# 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 5, 2006**

# 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 x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer 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 x

The number of shares of Common Stock outstanding as of June 2, 2006 was 42,174,877.

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**PART I.**

**ITEM 1. FINANCIAL INFORMATION**

**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 5, 2006 | April 29, 2005 | May 5, 2006 | April 29, 2005 |
| Net sales | $ 659,004 | $ 628,441 | $ 1,028,644 | $ 975,354 |
| Cost of sales | 428,748 | 411,798 | 666,514 | 637,048 |
| Gross profit | 230,256 | 216,643 | 362,130 | 338,306 |
| Selling, general, and administrative expense | 124,309 | 119,542 | 231,514 | 221,781 |
| Earnings from operations | 105,947 | 97,101 | 130,616 | 116,525 |
| Interest expense | (5,177) | (4,873) | (9,420) | (8,633) |
| Other income, net | 2,446 | 942 | 3,332 | 2,083 |
| Earnings before income taxes | 103,216 | 93,170 | 124,528 | 109,975 |
| Provision for income taxes | 33,134 | 31,212 | 40,167 | 36,841 |
| Net earnings | $ 70,082 | $ 61,958 | $ 84,361 | $ 73,134 |
| Basic net earnings per share of common stock | $ 1.62 | $ 1.38 | $ 1.94 | $ 1.61 |
| Diluted net earnings per share of common stock | $ 1.56 | $ 1.33 | $ 1.87 | $ 1.55 |
| Weighted average number of shares of common stock outstanding — Basic | 43,375 | 44,754 | 43,494 | 45,438 |
| Weighted average number of shares of common stock outstanding — Diluted | 44,957 | 46,592 | 45,000 | 47,210 |

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 5, 2006 | April 29, 2005 | October 31, 2005 |
|---|---|---|---|
| ASSETS | | | |
| Cash and cash equivalents | $ 27,240 | $ 14,449 | $ 41,402 |
| Receivables, net | 546,413 | 539,633 | 295,683 |
| Inventories, net | 248,134 | 256,926 | 235,347 |
| Prepaid expenses and other current assets | 18,688 | 13,476 | 16,084 |
| Deferred income taxes | 74,556 | 56,265 | 58,558 |
| Total current assets | 915,031 | 880,749 | 647,074 |
| Property, plant, and equipment | 520,839 | 498,171 | 506,884 |
| Less accumulated depreciation | 357,110 | 327,837 | 339,607 |
| | 163,729 | 170,334 | 167,277 |
| Other assets | 8,355 | 18,341 | 15,737 |
| Goodwill | 81,346 | 81,360 | 81,197 |
| Other intangible assets, net | 5,175 | 5,855 | 5,452 |

| | | | |
|---|---|---|---|
| Total assets | $ 1,173,636 | $ 1,156,639 | $ 916,737 |
| | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current portion of long-term debt | $ 23 | $ 45 | $ 46 |
| Short-term debt | 121,078 | 151,137 | 325 |
| Accounts payable | 126,201 | 114,915 | 87,952 |
| Accrued liabilities | 296,464 | 293,333 | 252,879 |
| Total current liabilities | 543,766 | 559,430 | 341,202 |
| | | | |
| Long-term debt, less current portion | 175,000 | 175,024 | 175,000 |
| Long-term deferred income taxes | 872 | 3,837 | 872 |
| Deferred revenue and other long-term liabilities | 9,356 | 7,827 | 9,629 |
| | | | |
| 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 42,371,599 shares as of May 5, 2006 (net of 11,660,621 treasury shares), 43,267,698 shares as of April 29, 2005 (net of 10,764,522 treasury shares), and 41,898,463 shares as of October 31, 2005 (net of 12,133,757 treasury shares) | 42,372 | 43,268 | 41,899 |
| Retained earnings | 413,569 | 376,269 | 359,716 |
| Accumulated other comprehensive loss | (11,299) | (9,016) | (11,581) |
| Total stockholders' equity | 444,642 | 410,521 | 390,034 |
| Total liabilities and stockholders' equity | $ 1,173,636 | $ 1,156,639 | $ 916,737 |

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 5, 2005 | April 29, 2006 |
| Cash flows from operating activities: | | |
| Net earnings | $ 84,361 | $ 73,134 |
| Adjustments to reconcile net earnings to net cash used in operating activities: | | |
| Equity losses from investments | 839 | 302 |
| Provision for depreciation and amortization | 21,053 | 18,592 |
| Gain on disposal of property, plant, and equipment | (11) | (242) |
| Stock-based compensation expense | 4,465 | 4,819 |
| Increase in deferred income taxes | (15,923) | (3,280) |
| Changes in operating assets and liabilities: | | |
| Receivables, net | (251,863) | (238,083) |
| Inventories, net | (10,839) | (20,248) |
| Prepaid expenses and other assets | (809) | 4,189 |
| Accounts payable, accrued expenses, and deferred revenue | 78,028 | 72,409 |
| Net cash used in operating activities | (90,699) | (88,408) |
| | | |
| Cash flows from investing activities: | | |
| Purchases of property, plant, and equipment | (17,155) | (15,106) |
| Proceeds from asset disposals | 787 | 2,351 |
| Increase in investment in affiliates | (371) | (197) |
| Decrease (increase) in other assets | 6,192 | (538) |
| Proceeds from sale of a business | — | 765 |
| Acquisition, net of cash acquired | — | (35,285) |
| Net cash used in investing activities | (10,547) | (48,010) |
| | | |
| Cash flows from financing activities: | | |
| Increase in short-term debt | 120,722 | 150,007 |
| Repayments of long-term debt | (23) | (22) |
| Excess tax benefits from stock-based awards | 15,625 | 4,015 |
| Proceeds from exercise of stock options | 7,376 | 5,631 |
| Purchases of Toro common stock | (49,286) | (94,029) |
| Dividends paid on Toro common stock | (7,842) | (5,482) |
| Net cash provided by financing activities | 86,572 | 60,120 |
| | | |
| Effect of exchange rates on cash | 512 | (9) |
| | | |
| Net decrease in cash and cash equivalents | (14,162) | (76,307) |

| | | |
|---|---|---|
| Cash and cash equivalents as of the beginning of the period | 41,402 | 90,756 |
| Cash and cash equivalents as of the end of the period | $ 27,240 | $ 14,449 |

See accompanying notes to condensed consolidated financial statements.



**THE TORO COMPANY AND SUBSIDIARIES**
**Notes to Condensed Consolidated Financial Statements (Unaudited)**
**May 5, 2006**

**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 5, 2006 cannot be annualized to determine the expected results for the fiscal year ending October 31, 2006. Certain amounts from prior period's financial statements have been reclassified to conform to this period's presentation.

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, 2005. The policies described in that report are used for preparing quarterly reports.

**Accounting Policies**

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, 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 were as follows:

| (Dollars in thousands) | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | May 5, 2006 | April 29, 2005 |
| Net earnings | $ 70,082 | $ 61,958 | $ 84,361 | $ 73,134 |
| Other comprehensive income: | | | | |
| Cumulative translation adjustments | 1,364 | 265 | 1,795 | 818 |
| Unrealized (loss) gain on derivative instruments, net of taxes | (1,177) | 838 | (1,513) | 1,308 |
| Comprehensive income | $ 70,269 | $ 63,061 | $ 84,643 | $ 75,260 |



**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 2006, option awards were granted with an exercise price equal to the market price of the company's common stock as of the date of grant. For certain non-officer employees, the options vest after two years from the date of grant and have a five-year contractual term. Other options granted during the first quarter of fiscal 2006 vest one-third each year over a three-year period and have a ten-year contractual term. Compensation expense equal to the grant date fair value is recognized for these awards over the vesting period. The company also issues Performance Shares to key employees. The company determines the fair value of these Performance Shares as of the date of grant and recognizes the expense over the vesting period. Total compensation expense for option awards and Performance Shares for the second quarter of fiscal 2006 and 2005 was $2.0 million and $2.2 million, respectively. Year-to-date compensation expense for option awards and Performance Shares through the second quarter of fiscal 2006 and 2005 was $4.1 million and $4.2 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 following table. 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 will 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 stock over the most recent historical period equivalent to the expected life of the option. The risk-free 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 2006 | Fiscal 2005 |
|---|---|---|
| Expected life of option in years | 2.5 – 6.5 | 3 – 7 |
| Expected volatility | 25.26% – 26.96% | 25.87% – 30.41% |
| Weighted-average volatility | 26.12% | 28.04% |
| Risk-free interest rate | 4.399% – 4.526% | 3.22% – 4.04% |
| Expected dividend yield | 0.65% – 0.70% | 0.18% – 0.25% |
| Weighted-average dividend yield | 0.67% | 0.22% |

The weighted-average fair value of options granted during the first quarters of fiscal 2006 and 2005 was $10.90 per share and $11.14 per share, respectively. The fair value of Performance Shares granted during the first quarters of fiscal 2006 and 2005 was $41.44 per share and $37.02 per share, respectively. No options or Performance Shares were granted during the second quarters of fiscal 2006 and 2005.

**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) 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 market value for that inventory. These reserves are based on a review and comparison of current inventory levels to the production and sales history of the inventory.

Inventories were as follows:

| (Dollars in thousands) | May 5, 2006 | April 29, 2005 | October 31, 2005 |
|---|---|---|---|
| Raw materials and work in process | $ 69,276 | $ 70,559 | $ 61,824 |
| Finished goods and service parts | 237,008 | 236,481 | 231,772 |
| | 306,284 | 307,040 | 293,596 |
| Less: LIFO | 40,011 | 30,227 | 40,011 |
| Other reserves | 18,139 | 19,887 | 18,238 |
| Total | $ 248,134 | $ 256,926 | $ 235,347 |



**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 5, 2006 | Three Months Ended April 29, 2005 | Six Months Ended May 5, 2006 | Six Months Ended April 29, 2005 |
|---|---|---|---|---|
| _Basic_ | | | | |
| Weighted average number of shares of common stock | 43,375 | 44,754 | 43,418 | 45,366 |
| Assumed issuance of contingent shares | — | — | 76 | 72 |
| Weighted average number of shares of common stock and assumed issuance of contingent shares | 43,375 | 44,754 | 43,494 | 45,438 |
| _Diluted_ | | | | |
| Weighted average number of shares of common stock and assumed issuance of contingent shares | 43,375 | 44,754 | 43,494 | 45,438 |
| Effect of dilutive securities | 1,582 | 1,838 | 1,506 | 1,772 |
| Weighted average number of shares of common stock, assumed issuance of contingent shares, and effect of dilutive securities | 44,957 | 46,592 | 45,000 | 47,210 |

Shares for all periods presented have been adjusted to reflect a two-for-one stock split effective March 28, 2005.

**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 two reportable business segments: Professional and Residential. The Other segment consists of company-owned distributor operations in the United States and corporate activities, including corporate financing activities and elimination of intersegment revenues and expenses.

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

| (Dollars in thousands) | Professional | Residential | Other | Total |
|---|---|---|---|---|
| _Three months ended May 5, 2006_ | | | | |
| Net sales | $ 439,098 | $ 210,293 | $ 9,613 | $ 659,004 |
| Intersegment gross sales | 18,947 | 3,517 | (22,464) | — |
| Earnings (loss) before income taxes | 104,177 | 18,136 | (19,097) | 103,216 |
| _Three months ended April 29, 2005_ | | | | |
| Net sales | $ 389,052 | $ 227,722 | $ 11,667 | $ 628,441 |
| Intersegment gross sales | 18,166 | 3,884 | (22,050) | — |
| Earnings (loss) before income taxes | 84,623 | 28,963 | (20,416) | 93,170 |

| | Professional | Residential | Other | Total |
|---|---|---|---|---|
| Six months ended May 5, 2006 | | | | |
| Net sales | $ 692,703 | $ 318,478 | $ 17,463 | $ 1,028,644 |
| Intersegment gross sales | 26,537 | 4,187 | (30,724) | — |
| Earnings (loss) before income taxes | 145,837 | 23,285 | (44,594) | 124,528 |
| Total assets | 545,760 | 259,959 | 367,917 | 1,173,636 |
| | | | | |
| Six months ended April 29, 2005 | | | | |
| Net sales | $ 634,282 | $ 323,598 | $ 17,474 | $ 975,354 |
| Intersegment gross sales | 28,063 | 4,573 | (32,636) | — |
| Earnings (loss) before income taxes | 123,488 | 33,397 | (46,910) | 109,975 |
| Total assets | 520,092 | 275,701 | 360,846 | 1,156,639 |



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 5, 2006 | April 29, 2005 | May 5, 2006 | April 29, 2005 |
| Corporate expenses | $ (22,669) | $ (21,937) | $ (47,927) | $ (47,883) |
| Finance charge revenue | 539 | 924 | 1,240 | 1,582 |
| Elimination of corporate financing expense | 5,435 | 5,524 | 8,917 | 8,498 |
| Interest expense, net | (5,177) | (4,873) | (9,420) | (8,633) |
| Other | 2,775 | (54) | 2,596 | (474) |
| Total | $ (19,097) | $ (20,416) | $ (44,594) | $ (46,910) |

**Goodwill**

The changes in the net carrying amount of goodwill for the first six months of fiscal 2006 were as follows:

| (Dollars in thousands) | Professional Segment | Residential Segment | Total |
|---|---|---|---|
| Balance as of October 31, 2005 | $ 70,801 | $ 10,396 | $ 81,197 |
| Translation adjustment | 78 | 71 | 149 |
| Balance as of May 5, 2006 | $ 70,879 | $ 10,467 | $ 81,346 |

**Other Intangible Assets**

The components of other amortizable intangible assets were as follows:

| (Dollars in thousands) | May 5, 2006 | | October 31, 2005 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Patents | $ 6,553 | $ (5,792) | $ 6,553 | $ (5,620) |
| Non-compete agreements | 1,000 | (867) | 1,000 | (821) |
| Customer related | 1,289 | (161) | 1,239 | (93) |
| Other | 2,000 | (1,425) | 2,000 | (1,285) |
| Total | $ 10,842 | $ (8,245) | $ 10,792 | $ (7,819) |
| | | | | |
| Total other amortizable intangible assets, net | $ 2,597 | | $ 2,973 | |

Amortization expense for intangible assets during the first six months of fiscal 2006 was $419,000. Estimated amortization expense for the remainder of fiscal 2006 and succeeding fiscal years is as follows: 2006 (remainder), $411,000; 2007, $637,000; 2008, $461,000; 2009, $251,000; 2010, $174,000; 2011, $174,000 and after 2011, $489,000.

The company also had $2.5 million of non-amortizable intangible assets related to the Hayter brand name.

**Warranty Guarantees**

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



Warranty provisions, claims, and changes in estimates for the first six-month periods in fiscal 2006 and 2005 were as follows:

| (Dollars in thousands) Six Months Ended | Beginning Balance | Warranty Provision | Warranty Claims | Changes in Estimates | Ending Balance |
|---|---|---|---|---|---|
| May 5, 2006 | $ 61,385 | $ 23,533 | $ (15,221) | $ 343 | $ 70,040 |
| April 29, 2005 | $ 60,988 | $ 22,526 | $ (16,593) | $ 503 | $ 67,424 |

**Postretirement Benefit Plans**

The following table presents the components of net periodic benefit costs:

| (Dollars in thousands) | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | May 5, 2006 | April 29, 2005 |
| Service cost | $ 95 | $ 131 | $ 190 | $ 262 |
| Interest cost | 128 | 128 | 256 | 256 |
| Prior service cost | (48) | (48) | (96) | (96) |
| Amortization of losses | 68 | 83 | 136 | 166 |
| Net expense | $ 243 | $ 294 | $ 486 | $ 588 |

As of May 5, 2006, approximately $284,000 of contributions had been made. The company presently expects to contribute approximately $550,000 to its postretirement health-care benefit plan in fiscal 2006.

The company maintains The Toro Company Investment, Savings and Employee Stock Ownership Plan for eligible employees. The company's expenses under this plan were $4.2 million and $8.3 million for the second quarter and year-to-date periods in fiscal 2006, respectively, and $4.0 million and $7.7 million for the second quarter and year-to-date periods in fiscal 2005, respectively.

**Derivative Instruments and Hedging Activities**

The company uses derivative instruments to assist in the management of exposure to currency exchange rates. The company uses derivative instruments only to limit underlying exposure to currency fluctuations, and not for trading purposes. The company documents relationships between hedging instruments and the hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. The company assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged item.

The company enters into foreign currency exchange contracts to hedge the risk from forecasted settlements in local currencies of trade sales and purchases. These contracts are designated as cash flow hedges and are reported at fair value as a hedge asset or liability in prepaid expenses or accrued liabilities, as applicable. Changes in the fair value of these contracts are reported in accumulated other comprehensive loss until the hedged transaction occurs. Once the forecasted transaction has been recognized as a sale or inventory purchase and a related asset or liability recorded in the balance sheet, the related fair value of the derivative hedge contract is reclassified from accumulated other comprehensive income (loss) into earnings. During the three and six months ended May 5, 2006, the amount of gains reclassified to earnings for such cash flow hedges was $0.5 million and $1.0 million, respectively. For the six months ended May 5, 2006, the gains treated as an addition to net sales for contracts to hedge trade sales were $0.8 million and the gains treated as a reduction of cost of sales for contracts to hedge inventory purchases were $0.2 million. As of May 5, 2006, the notional amount of such contracts outstanding was $54.1 million. The unrecognized after-tax loss portion of the fair value of the contracts recorded in accumulated other comprehensive loss as of May 5, 2006 was $0.9 million.

The company also enters into other foreign currency exchange contracts. These contracts are intended to hedge intercompany financing transactions and other activities and are not designed as hedging instruments under the accounting criteria of SFAS No. 133; therefore, changes in fair value of these instruments are recorded in other income, net.



**Contingencies**

On June 3, 2004, eight individuals who claim to have purchased lawnmowers in Illinois and Minnesota filed a lawsuit (Ronnie Phillips et al. v. Sears Roebuck Corporation et. al., No.04-L-334 (20th Judicial Circuit, St. Clair County, IL)) against the company and eight other defendants alleging that the horsepower labels on the products the plaintiffs purchased were inaccurate. The plaintiffs seek certification of a class of all persons in the United States who, beginning January 1, 1995 through the present purchased a lawnmower containing a two stroke or four stroke gas combustible engine up to 20 horsepower that was manufactured or sold by the defendants. The complaint seeks an injunction, unspecified compensatory and punitive damages, and attorneys' fees. No answers have been entered in the case, and there has yet been no formal discovery. A number of procedural motions were filed by the defendants, but have not yet been decided. On April 20, 2005, the court issued a stay of discovery and procedural matters to permit the parties to engage in settlement discussions. An attempt at mediation in October 2005 was unsuccessful. On May 17, 2006, the court granted plaintiffs' motion to amend the complaint to add 84 additional plaintiffs. The amended complaint asserts violations of the federal Racketeer Influenced and Corrupt Organizations (RICO) Act and statutory and common law claims arising from the laws of 48 states. The amended complaint also adds an engine manufacturer as an additional defendant, revises the claim to cover lawnmowers with up to a 30 horsepower engine, expands the class period to January 1, 1994 through the present, and seeks treble damages under the RICO Act. In late May 2006, the case was removed to Federal court. Toro has been notified that defendant MTD Products Inc. has agreed to settle with plaintiffs. All remaining non-settling defendants have filed counterclaims against MTD Products Inc. for potential contribution amounts. Management continues to evaluate this lawsuit and is unable to reasonably estimate the likelihood of loss or the amount or range of potential loss that could result from this litigation. Therefore, an accrual has not been established for any potential loss in connection with this lawsuit. The company is also unable to assess at this time whether the lawsuit will have a material adverse effect on its annual consolidated operating results or financial condition, although an unfavorable resolution could be material to the company's consolidated operating results for a particular period.

In the ordinary course of business, in addition to that described above, the company may become liable with respect to pending and threatened litigation for product liability, tax, patent, environmental, and other matters. While the ultimate results of current claims, investigations, and lawsuits involving the company are unknown at this time, management believes that, except for the lawsuit discussed above, the outcomes of these cases are unlikely to have a material adverse effect on the consolidated operating results, liquidity, or financial position of the company.

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

**Nature of Operations**

The Toro Company is in the business of designing, manufacturing, and marketing professional turf maintenance equipment and services, turf and micro irrigation systems, landscaping equipment, and residential yard products worldwide. Our products are sold through a network of distributors, dealers, hardware retailers, home centers, mass retailers, and over the Internet, mainly through Internet retailers. Our businesses are organized into two segments: professional and residential. A third segment called "other" consists of domestic distribution companies and corporate activities. Our emphasis is to provide well-built, dependable, and innovative products supported by an extensive service network. A significant portion of our revenues has historically been attributable to new and enhanced products. As we enter the last six months of our "6 + 8" profitability and growth initiative, we expect to continue to invest in growth strategies directed at underserved markets, such as accelerating our growth in international markets. The goals of this initiative are to achieve a consistent after-tax return on net sales of 6 percent or more and grow revenues at an average rate of 8 percent or more over the three-year period ending October 31, 2006.

**RESULTS OF OPERATIONS**

**Overview**

Our results for the second quarter of fiscal 2006 were strong with double digit earnings growth. Our net earnings rose 13.1 percent compared to the second quarter of fiscal 2005 on a net sales growth rate of 4.9 percent. Year-to-date net earnings rose 15.4 percent in fiscal 2006 compared to the same period last fiscal year on a year-to-date sales growth rate of 5.5 percent. Sales growth was led by continued strong sales in our professional segment, somewhat hampered by a decline in sales for the residential segment. International sales continued its growth momentum with an increase of 6.7 percent and 16.6 percent for the second quarter and year-to-date period of fiscal 2006, respectively, compared to the same periods last fiscal year. Factoring out the additional sales from our purchase of Hayter Limited, which we acquired in February 2005, total year-to-date net sales were up 4.7 percent for fiscal 2006 compared to the same period in fiscal 2005. Net earnings as a percentage of net sales rose from 9.9 percent and 7.5 percent in the second quarter and year-to-date period of fiscal 2005, respectively, to 10.6 percent and 8.2 percent in the second quarter and year-to-date period of fiscal 2006, respectively. Higher gross margins, a lower effective tax rate, and continued leveraging of selling, general, and administrative expenses contributed to the earnings improvement. Our financial condition remains strong with only modest increases in receivables and a decline in inventory levels as compared to the end of the second quarter of fiscal 2005. We also increased our second quarter cash dividend by 50 percent compared to the quarterly cash dividend paid in the second quarter of fiscal 2005.

Our fiscal 2006 second quarter results were strong, and we are optimistic that our results for the full fiscal year of 2006 will end strong. We continue to keep a cautionary eye on the weather, field inventory levels, retail demand, world economies, commodity prices, competitive actions, and other factors identified below under the heading "Forward-Looking Information," which could cause our actual results to differ from our outlook. In particular, retail demand for the first half of fiscal 2006 was lower than our expectations, which could have a negative impact on our fiscal third quarter net sales if such retail demand trends continue.

**Net Earnings**

Net earnings for the second quarter of fiscal 2006 were $70.1 million or $1.56 per diluted share compared to $62.0 million or $1.33 per diluted share for the second quarter of fiscal 2005, a net earnings per diluted share increase of 17.3 percent. Year-to-date net earnings in fiscal 2006 were $84.4 million or $1.87 per diluted share compared to $73.1 million or $1.55 per diluted share last fiscal year, a net earnings per diluted share increase of 20.6 percent. The primary factors contributing to these increases were higher sales volumes, an increase in gross margins, a lower effective tax rate, and improved leveraging of selling, general, and administrative costs. In addition, second quarter and year-to-date fiscal 2006 net earnings per diluted share were benefited by approximately $0.06 per share and $0.08 per share, respectively, compared to the same periods in fiscal 2005 as a result of reduced shares outstanding due to our significant Toro common stock repurchases.



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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | May 5, 2006 | April 29, 2005 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 65.1 | 65.5 | 64.8 | 65.3 |
| Gross profit | 34.9 | 34.5 | 35.2 | 34.7 |
| Selling, general, and administrative expense | (18.9) | (19.0) | (22.5) | (22.7) |
| Interest expense | (0.8) | (0.8) | (0.9) | (0.9) |
| Other income, net | 0.4 | 0.1 | 0.3 | 0.2 |
| Provision for income taxes | (5.0) | (4.9) | (3.9) | (3.8) |
| Net earnings | 10.6% | 9.9% | 8.2% | 7.5% |

**Net Sales**

Worldwide consolidated net sales for the second quarter and year-to-date period of fiscal 2006 were up 4.9 percent and 5.5 percent, respectively, from the same periods in the prior fiscal year. Factoring out the effect of the additional sales from Hayter, which was acquired in February 2005, net sales for the year-to-date period of fiscal 2006 increased 4.7 percent over the same period last fiscal year. The net sales increase was led by price increases, market share gains, and strong worldwide demand in the professional segment as a result of the introduction of new products. International sales continued to be strong,

particularly in the professional segment, despite the unfavorable impact of currency exchange rates that hampered sales by approximately $5 million and $7 million for the second quarter of fiscal 2006 and year-to date period of fiscal 2006, respectively, compared to the same periods last fiscal year. Residential segment sales were down as a result of lower walk power mower sales, somewhat offset by an increase of new riding product shipments. International residential segment sales were down for the second quarter of fiscal 2006 compared to the second quarter of fiscal 2005 as a result of lower sales at Hayter. However, international residential segment sales were up for the year-to-date period of fiscal 2006 compared to the same period last year.

**Gross Profit**

Gross profit for the second quarter and year-to-date period of fiscal 2006 increased 6.3 percent and 7.0 percent, respectively, compared to the same periods of the prior fiscal year due to increased sales. As a percentage of net sales, gross profit for the second quarter and year-to-date period of fiscal 2006 was 34.9 percent and 35.2 percent, respectively, compared to 34.5 percent and 34.7 percent for the second quarter and year-to-date period of fiscal 2005, respectively. The increase in gross profit as a percentage of net sales was the result of the following factors: (i) price increases introduced on some products to help mitigate the impact of higher commodity costs during the past several years; (ii) a higher proportionate share of professional segment sales that carry higher average gross margins than residential segment sales; and (iii) cost reduction efforts, including benefits from past and continuing profit improvement initiatives. Somewhat offsetting those positive factors were: (i) continued higher commodity costs; (ii) lower gross margins for the new line of riding products in the residential segment; (iii) increased freight costs due to higher fuel costs and increased demand for transportation; and (iv) higher tooling costs for new products introduced during the past two years.

**Selling, General, and Administrative Expense**

Selling, general, and administrative expense (SG&A) increased for the second quarter and year-to-date period of fiscal 2006 by 4.0 percent and 4.4 percent, respectively, from the same periods of the prior fiscal year. SG&A as a percentage of net sales for the second quarter and year-to-date period of fiscal 2006 was 18.9 percent and 22.5 percent, respectively, compared to 19.0 percent and 22.7 percent for the second quarter and year-to-date period of fiscal 2005, respectively. The decrease in SG&A expense as a percentage of net sales was due primarily to leveraging the fixed portion of SG&A costs over higher sales volumes. Somewhat offsetting those decreases were: (i) increased investments in engineering and information systems as part of our “6 + 8” initiative and (ii) higher warranty expense due to special provisions for product modifications.



**Interest Expense**

Interest expense for the second quarter and year-to-date period of fiscal 2006 increased by 6.2 percent and 9.1 percent, respectively, from the same periods in the prior year. These increases were due primarily to higher average interest rates on short-term debt.

**Other Income, Net**

Other income, net for the second quarter and year-to-date period of fiscal 2006 was $2.4 million and $3.3 million, respectively. These amounts represent increases of $1.5 million and $1.2 million, respectively, from the same periods in the prior fiscal year. These increases were due primarily to currency exchange rate gains this year compared to currency exchange rate losses last year and higher litigation settlement recovery in fiscal 2006 compared to fiscal 2005.

**Provision for Income Taxes**

The effective tax rate for the second quarter of fiscal 2006 was 32.1 percent compared to 33.5 percent in the second quarter of fiscal 2005. The effective tax rate for the year-to-date period of fiscal 2006 was 32.3 percent compared to 33.5 percent for the same period in the prior fiscal year. The decline in the effective tax rate was due to the favorable resolution of tax matters from prior years’ tax returns.

**BUSINESS SEGMENTS**

As described previously, we operate in two reportable business segments: professional and residential. A third reportable segment called “other” consists of company-owned domestic distributorships, and corporate activities, including corporate financing activities. Operating earnings for each of our two business segments is defined as earnings from operations plus other income, net. Operating loss for our third “other” segment includes earnings (loss) from operations, corporate activities, including corporate financing activities, other income, net, and interest expense.

The following table summarizes net sales by segment:

| (Dollars in thousands) | Three Months Ended | | | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | $ Change | % Change |
| Professional | $ 439,098 | $ 389,052 | $ 50,046 | 12.9% |
| Residential | 210,293 | 227,722 | (17,429) | (7.7) |
| Other | 9,613 | 11,667 | (2,054) | (17.6) |
| Total * | $ 659,004 | $ 628,441 | $ 30,563 | 4.9% |
| * Includes international net sales of: | $ 168,290 | $ 157,722 | $ 10,568 | 6.7% |

| (Dollars in thousands) | Six Months Ended | | | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | $ Change | % Change |
| Professional | $ 692,703 | $ 634,282 | $ 58,421 | 9.2% |
| Residential | 318,478 | 323,598 | (5,120) | (1.6) |
| Other | 17,463 | 17,474 | (11) | (0.1) |
| Total * | $ 1,028,644 | $ 975,354 | $ 53,290 | 5.5% |

| * Includes international net sales of: | $ 288,349 | $ 247,369 | $ 40,980 | 16.6% |
|---|---|---|---|---|



The following table summarizes operating earnings (loss) by segment:

| (Dollars in thousands) | Three Months Ended | | | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | $ Change | % Change |
| Professional | $ 104,177 | $ 84,623 | $ 19,554 | 23.1% |
| Residential | 18,136 | 28,963 | (10,827) | (37.4) |
| Other | (19,097) | (20,416) | 1,319 | 6.5 |
| Total | $ 103,216 | $ 93,170 | $ 10,046 | 10.8% |

| (Dollars in thousands) | Six Months Ended | | | |
|---|---|---|---|---|
| | May 5, 2006 | April 29, 2005 | $ Change | % Change |
| Professional | $ 145,837 | $ 123,488 | $ 22,349 | 18.1% |
| Residential | 23,285 | 33,397 | (10,112) | (30.3) |
| Other | (44,594) | (46,910) | 2,316 | 4.9 |
| Total | $ 124,528 | $ 109,975 | $ 14,553 | 13.2% |

**Professional**

*Net Sales*. Worldwide net sales for the professional segment in the second quarter and year-to-date period of fiscal 2006 were up 12.9 percent and 9.2 percent, respectively, compared to the same periods last fiscal year. Factoring out the additional sales from the acquisition of Hayter, professional segment net sales for the year-to-date period of fiscal 2006 were up 8.3 percent compared to the same period last fiscal year. This increase was led by strong international professional segment sales, which were up 13.5 percent and 18.0 percent for the second quarter and year-to-date period of fiscal 2006, respectively, compared to the same periods last fiscal year, due to continued demand in the international markets, the success of new products introduced within the past two years, and the additional sales from the Hayter acquisition for the year-to-date comparison. Shipments of landscape contractor equipment also increased due mainly to the introduction of new products and strong orders from our customers in anticipation of strong retail demand during fiscal 2006, which has also resulted in higher field inventory levels as of the end of the second quarter of fiscal 2006 compared to the end of the second quarter of fiscal 2005.

*Operating Earnings.* Operating earnings for the professional segment in the second quarter and year-to-date period of fiscal 2006 increased 23.1 percent and 18.1 percent, respectively, compared to the same periods last fiscal year. Expressed as a percentage of net sales, professional segment operating margins increased to 23.7 percent compared to 21.8 percent in the second quarter of fiscal 2005, and the fiscal 2006 year-to-date professional segment operating margins increased to 21.1 percent compared to 19.5 percent last fiscal year. This profit improvement was the result of higher gross margins in the fiscal 2006 periods compared to the fiscal 2005 periods due to the same factors discussed previously in the Gross Profit section above. Also contributing to the operating earnings improvement was lower SG&A expense as a percentage of net sales due mainly to leveraging the fixed portion of SG&A costs over higher sales volumes.



**Residential**

*Net Sales*. Worldwide net sales for the residential segment in the second quarter and year-to-date period of fiscal 2006 were down 7.7 percent and 1.6 percent, respectively, compared to the same periods last fiscal year. Factoring out the additional sales from the acquisition of Hayter, residential segment net sales for the year-to-date period of fiscal 2006 were down 2.5 percent compared to the same period last fiscal year. This decline was led by lower shipments of walk power mowers and other product lines due mainly to customers' efforts to lower their inventory levels and lower than expected retail demand. In addition, sales of Lawn-Boy products were down this fiscal year compared to last fiscal year as a result of last year's initial stocking shipments due to expanded placement for new products in the home center distribution channel. International residential segment sales were down for the second quarter of fiscal 2006 compared to the second quarter of fiscal 2005 as a result of lower sales at Hayter due to product availability and quality issues. However, international residential segment sales were up for the year-to-date period of fiscal 2006 compared to the same period last fiscal year. Somewhat offsetting those decreases were higher shipments of riding products due to the introduction of new models and expanded placement at a key retailer.

*Operating Earnings.* Operating earnings for the residential segment in the second quarter of fiscal 2006 decreased 37.4 percent compared to the second quarter of fiscal 2005, and fiscal 2006 year-to-date operating earnings were down by 30.3 percent compared to the same period last year. Expressed as a percentage of net sales, residential segment operating margin decreased to 8.6 percent compared to 12.7 percent in the second quarter of fiscal 2005, and fiscal 2006 year-to-date residential segment operating margin decreased to 7.3 percent compared to 10.3 percent last year. Those decreases were due mainly to lower gross margins as a result of higher commodity costs with minimal price increases and lower gross margins for the new line of riding products. Also contributing to the decline in operating earnings was higher SG&A expense as a percent of net sales due mainly to lower sales volumes and higher warranty costs as a result of a special provision for a product recall.

**Other**

*Net Sales*. Net sales for the other segment include sales from our wholly owned domestic distribution companies less sales from the professional and residential segments to those distribution companies. In addition, elimination of the professional and residential segments' floor plan interest costs from Toro Credit Company are also included in this segment. The other segment net sales decreased for the second quarter and year-to-date period of fiscal 2006 by 17.6 percent

and 0.1 percent, respectively, compared to the same periods last fiscal year. This decline was due to lower sales at a company-owned distributor as a result of the change in the method of distribution of Exmark products to shipping directly to dealers that impacted the region of our Midwestern distributorship.

*Operating Losses.* Operating losses for the other segment were down for the second quarter and year-to-date period of fiscal 2006 by $1.3 million or 6.5 percent and $2.3 million or 4.9 percent, respectively, compared to the same periods last fiscal year. The decreased losses were due primarily to currency exchange rate gains this year compared to currency exchange rate losses last fiscal year, somewhat offset by higher interest expense.



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**FINANCIAL POSITION**

**Working Capital**

During the first half of fiscal 2006, our financial condition remained strong and emphasis continued on improving asset management. Average working capital for the first half of fiscal 2006 was $326.8 million compared to $301.4 million for the first half of fiscal 2005. The increase of 8.4 percent was primarily due to lower average short-term debt. Average receivables for the first half of fiscal 2006 slightly decreased by 0.2 percent compared to the first half of fiscal 2005 on a sales increase of 5.5 percent. Our average days sales outstanding for receivables improved to 74.4 days based on sales for the last twelve months ended May 5, 2006, compared to 75.4 days for the twelve months ended April 29, 2005. Average inventory levels increased slightly by 0.1 percent for the first half of fiscal 2006 compared to the first half of fiscal 2005. Average inventory turnover slightly improved by 0.2 percent for the last twelve months ended May 5, 2006 compared to the last twelve months ended April 29, 2005. These improvements reflect our continuing efforts to improve asset utilization.

**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, capital expenditures, expansion and upgrading of existing facilities, as well as for financing receivables from customers. We believe that cash generated from operations, together with our fixed rate long-term debt, bank credit lines, and cash on hand, will provide us with adequate liquidity to meet our operating requirements. We believe that the funds available through existing or anticipated financing arrangements and forecasted cash flows, will be sufficient to provide the necessary capital resources for our anticipated working capital, capital expenditures, acquisitions, debt repayments, dividend payments, and stock repurchases for at least the next twelve months.

Our Board of Directors approved a cash dividend of $0.09 per share for the second quarter of fiscal 2006 paid on April 12, 2006, which was an increase over our cash dividend of $0.06 per share for the second quarter of fiscal 2005.

*Cash Flow.* Cash used in operating activities for the first six months of fiscal 2006 was 2.6 percent higher than the first six months of fiscal 2005 due primarily to a higher increase in receivables and deferred taxes, somewhat offset by higher net earnings and a lower increase in inventory levels for the first six months of fiscal 2006 compared to the first six months of fiscal 2005. Cash used in investing activities was lower by $37.5 million compared to the first six months of fiscal 2006, due mainly to cash utilized last year for the purchase of Hayter. Cash provided by financing activities was higher by 44.0 percent compared to the first six months of fiscal 2005. This change of $26.5 million was due to lower levels of our common stock repurchased and an increase in tax benefits for stock-based awards in the first six months of fiscal 2006 compared to the first six months of fiscal 2005, somewhat offset by a lower increase in short-term debt.

*Credit Lines and Other Capital Resources.* Our business is seasonal, with accounts receivable balances historically increasing between January and April as a result of higher sales volumes and extended payment terms made available to our customers, and decreasing between May and December when payments are received. The seasonality of production and shipments causes our working capital requirements to fluctuate during the year. Our peak borrowing usually occurs between February and May. Seasonal cash requirements are financed from operations and with short- and medium-term financing arrangements, including a $175.0 million unsecured senior five-year revolving credit facility, which expires in October 2010. Interest expense on this credit line is determined based on a LIBOR rate plus a basis point spread defined in the credit agreement. In addition, our non-U.S. operations and a domestic subsidiary also maintain unsecured short-term lines of credit of approximately $17 million. These facilities bear interest at various rates depending on the rates in their respective countries of operation. We also have a letter of credit subfacility as part of our credit agreements. Average short-term debt was $62.7 million in the first six months of fiscal 2006 compared to $85.1 million in the first six months of fiscal 2005, a decrease of 26.4 percent. This decline was the result of cash utilized last year for the acquisition of Hayter and significant stock repurchases. As of May 5, 2006, we had $71.8 million of unutilized availability under our credit agreements.

Significant financial covenants in our credit agreements are interest coverage and debt to capitalization ratios. We were in compliance with all covenants related to our credit agreements as of May 5, 2006, and expect to be in compliance with all covenants during fiscal 2006. If we were out of compliance with any covenant required by our credit agreements, the banks could terminate their commitments unless we could negotiate a covenant waiver from the banks. In addition, our long-term public notes and debentures could become due and payable if we were unable to obtain a covenant waiver or refinance our medium-term debt under our credit agreements. If our credit rating falls below investment grade, the interest rate we currently pay on outstanding debt under the credit agreements would increase, but the credit commitments could not be cancelled by the banks based only on a ratings downgrade. Our debt rating for long-term unsecured senior, non-credit enhanced debt has been unchanged for the second quarter of fiscal 2006 by Standard and Poor’s Ratings Group at BBB- and by Moody’s Investors Service at Baa3.



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**Off-Balance Sheet Arrangements and Contractual Obligations**

Our off-balance sheet arrangements generally relate to customer financing activities, inventory purchase commitments, operating lease commitments, and currency contracts. See our most recently filed Annual Report on Form 10-K for further details regarding our off-balance sheet arrangements and contractual obligations. There has been no material change in this information.

**Inflation**

We are subject to the effects of inflation and changing prices. In the first half of fiscal 2006, average prices paid for fuel, petroleum-based resins, and other commodities were higher compared to the first half of fiscal 2005, which resulted in a negative impact on our gross margin and net earnings. We expect this trend to continue for the remainder of fiscal 2006. We will continue to attempt to mitigate the impact of these anticipated increases in commodity prices and other inflationary pressures by actively pursuing internal cost reduction efforts, introducing moderate price increases on some products, and through vendor negotiations.

**Critical Accounting Policies and Estimates**

In preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, we must make decisions which impact the reported amounts of assets, liabilities, revenues and expenses, and 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, we apply judgments based on our 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.

Our significant accounting policies are described in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended October 31, 2005. Some of those significant accounting policies require us to make difficult subjective or complex judgments or estimates. An accounting estimate is considered to be critical if it meets both of the following criteria: (i) the estimate requires assumptions about matters that are highly uncertain at the time the accounting estimate is made, and (ii) different estimates reasonably could have been used or changes in the estimates that are reasonably likely to occur from period to period would have a material impact on the presentation of our financial condition, changes in financial condition or results of operations. Our critical accounting estimates include the following:

*Warranty Reserve*. Warranty coverage on our products ranges from a period of six months to seven years, and covers parts, labor, and other expenses for non-maintenance repairs, provided operator abuse, improper use or negligence did not necessitate the repair. At the time of sale, we accrue a warranty reserve by product line for estimated costs in connection with future warranty claims. We also establish reserves for major rework campaigns upon approval. The amount of our warranty reserves is based primarily 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, and the historical length of time between the sale and resulting warranty claim. We periodically assess the adequacy of our warranty reserves based on changes in these factors and record any necessary adjustments if actual claim experience indicates that adjustments are necessary. Actual claims could be higher or lower than amounts estimated, as the amount and value of warranty claims are subject to variation of such factors as performance of new products, significant manufacturing or design defects not discovered until after the product is delivered to customers, product failure rates, and higher or lower than expected service costs for a repair. We believe that analysis of historical trends and knowledge of potential manufacturing or design problems provide sufficient information to establish a reasonable estimate for warranty claims at the time of sale. However, since we cannot predict with certainty future warranty claims or costs associated with servicing those claims, our actual warranty costs may differ from our estimates. An unexpected increase in warranty claims or in the costs associated with servicing those claims would result in an increase in our warranty accrual and a decrease in our net earnings. The accrual for future estimated warranty claims was $70.0 million as of May 5, 2006 compared to $67.4 million as of April 29, 2005.

*Accounts and Notes Receivable Valuation*. We value accounts and notes receivable, net of an allowance for doubtful accounts. Each quarter, we estimate our ability to collect outstanding receivables that provides a basis for an allowance estimate for doubtful accounts. In doing so, we evaluate the age of our receivables, past collection history, current financial conditions of key customers, and economic conditions. Based on this evaluation, we establish a reserve for specific accounts and notes receivable that we believe are uncollectible, as well as an estimate of uncollectible receivables not specifically known. Portions



of our accounts receivable are protected by a security interest in products held by customers, which minimizes our collection exposure. A deterioration in the financial condition of any key customer or a significant slow down in the economy could have a material negative impact on our ability to collect a portion or all of the accounts and notes receivable. We believe that an analysis of historical trends and our current knowledge of potential collection problems provide us with sufficient information to establish a reasonable estimate for an allowance for doubtful accounts. However, since we cannot predict with certainty future changes in the financial stability of our customers, our actual future losses from uncollectible accounts may differ from our estimates. In the event we determined that a smaller or larger uncollectible accounts reserve is appropriate, we would record a credit or charge to selling, general, and administrative expense in the period that we made such a determination. As of May 5, 2006, we had $3.6 million reserved against our accounts and notes receivable compared to $3.2 million as of April 29, 2005.

**Forward-Looking Information**

*This Quarterly Report on Form 10-Q contains not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and that are subject to the safe harbor created by those sections. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or web casts open to the public, in press releases or reports, on our Internet web sites, or otherwise. Statements that are not historical are forward-looking and reflect expectations and assumptions. We try to identify forward-looking statements in this report and elsewhere by using words such as "expect", "looking ahead", "plan", "anticipate", "estimate", "believe", "should", "may", "intend", and similar expressions. Our forward-looking statements generally relate to our future performance, including our anticipated operating results and liquidity requirements, our business strategies and goals, and the effect of laws, rules, regulations, and new accounting pronouncements and outstanding litigation on our business, operating results, and financial condition.*

Forward-looking statements involve risks and uncertainties. These risks and uncertainties include factors that affect all businesses operating in a global market as well as matters specific to Toro. The following are some of the factors known to us that could cause our actual results to differ materially from what we have anticipated in our forward-looking statements:

- Weather conditions may reduce demand for some of our products and adversely affect our net sales.
- Increases in the cost and availability of raw materials and components that we purchase and increases in our other costs of doing business, such as transportation costs, may adversely affect our profit margins and business.

- Inflationary pressures and higher short-term and mortgage interest rates could cause consumers to reduce spending, which could have an adverse affect on our net sales and earnings.

- Our professional segment net sales are dependent upon the level of growth in the residential and commercial construction markets, growth of homeowners' outsourcing lawn care, the amount of investment in golf course renovations and improvements, new golf course development, and the amount of government spending.

- Our residential segment net sales are dependent upon the amount of shelf space retailers assign to our products, changing buying patterns of customers, and The Home Depot, Inc. as a major customer.

- A significant percentage of our consolidated net sales is generated outside of the United States, and we intend to continue to expand our international business. Our international operations require significant management attention and financial resources; expose us to difficulties presented by international economic, political, legal, accounting, and business factors; and may not be successful or produce desired levels of net sales and earnings.

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

- We intend to grow our business in part through additional acquisitions, alliances, and joint venture arrangements, which are risky and could harm our business.

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

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

- A significant portion of our net sales are financed by third parties. Some Toro dealers and Exmark distributors and dealers finance their inventories with third party financing sources. 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 customers by these third parties, or any delay in securing replacement credit sources, could negatively impact our sales and operating results.



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- 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.

- 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 and move production between manufacturing facilities could adversely affect our business and operating results.

- Our business is subject to a number of other factors that may adversely affect our operating results, financial condition, or business, such as changes in domestic and global economies, including but not limited to slow growth rate, slow down in home sales, rise in interest rates, inflation, unemployment, weaker consumer confidence, and currency exchange rates; natural disasters that may result in shortages of raw materials, higher fuel and energy costs, and an increase in insurance premiums; financial viability of some distributors and dealers, changes in distributor ownership, our success in partnering with new dealers, and our customers' ability to pay amounts owed to us; and continued threat of terrorist acts and war that may result in heightened security and higher costs for import and export shipments of components or finished goods, reduced leisure travel, and contraction of the U.S. and world economies.

- If we are unable to continue to enhance existing products and develop and market new products that respond to customer needs and achieve market acceptance, we may experience a decrease in demand for our products, and our business could suffer.

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

- Our business, properties, and products are subject to governmental regulation with which compliance may require us to incur expenses or modify our products or operations and may expose us to penalties for non-compliance. Governmental regulation may also adversely affect the demand for some of our products and our operating results.

- We are subject to product liability claims, product quality issues, and other litigation from time to time that could adversely affect our operating results or financial condition, including without limitation the pending litigation against the company and other defendants that challenges the horsepower ratings of lawnmowers, of which the company is currently unable to assess whether the litigation would have a material adverse effect on the company's consolidated operating results or financial condition, although an adverse result might be material to operating results in a particular period.

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 recent filed Annual Report on Form 10-K.

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

*any further disclosures we make on related subjects in our future 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. Changes in these factors could cause fluctuations in our net earnings and cash flows. See further discussions on these market risks below.

Foreign Currency Exchange Rate Risk. In the normal course of business, we actively manage our exposure to foreign currency market risk by entering into various hedging instruments, authorized under company policies that place controls on these activities, with counterparties that are highly rated financial institutions. Our hedging activities involve the use of a variety of derivative financial instruments. We use derivative instruments only in an attempt to limit underlying exposure from currency fluctuations and to minimize earnings and cash volatility associated with foreign exchange rate changes, and not for trading



purposes. We are exposed to foreign currency exchange rate risk arising from transactions in the normal course of business, such as sales and loans to wholly owned subsidiaries as well as sales to third party customers, purchases from suppliers, and bank lines of credit with creditors denominated in foreign currencies. Because our products are manufactured or sourced primarily from the United States, a stronger U.S. dollar generally has a negative impact on results from operations outside the United States while a weaker dollar generally has a positive effect. Our primary exchange rate exposures are with the Euro, the Japanese yen, the Australian dollar, the Canadian dollar, the British pound, and the Mexican peso against the U.S. dollar.

We enter into various contracts, principally forward contracts that change in value as foreign exchange rates change, to protect the value of existing foreign currency assets, liabilities, anticipated sales, and probable commitments. Decisions on whether to use such contracts are made based on the amount of exposures to the currency involved, and an assessment of the near-term market value for each currency. Worldwide foreign currency exchange rate exposures are reviewed monthly. The gains and losses on these contracts offset changes in the value of the related exposures. Therefore, changes in market values of these hedge instruments are highly correlated with changes in market values of underlying hedged items both at inception of the hedge and over the life of the hedge contract. During the three and six months ended May 5, 2006, the amount of gains reclassified to earnings for such cash flow hedges was $0.5 million and $1.0 million, respectively. For the six months ended May 5, 2006, the gains treated as an addition to net sales for contracts to hedge trade sales were $0.8 million and the gains treated as a reduction of cost of sales for contracts to hedge inventory purchases were $0.2 million.

The following foreign currency exchange contracts held by us have maturity dates in fiscal 2006. All items are non-trading and stated in U.S. dollars. Some derivative instruments we enter into do not meet the hedging criteria of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities;" 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 (AOCL), and fair value impact of derivative instruments in other income, net for the six months ended May 5, 2006 were as follows:

| Dollars in thousands (except average contracted rate) | Average Contracted Rate | Notional Amount | Value in Accumulated Other Comprehensive Income (Loss) | Fair Value Impact Gain (Loss) |
|---|---|---|---|---|
| Buy US dollar/Sell Australian dollar | 0.7483 | $ 35,955.3 | $ (423.6) | $ (411.8) |
| Buy US dollar/Sell Canadian dollar | 0.8668 | 4,693.7 | (174.3) | (158.3) |
| Buy US dollar/Sell Euro | 1.2298 | 93,238.6 | (1,026.2) | (991.5) |
| Buy US dollar/Sell British pound | 1.8402 | 25,578.8 | — | (38.2) |
| Buy Australian dollar /Sell US dollar | 0.7395 | 856.5 | 24.2 | 8.9 |
| Buy Euro/Sell US dollar | 1.2479 | 1,247.9 | 16.6 | — |
| Buy Japanese Yen/Sell US dollar | 113.5000 | 44.1 | — | (0.1) |
| Buy Mexican peso/Sell US dollar | 10.8278 | 7,388.4 | (153.8) | 250.7 |

Interest Rate Risk. We are exposed to interest rate risk arising from transactions that are entered into during the normal course of business. Our short-term debt rates are dependent upon a LIBOR or commercial paper rate plus a basis point spread defined in our credit agreements. See our most recently filed Annual Report on Form 10-K (Item 7A). 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. We manage some of this risk by using a combination of short- and long-term agreements with some vendors. The primary commodity price exposures are with steel, plastic resin, diesel fuel, aluminum, copper, and linerboard. Further information regarding rising prices for commodities is presented in Item 2, section entitled "Inflation."

We utilize well-defined financial contracts in the normal course of operations as a means to manage certain commodity price risks. The majority of these contracts are fixed-price contracts for future purchases of natural gas, which meet the definition of "normal purchases and normal sales" and therefore, are not considered derivative instruments for accounting purposes.



## 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 reasonably ensure 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 material information relating to our company and our consolidated subsidiaries is made known to management, including our Chief Executive Officer and Chief Financial Officer, particularly during the period when our periodic reports are being prepared. There was no change in our internal control over financial reporting that occurred during our fiscal second quarter ended May 5, 2006 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

On June 3, 2004, eight individuals who claim to have purchased lawnmowers in Illinois and Minnesota filed a lawsuit (Ronnie Phillips et al. v. Sears Roebuck Corporation et. al., No.04-L-334 (20th Judicial Circuit, St. Clair County, IL)) against the company and eight other defendants alleging that the horsepower labels on the products the plaintiffs purchased were inaccurate. The plaintiffs seek certification of a class of all persons in the United States who, beginning January 1, 1995 through the present purchased a lawnmower containing a two stroke or four stroke gas combustible engine up to 20 horsepower that was manufactured or sold by the defendants. The complaint seeks an injunction, unspecified compensatory and punitive damages, and attorneys' fees. No answers have been entered in the case, and there has yet been no formal discovery. A number of procedural motions were filed by the defendants, but have not yet been decided. On April 20, 2005, the court issued a stay of discovery and procedural matters to permit the parties to engage in settlement discussions. An attempt at mediation in October 2005 was unsuccessful. On May 17, 2006, the court granted plaintiffs' motion to amend the complaint to add 84 additional plaintiffs. The amended complaint asserts violations of the federal Racketeer Influenced and Corrupt Organizations (RICO) Act and statutory and common law claims arising from the laws of 48 states. The amended complaint also adds an engine manufacturer as an additional defendant, revises the claim to cover lawnmowers with up to a 30 horsepower engine, expands the class period to January 1, 1994 through the present, and seeks treble damages under the RICO Act. In late May 2006, the case was removed to Federal court. Toro has been notified that defendant MTD Products Inc. has agreed to settle with plaintiffs. All remaining non-settling defendants have filed counterclaims against MTD Products Inc. for potential contribution amounts. Management continues to evaluate this lawsuit and is unable to reasonably estimate the likelihood of loss or the amount or range of potential loss that could result from this litigation. Therefore, an accrual has not been established for any potential loss in connection with this lawsuit. The company is also unable to assess at this time whether the lawsuit will have a material adverse effect on its annual consolidated operating results or financial condition, although an unfavorable resolution could be material to the company's consolidated operating results for a particular period.

We are a party to litigation in the ordinary course of business. Litigation occasionally involves claims for punitive as well as compensatory damages arising out of use of our products. We are also subject to administrative proceedings with respect to claims involving the discharge of hazardous substances into the environment. Some of these claims assert damages and liability for remedial investigations and clean up costs. We are also typically involved in commercial disputes, employment disputes, and patent litigation cases in the ordinary course of business, both as a plaintiff and as a defendant. While the ultimate results of the current cases are unknown at this time, management believes that, except for the lawsuit discussed above, the outcomes of these cases are unlikely to have a material adverse effect on our consolidated operating results or financial position. Further, we maintain insurance against some product liability losses.



### Item 1A. RISK FACTORS

In addition to the other information set forth in this report, careful consideration should be taken of the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended October 31, 2005, which could materially affect our business, financial condition, or future operating results. The risks described in our Annual Report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

### Item 2. CHANGES IN SECURITIES, USE OF PROCEEDS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table shows our second quarter of fiscal 2006 stock repurchase activity.

| Period | Total Number of Shares Purchased(1) | Average Price Paid per Share | Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(1) |
|---|---|---|---|---|
| February 4, 2006 through March 3, 2006 | 33,031 | $ 43.29 | 33,031 | 1,149,854 |
| March 4, 2006 through March 31, 2006 | 195,183 | 47.51 | 195,183 | 954,671 |
| April 1, 2006 through May 5, 2006 | 233,401(2) | 47.44 | 231,796 | 722,875 |
| Total | 461,615 | 47.17 | 460,010 | |

(1) On July 19, 2005, the company's Board of Directors authorized the repurchase of 2,000,000 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 purchased 460,010 shares during the periods indicated above under this program.

(2) Includes 1,605 units (shares) of the company's common stock purchased in open-market transactions at an average price of $47.98 per share on behalf of a rabbi trust formed to pay benefit obligations of the company to participants in deferred compensation plans. These 1,605 shares were not repurchased under the company's repurchase program described in footnote (1) above.



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### Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Annual Meeting of Stockholders was held on March 14, 2006.

(b) The results of the stockholder votes were as follows:

| | | For | Against/ Withheld | Abstain | Broker Non-Votes |
|---|---|---|---|---|---|
| 1. | Election of Directors — for terms expiring in March 2009 | | | | |
| | Janet K. Cooper | 37,159,266 | 1,574,342 | 0 | 0 |
| | Gregg W. Steinhafel | 37,394,901 | 1,338,707 | 0 | 0 |
| 2. | Approve Amendment of The Toro Company 2000 Stock Option Plan | 29,697,851 | 5,003,575 | 130,167 | 3,902,015 |
| 3. | Ratify Selection of Independent Registered Public Accounting Firm | 37,643,554 | 966,749 | 123,305 | 0 |
| 4. | Approval to transact any other business or any adjournment of the meeting | 18,105,164 | 18,035,591 | 2,592,853 | 0 |

Robert C. Buhrmaster, Winslow H. Buxton, Robert H. Nassau, and Christopher A. Twomey continue to serve as directors of the company for terms expiring in March 2007.

Ronald O. Baukol, Katherine J. Harless, and Michael J. Hoffman continue to serve as directors of the company for terms expiring in March 2008.

Dale R. Olseth resigned as director of the company effective March 15, 2006.



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### Item 6. EXHIBITS

(a) Exhibits

| | |
|---|---|
| 3(i) and 4(a) | The Toro Company Amended and Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3(i) and 4(a) to Registrant's Current Report on Form 8-K dated March 15, 2005, Commission File No. 1-8649). |
| 3(ii) and 4(b) | Bylaws of Registrant (incorporated by reference to Exhibit 3 to Registrant's Current Report on Form 8-K dated November 30, 2005, Commission File No. 1-8649). |
| 4(c) | Specimen Form of Common Stock Certificate (incorporated by reference to Exhibit 4(c) to Registrant's Annual Report on Form 10-K dated October 31, 2004). |
| 4(d) | Rights Agreement dated as of May 20, 1998, between Registrant and Wells Fargo Bank Minnesota, National Association relating to rights to purchase Series B Junior Participating Voting Preferred Stock, as amended (incorporated by reference to Registrant's Current Report on Form 8-K dated May 27, 1998, Commission File No. 1-8649). |
| 4(e) | Certificate of Adjusted Purchase Price or Number of Shares dated April 14, 2003 filed by Registrant with Wells Fargo Bank Minnesota, N.A., as Rights Agent, in connection with Rights Agreement dated as of May 20, 1998 (incorporated by reference to Exhibit 2 to Registrant's Amendment No. 1 to Registration Statement on Form 8-A/A dated April 14, 2003, Commission File No. 1-8649). |
| 4(f) | Certificate of Adjusted Purchase Price or Number of Shares dated April 12, 2005 filed by Registrant with Wells Fargo Bank Minnesota, N.A., as Rights Agent, in connection with Rights Agreement dated as of May 20, 1998 (incorporated by reference to Exhibit 2 to Registrant's Amendment No. 2 to Registration Statement on Form 8-A/A dated March 21, 2005, Commission File No. 1-8649). |
| 4(g) | Indenture dated as of January 31, 1997, between Registrant and First National Trust Association, as Trustee, relating to the Registrant's 7.125% Notes due June 15, 2007 and its 7.80% Debentures due June 15, 2027 (incorporated by reference to Exhibit 4(a) to Registrant's Current Report on Form 8-K for June 24, 1997, Commission File No. 1-8649). |
| 10(a) | The Toro Company 2000 Stock Option Plan, as amended. |
| 10(b) | The Toro Company Performance Share Plan (incorporated by reference to Exhibit 1 to Registrant's Current Report on Form 8-K dated February 16, 2006, Commission File No. 1-8649). |
| 31(a) | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) (Section 302 of the Sarbanes-Oxley Act of 2002) (filed |

| | herewith). |
|---|---|
| 31(b) | 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). |



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**SIGNATURES**

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

THE TORO COMPANY
(Registrant)

Date: June 12, 2006

By /s/ Stephen P. Wolfe
Stephen P. Wolfe
Vice President Finance and
Chief Financial Officer
(duly authorized officer and principal financial officer)

# THE TORO COMPANY
# 2000 STOCK OPTION PLAN

1. **Purpose**. The purpose of The Toro Company 2000 Stock Option Plan (the "Plan") is to enhance stockholder value of The Toro Company (the "Company") by providing an incentive to key employees and other key individuals who perform services for the Company to contribute significantly to the long-term performance and growth of the Company; to link a significant portion of a participant's compensation to the value of the Company's Common Stock, par value $1.00 per share, and related Preferred Share Purchase Rights ("Common Stock"); and to attract and retain experienced and knowledgeable employees on a competitive basis. These purposes are expected to be achieved by granting options to acquire the Common Stock ("options").

2. **Eligibility**. Any employee of the Company who is regularly employed in an executive, managerial, professional or technical position and any other individual who performs services for the Company and who contributes significantly to the strategic and long-term performance objectives of the Company is eligible to participate in the Plan. Options may be granted to directors of the Company who are also employees of the Company. More than one option may be granted to the same individual.

   a. **Limitations**. No option may be granted to an individual who owns, directly or indirectly, Common Stock or other capital stock of the Company possessing more than 5% of the total combined voting power or value of any class of capital stock of the Company or a subsidiary immediately after such option is granted, and the maximum number of shares that may be covered by options granted to any individual during any calendar year shall be 100,000 shares. Except for the foregoing limitations, there is no minimum or maximum number of shares of Common Stock with respect to which options may be granted to any individual under the Plan. Individuals to whom options are granted are referred to as "option holders".

3. **Stock Options**.

   a. **ISOs and Nonqualified Options**. Options granted under the Plan may be either nonqualified stock options ("nonqualified options") or incentive stock options ("Incentive Stock Options") as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code").

      i. ***Incentive Stock Options***. Incentive Stock Options shall meet the applicable requirements of, and contain or be deemed to contain all provisions required by, the Code or corresponding provisions of subsequent revenue laws and regulations in effect at the time such options are granted. Any ambiguities in construction shall be interpreted in order to effectuate such intent. To the extent that the aggregate fair market value of Common Stock (determined at the time of grant of the Incentive Stock Option) with respect to which Incentive Stock Options are exercisable for the first time by an option holder during any calendar year (under all such plans of the Company and its parent and subsidiary corporations) exceeds $100,000 or such other limit as may be imposed by the Code, such options to the extent they exceed such limit shall be treated as options which are not Incentive Stock Options. In applying the foregoing limitation, options shall be taken into account in the order in which they were granted.



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   b. **Agreements**. Options shall be evidenced by stock option agreements in such form and not inconsistent with the Plan as the Compensation and Human Resources Committee (the "Committee") of the Board of Directors shall approve from time to time.

   c. **Number of Shares, Date of Grant and Term**. An option agreement shall specify the number of shares of Common Stock to which it pertains; the date of grant, which shall be the date on which the Committee grants an option or any later date which the Committee specifically designates, and the term of the option, which shall not exceed ten years.

   d. **Exercise Price**. The exercise price of an option shall be not less than 100% of fair market value of the Common Stock on the date of grant. Fair market value is the 4 p.m. Eastern Time closing price for the Common Stock as reported by the New York Stock Exchange. After an option is granted, the exercise price shall not be reduced.

   e. **Vesting, Transferability and Exercisability.**

      (i) ***Vesting***. An option granted to an officer or general manager of the Company shall vest and become exercisable in three approximately equal installments on each of the first, second and third anniversaries after the date of grant. An option granted to an employee or other service provider who is not an officer or general manager of the Company shall vest and become exercisable in full on the second anniversary after the date of grant. Notwithstanding the foregoing, the Committee shall have the authority to provide in any option agreement for any one or more of the following: (a) longer periods after the date of grant during which an option or any portion thereof may not yet be exercisable, (b) acceleration of vesting in the event of an option holder's disability or death and (c) continued vesting after an option holder's retirement, subject to Section 3.e(iii)(c).

      (ii) ***No Transfer***. Options shall not be transferable by the option holder except by will or applicable laws of descent and distribution.

      (iii) ***Exercise***. During the lifetime of an option holder, an option may be exercised only by the option holder and only while an employee of the Company or a parent or subsidiary of the Company or otherwise performing services for the Company or a parent or subsidiary and only if the option holder has been continuously so employed or engaged since the date such options were granted, except as the Committee may otherwise determine and provide for in an option agreement at the time of grant or, if the Committee does not so provide, as follows:

         (a) *Disability*. In the event of disability of an option holder, options may be exercised by such individual or his or her guardian or legal representative, not later than the earlier of the date the option expires or one year after the date employment or performance of services ceases by reason of such disability, but only with respect to an option exercisable at the time employment or performance of services ceases.

         (b) *Death*. An option may be exercised after the death of an option holder only by such individual's legal representatives, heirs or legatees, not later than the earlier of the date the option expires or one year after the date of death of such individual, and only with respect to an option exercisable at the time of death.

(c) *Retirement*. An option may be exercised by an option holder after such individual ceases to be an employee by reason of retirement for up to four years after the date of retirement but not later than the date the option expires, provided that the option holder has remained an employee of the Company through the last day of the fiscal year in which the option is granted. "Retirement" shall have the meaning established by the Committee from time to time or, if no such meaning is established, shall mean termination of employment with the Company at or after age 55 and with a number of years of service that, when added together with the option holder's age, equals at least 65.

(d) *Other Termination of Employment*. An option may be exercised by an option holder after such individual ceases to be an employee (for reasons other than disability, death or retirement) for up to three months after the date of termination of employment but not later than the date the option expires.

(iv) ***Non-compete***. Notwithstanding any other provision of paragraph 3.e., if within one year after the termination of employment with or performance of services for the Company, an option holder is (a) employed or retained by or renders service to any organization that, directly or indirectly, competes with or becomes competitive with the Company, or if the rendering of such services is prejudicial or in conflict with the interests of the Company, or (b) violates any confidentiality agreement or agreement governing the ownership or assignment of intellectual property rights with the Company, or (c) engages in any other conduct or act determined to be injurious, detrimental or prejudicial to any interest of the Company, the Company may cancel or rescind or restrict all options held by such individual and shall have the right to the return of the economic value of any option which was realized or obtained (measured at the date of exercise) by such individual at any time during the period beginning on the date that is twelve months prior to the date of termination to the date of the last exercise, provided however, that this provision shall not be applicable in the event of a Change of Control.

(v) ***Interruption in Service***. Absence on leave from the Company, or other interruption in the performance of services, by an option holder shall, if approved by the Committee, not be deemed a cessation or interruption of employment or services for the purposes of the Plan.

f. **Methods of Exercise and Payment of Exercise Price**. Subject to the terms and conditions of the Plan and the terms and conditions of the option agreement, an option may be exercised in whole at any time or in part from time to time, by delivery to the Company at its principal office of a written notice of exercise specifying the number of shares with respect to which the option is being exercised, accompanied by payment in full of the exercise price for shares to be purchased at that time. Payment may be made (i) in cash, (ii) by tendering (either actually or by attestation) shares of Common Stock already owned for at least six months (or other period necessary to avoid a charge to the Company's earnings for financial statement purposes) valued at the fair market value of the Common Stock on the date of exercise or (iii) in a combination of cash and Common Stock; or the Committee may also, in its sole discretion exercised either at the time the option is granted or at any time before an option is exercised, (iv) permit option holders to



deliver a notice of exercise of options, together with irrevocable instructions, approved in advance by proper officers of the Company, (A) to a brokerage firm designated by the Company, to deliver promptly to the Company the aggregate amount of sale or loan proceeds to pay the exercise price and any related tax withholding obligations and (B) to the Company, to deliver certificates for such purchased shares directly to such brokerage firm, all in accordance with regulations of the Federal Reserve Board; or (v) authorize such other methods as it deems appropriate and as comply with requirements of the Code, the Securities Exchange Act of 1934 (the "Exchange Act") and other applicable laws and regulations. No shares of Common Stock shall be issued until full payment has been made.

g. **Rights as a Stockholder**. An option holder shall have no rights as a stockholder with respect to any Common Stock covered by an option until the option is exercised and shares of Common Stock are issued. Except as otherwise expressly provided in the Plan, no adjustments shall be made for dividends or other rights for which the record date is prior to issuance of the Common Stock.

4. **Common Stock Subject to the Plan**. Subject to adjustment to reflect corporate transactions provided for in paragraph 4.a. and subject to increase by amendment of the Plan, the total number of shares of Common Stock that is reserved and available for issuance pursuant to options granted under the Plan shall be 6,400,000. Any shares issued by the Company in connection with the assumption or substitution of outstanding grants from any acquired corporation shall not reduce the shares available for option grants under the Plan. Shares of Common Stock that may be issued under the Plan may be authorized but unissued shares, reacquired or treasury shares, or outstanding shares acquired in the market or from private sources, or a combination thereof.

a. **Adjustments for Corporate Transactions**. In the event of a corporate transaction involving the Company (including, without limitation, any merger, consolidation, recapitalization, reorganization, split off, spin off, reclassification, combination, stock dividend, stock split, reverse stock split, repurchase, exchange, extraordinary cash dividend, issuance of warrants or other rights to purchase Common Stock or other securities of the Company, or other similar corporate transaction or change in the corporate structure of the Company affecting the Common Stock, or a sale by the Company of all or part of its assets or any distribution to stockholders other than a normal cash dividend), the Committee shall make such proportional adjustments as are necessary to preserve the benefits or potential benefits of the options. Action by the Committee may include appropriate adjustments in all or any of (i) the number of shares of the Common Stock or other new or different securities that may be available for option grants under the Plan; (ii) the number of shares of Common Stock or other new or different securities subject to outstanding options; (iii) the option price per share of outstanding options and, if deemed appropriate, cash payments; (iv) the maximum number and kind of securities that may be made subject to options for any individual as set forth in paragraph 2.a.; or (v) any other adjustment the Committee determines to be equitable. The Committee may also, in its sole discretion, make provisions in any option agreement for the protection of outstanding options in the event of such a corporate transaction.



5. **Administration of the Plan**. The Plan shall be administered by the Committee, provided that members of the Committee shall be "non-employee directors" as contemplated by Rule 16b-3 under the Exchange Act or any successor rule and shall qualify to administer the Plan as "outside directors" as contemplated

by Section 162(m) of the Internal Revenue Code and the regulations thereunder ("Section 162(m)"). The Committee may delegate administrative duties and all decisions not required to be exercised by it under Section 162(m), Section 16 of the Exchange Act or the rules of the New York Stock Exchange to an officer of the Company. The decision of the Committee on any matter affecting the Plan and obligations arising under the Plan or any option granted thereunder shall be deemed final and binding upon all persons, including the Company, its stockholders and option holders. No member of the Board or of the Committee shall be liable for any action taken or determination made in good faith with respect to the Plan or any option granted under the Plan.

Subject to the express provisions of the Plan, the Committee shall have authority, in its discretion, to grant options; to interpret the Plan; to prescribe, amend and rescind rules and regulations relating to the Plan; to determine the exercise price of each option to purchase Common Stock, the individuals to whom and the time or times at which options shall be granted, the number of shares to be subject to each option, when an option may be exercisable and the other terms and provisions (and amendments thereto) of the respective option agreements (which need not be identical); to determine whether a particular option is to be an Incentive Stock Option; and to make all other determinations deemed necessary or advisable for the administration of the Plan.

6. **Foreign Nationals and Residents of California**.

a. **Foreign Nationals**. Without amending the Plan, options may be granted to individuals who are foreign nationals or are employed or otherwise performing services for the Company or any subsidiary outside the United States or both, on such terms and conditions different from those specified in the Plan as may, in the judgment of the Committee, be necessary or desirable to further the purposes of the Plan.

b. **California Residents**. Without amending the Plan, and notwithstanding any provision of the Plan to the contrary, options granted to individuals who are residents of the State of California may contain such terms and conditions as may be required by applicable California statutes governing stock options.

7. **Change of Control**. In the event of a Change of Control of the Company as hereinafter defined, whether or not approved by the Board, all options shall fully vest, unless otherwise limited by the Committee at the time of the option grant, and be exercisable in their entirety immediately, and notwithstanding any other provisions of the Plan, shall continue to be exercisable for three years following the Change of Control, but not later than ten years after the date of grant.

a. **Definition**. For the purpose of this paragraph 7, a "Change of Control" shall mean:

(i) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act) of 15% or more of either (A) the then-outstanding shares of Common Stock of the Company (the "Outstanding Company Common Stock") or (B) the combined voting power of the then-outstanding



voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that for purposes of this subsection (i), the following acquisitions shall not constitute a Change of Control: (A) any acquisition directly from the Company, (B) any acquisition by the Company, (C) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company, or (D) any acquisition by any corporation pursuant to a transaction that complies with clauses (A), (B) and (C) of subsection (iii) of this paragraph 7; or

(ii) Individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board; or

(iii) Consummation of a reorganization, merger or consolidation of the Company or sale or other disposition of all or substantially all of the assets of the Company or the acquisition by the Company of assets or stock of another entity (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock and

Outstanding Company Voting Securities, as the case may be, (B) no Person (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 15% or more of, respectively, the then-outstanding shares of common stock of the corporation resulting from such Business Combination, or the combined voting power of the then-outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or



(iv) Approval by the stockholders of the Company of a complete liquidation or dissolution of the Company.

8. **Tax Withholding**. The Company shall have the right to deduct from any settlement made under the Plan, including the exercise of an option or the sale of shares of Common Stock, any federal, state or local taxes of any kind required by law to be withheld with respect to such payments or to require the option holder to pay the amount of any such taxes or to take such other action as may be necessary in the opinion of the Company to satisfy all obligations for the payment of such taxes. If Common Stock is withheld or surrendered to satisfy tax withholding, such stock shall be valued at its fair market value as of the date such Common Stock is withheld or surrendered. The Company may also deduct from any such settlement any other amounts due the Company by the option holder.

9. **Governing Law**. The Plan, options granted under the Plan and agreements entered into under the Plan shall be construed, administered and governed in all respects under and by the applicable laws of the State of Delaware, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of the Plan or an agreement to the substantive law of another jurisdiction.

10. **Plan Amendment and Termination**. The Board may amend, suspend or terminate the Plan at any time, with or without advance notice to option holders, including an amendment to increase in an immaterial amount the number of shares of Common Stock with respect to which options may be granted; provided however that no amendment that would (a) increase the maximum number of shares that may be subjected to options or (b) increase the number of shares that may be covered by an option grant to any person referred to in Section 162(m) or (c) modify requirements as to eligibility for participation in the Plan or (d) constitute a material revision to the terms of the Plan within the meaning of the rules and regulations of the New York Stock Exchange or the Securities and Exchange Commission or (e) than is required by any applicable law, rule or regulation to be approved by the stockholders of the Company shall be effective unless the stockholders of the Company shall have approved such amendment in accordance with applicable provisions of the Code, other law, rule or regulation. No amendment, modification or termination of the Plan may adversely affect in a material manner any right of any option holder with respect to any option theretofore granted without such option holder’s written consent.

11. **Effective Date and Duration of the Plan**. The Plan first became effective on March 29, 2000. Any amendment to the Plan shall be effective on the date established by the Committee, subject to stockholder approval, if required. The Plan shall remain in effect until all shares reserved for issuance pursuant to the Plan have been purchased pursuant to options granted under the Plan, provided that options under the Plan must be granted not later than ten years after the effective date of the Plan or any future amendment approved by stockholders.

**Exhibit 31(a)**

**Certification pursuant to**
**Section 302 of the Sarbanes-Oxley Act of 2002**

I, Michael J. Hoffman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Toro Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: June 12, 2006

/s/ Michael J. Hoffman

Michael J. Hoffman
President and Chief Executive Officer
(Principal Executive Officer)

**Exhibit 31(b)**

**Certification pursuant to**
**Section 302 of the Sarbanes-Oxley Act of 2002**

I, Stephen P. Wolfe, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Toro Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: June 12, 2006

/s/ Stephen P. Wolfe

Stephen P. Wolfe
Vice President Finance and
Chief Financial Officer
(Principal Financial Officer)

**Exhibit 32**

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of The Toro Company (the "Company") on Form 10-Q for the quarterly period ended May 5, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Michael J. Hoffman, President and Chief Executive Officer of the Company, and Stephen P. Wolfe, Vice President Finance and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Michael J. Hoffman

Michael J. Hoffman
President and Chief Executive Officer
June 12, 2006

/s/ Stephen P. Wolfe

Stephen P. Wolfe
Vice President Finance and
Chief Financial Officer
June 12, 2006

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.