Six Months Ended	Net Sales	Cost of Sales	Other Income, Net	Net Sales	Cost of Sales	Other Income, Net
Total Consolidated Statements of Earnings income (expense) amounts in which the effects of cash flow hedging instruments are recorded	$1,423,526	$(895,231)	$ 7,894	$1,388,606	$(878,812)	$ 7,567
Gain (loss) on derivatives designated as cash flow hedging instruments:						
Forward currency contracts						
Amount of gain (loss) reclassified from AOCL into earnings	(3,312)	473	—	2,066	(1,323)	—
Gain (loss) on components excluded from effectiveness testing recognized in earnings based on changes in fair value	$(101)	$(118)	$ —	$—	$—	$ 369

The following table presents the impact and location of derivative instruments on the Condensed Consolidated Statements of Earnings for the company's derivatives not designated as cash flow hedging instruments:

	Three Months Ended		Six Months Ended	
(Dollars in thousands)	May 4, 2018	May 5, 2017	May 4, 2018	May 5, 2017
Gain (loss) on derivatives not designated as cash flow hedging instruments				

Forward currency contracts				
Other income, net	$1,200	$(590)	$(616)	$ 554
Total gain (loss) on derivatives not designated as cash flow hedging instruments	$1,200	$(590)	$(616)	$ 554

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Note 13 — Fair Value Measurements

The company categorizes its assets and liabilities measured at fair value 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.

Recurring Fair Value Measurements

The company's derivative instruments consist of forward currency contracts that are measured at fair value on a recurring basis. The fair value of forward currency contracts is determined based on observable market transactions of forward currency prices and spot currency rates as of the reporting date. There were no transfers between levels for the company's recurring fair value measurements during the three and six months ended May 4, 2018 and May 5, 2017, or the twelve months ended October 31, 2017.

The following tables present, by level within the fair value hierarchy, the company's financial assets and liabilities that are measured at fair value on a recurring basis as of May 4, 2018, May 5, 2017, and October 31, 2017, according to the valuation technique utilized to determine their fair values:

(Dollars in thousands)		Fair Value Measurements Using Inputs Considered as:		
May 4, 2018	Fair Value	Level 1	Level 2	Level 3
Assets:				
Forward currency contracts	$ 1,213	$ —	$ 1,213	$ —
Total assets	$ 1,213	$ —	$ 1,213	$ —
Liabilities:				
Forward currency contracts	$ 1,505	$ —	$ 1,505	$ —
Total liabilities	$ 1,505	$ —	$ 1,505	$ —

(Dollars in thousands)		Fair Value Measurements Using Inputs Considered as:		
May 5, 2017	Fair Value	Level 1	Level 2	Level 3
Assets:				
Forward currency contracts	$ 2,831	$ —	$ 2,831	$ —
Total assets	$ 2,831	$ —	$ 2,831	$ —
Liabilities:				
Forward currency contracts	$ —	$ —	$ —	$ —
Total liabilities	$ —			