

HURCO COMPANIES INC  
Form 10-Q  
September 05, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended July 31, 2014 or  
 Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 0-9143

**HURCO COMPANIES, INC.**

(Exact name of registrant as specified in its charter)

**Indiana**

(State or other jurisdiction of  
incorporation or organization)

**35-1150732**

(I.R.S. Employer Identification Number)

**One Technology Way**

**Indianapolis, Indiana**

(Address of principal executive offices) (Zip code)

**46268**

Registrant's telephone number, including area code

**(317) 293-5309**

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to the filing requirements for the past 90 days:

Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Yes  No

The number of shares of the Registrant's common stock outstanding as of September 2, 2014 was 6,504,880.

**HURCO COMPANIES, INC.**

July 2014 Form 10-Q Quarterly Report

**Table of Contents**

**Part I - Financial Information**

Item 1.	<u>Financial Statements</u>	
	<u>Condensed Consolidated Statements of Income Three and nine months ended July 31, 2014 and 2013</u>	3
	<u>Condensed Consolidated Statements of Comprehensive Income Three and nine months ended July 31, 2014 and 2013</u>	4
	<u>Condensed Consolidated Balance Sheets As of July 31, 2014 and October 31, 2013</u>	5
	<u>Condensed Consolidated Statements of Cash Flows Three and nine months ended July 31, 2014 and 2013</u>	6
	<u>Condensed Consolidated Statements of Changes in Shareholders' Equity Nine months ended July 31, 2014 and 2013</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	25
Item 4.	<u>Controls and Procedures</u>	28
	<b><u>Part II - Other Information</u></b>	
Item 1.	<u>Legal Proceedings</u>	29
Item 1A.	<u>Risk Factors</u>	29
Item 5.	<u>Other Information</u>	29
Item 6.	<u>Exhibits</u>	30
	<u>Signatures</u>	31



**PART I - FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****HURCO COMPANIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)

	Three Months Ended July 31		Nine Months Ended July 31	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Sales and service fees	\$55,379	\$45,158	\$160,080	\$138,862
Cost of sales and service	37,367	33,443	111,520	98,948
Gross profit	18,012	11,715	48,560	39,914
Selling, general and administrative expenses	11,869	10,012	33,675	29,611
Operating income	6,143	1,703	14,885	10,303
Interest expense	65	74	196	194
Interest income	23	14	55	61
Investment income (expense)	4	4	40	19
Other (income) expense, net	46	530	331	861
Income before income taxes	6,059	1,117	14,453	9,328
Provision for income taxes	1,684	263	4,173	3,037
Net income	\$4,375	\$854	\$10,280	\$6,291
Income per common share				
Basic	\$0.67	\$0.13	\$1.57	\$0.96
Diluted	\$0.66	\$0.13	\$1.56	\$0.96

Weighted average common shares outstanding

Basic	6,505	6,458	6,493	6,452
Diluted	6,548	6,507	6,529	6,495
<b>Dividends paid per share</b>	\$0.07	\$ 0.05	\$0.19	\$ 0.05

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

**HURCO COMPANIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)

	Three Months Ended July 31		Nine Months Ended July 31	
	2014 (Unaudited)	2013	2014 (Unaudited)	2013
Net income	\$ 4,375	\$ 854	\$ 10,280	\$ 6,291
Other comprehensive income (loss):				
Translation of foreign currency financial statements	(886 )	(520 )	(372 )	(614 )
(Gain) / loss on derivative instruments reclassified into operations, net of tax \$134, \$(28), \$398 and \$(625), respectively	243	(49 )	724	(1,098 )
Gain / (loss) on derivative instruments, net of tax \$340, \$(245), \$(326) and \$(395), respectively	619	(430 )	(592 )	(693 )
Total other comprehensive income (loss)	(24 )	(999 )	(240 )	(2,405 )
Comprehensive income (loss)	\$ 4,351	\$ (145 )	\$ 10,040	\$ 3,886

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

**HURCO COMPANIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per-share data)

	July 31 2014 (Unaudited)	October 31 2013 (Audited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 51,345	\$ 42,804
Accounts receivable, net	37,620	36,145
Inventories, net	99,338	95,260
Deferred income taxes	2,096	2,080
Derivative assets	1,189	699
Prepaid expenses	8,691	6,584
Other	1,479	1,430
Total current assets	201,758	185,002
Non-current assets:		
Property and equipment:		
Land	782	782
Building	7,314	7,326
Machinery and equipment	19,787	19,059
Leasehold improvements	3,594	3,634
	31,477	30,801
Less accumulated depreciation and amortization	(19,490 )	(18,502 )
	11,987	12,299
Software development costs, less accumulated amortization	3,625	3,714
Goodwill	2,771	2,807
Intangible assets, net	1,811	2,155
Investments and other assets, net	5,746	5,258
	\$ 227,698	\$ 211,235
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 41,819	\$ 35,527
Accrued expenses and other	14,538	13,504
Accrued warranty expenses	1,849	1,778
Derivative liabilities	668	1,212
Short-term debt	3,239	3,665
Total current liabilities	62,113	55,686
Non-current liabilities:		
Deferred income taxes	804	743



Edgar Filing: HURCO COMPANIES INC - Form 10-Q

Accrued tax liability	1,127	1,103
Deferred credits and other	2,402	2,212
Total liabilities	66,446	59,744
Shareholders' equity:		
Preferred stock: no par value per share, 1,000,000 shares authorized, no shares issued	—	—
Common stock: no par value, \$.10 stated value per share, 12,500,000 shares authorized, 6,585,918 and 6,533,510 shares issued; and 6,504,880 and 6,465,054 shares outstanding, as of July 31, 2014 and October 31, 2013, respectively	651	647
Additional paid-in capital	55,651	54,698
Retained earnings	107,174	98,130
Accumulated other comprehensive loss	(2,224 )	(1,984 )
Total shareholders' equity	161,252	151,491
	\$ 227,698	\$ 211,235

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

**HURCO COMPANIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	Three Months Ended July 31		Nine Months Ended July 31	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
Cash flows from operating activities:				
Net income	\$ 4,375	\$ 854	\$ 10,280	\$ 6,291
Adjustments to reconcile net income to net cash provided by (used for) operating activities, net of acquisitions:				
Provision for doubtful accounts	3	27	(48 )	(31 )
Deferred income taxes	(71 )	(107 )	(57 )	(692 )
Equity in income of affiliates	(82 )	(117 )	(247 )	(231 )
Depreciation and amortization	808	791	2,359	2,506
Foreign currency (gain) loss	2,031	366	664	142
Unrealized (gain) loss on derivatives	(634 )	518	(106 )	705
Stock-based compensation	265	238	657	741
Change in assets and liabilities, net of acquisitions:				
(Increase) decrease in accounts receivable	(364 )	6,663	(1,520 )	9,720
(Increase) decrease in inventories	(5,182 )	(3,778 )	(5,205 )	(3,519 )
(Increase) decrease in prepaid expenses	(783 )	(379 )	(2,107 )	(456 )
Increase (decrease) in accounts payable	4,965	(279 )	6,633	3,046
Increase (decrease) in accrued expenses	1,681	846	1,125	(3,522 )
Net change in derivative assets and liabilities	(510 )	82	121	(529 )
Other	(448 )	(1,104 )	(434 )	(727 )
Net cash provided by (used for) operating activities	6,054	4,621	12,115	13,444
Cash flows from investing activities:				
Purchase of property and equipment	(476 )	(375 )	(1,427 )	(1,147 )
Software development costs	(285 )	(233 )	(708 )	(750 )
Other investments	147	(8 )	(68 )	(48 )
Acquisition of business, net of cash acquired	—	(380 )	—	(380 )
Proceeds from sale of equipment	—	—	126	—
Net cash provided by (used for) investing activities	(614 )	(996 )	(2,077 )	(2,325 )
Cash flows from financing activities:				
Dividends paid	(456 )	(323 )	(1,236 )	(323 )
Proceeds from exercise of stock options	—	303	298	303
Tax benefit from exercised of stock option	—	10	—	10
Restricted shares vested	—	—	2	1
Repayment of short- term debt	—	(2,205 )	(386 )	(2,205 )
Net cash provided by (used for) financing activities	(456 )	(2,215 )	(1,322 )	(2,214 )

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

Effect of exchange rate changes on cash	(313 )	(75 )	(175 )	(63 )
Net increase (decrease) in cash and cash equivalents	4,671	1,335	8,541	8,842
Cash and cash equivalents at beginning of period	46,674	43,277	42,804	35,770
Cash and cash equivalents at end of period	\$ 51,345	44,612	\$ 51,345	\$ 44,612

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

**HURCO COMPANIES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****For the nine months ended July 31, 2014 and 2013**

(Unaudited)

(In thousands, except shares outstanding)	Common stock		Additional	Retained	Accumulated other comprehensive	Total
	Shares	Amount	paid-in capital	earnings	income (loss)	
Balances, October 31, 2012	6,447,210	\$ 645	\$ 53,415	\$ 90,586	\$ (853)	) \$ 143,793
Net income	—	—	—	6,291	—	6,291
Other comprehensive loss	—	—	—	—	(2,405)	) (2,405 )
Stock-based compensation expense	6,475	1	740	—	—	741
Tax benefits from exercise of stock options	—	—	10	—	—	10
Exercise of common stock options	11,369	1	303	—	—	304
Dividends paid	—	—	—	(323)	—	) (323 )
Balances, July 31, 2013 (Unaudited)	6,465,054	\$ 647	\$ 54,468	\$ 96,554	\$ (3,258)	) \$ 148,411
Balances, October 31, 2013	6,465,054	\$ 647	\$ 54,698	\$ 98,130	\$ (1,984)	) \$ 151,491
Net income	—	—	—	10,280	—	10,280
Other comprehensive loss	—	—	—	—	(240)	) (240 )
Stock-based compensation expense	23,520	2	655	—	—	657
Exercise of common stock options	16,306	2	298	—	—	300
Dividends paid	—	—	—	(1,236)	—	) (1,236 )
Balances, July 31, 2014 (Unaudited)	6,504,880	\$ 651	\$ 55,651	\$ 107,174	\$ (2,224)	) \$ 161,252

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



**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

1. GENERAL

The unaudited Condensed Consolidated Financial Statements include the accounts of Hurco Companies, Inc. and its consolidated subsidiaries. As used in this report, unless the context indicates otherwise, the terms “we”, “us”, “our” and similar language refer to Hurco Companies, Inc. and its consolidated subsidiaries as a whole.

We design and produce computerized machine tools, interactive computer control systems, machine tool components, and software for sale through our distribution network to the worldwide metal cutting market. We also provide software options, computer control upgrades, accessories and replacement parts for our products, as well as customer service and training support.

The condensed financial information as of July 31, 2014 and for the three and nine months ended July 31, 2014 and July 31, 2013 is unaudited. However, in our opinion, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our consolidated financial position, results of operations, changes in shareholders' equity and cash flows at the end of the interim periods. We suggest that you read these condensed consolidated financial statements in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended October 31, 2013.

2. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to certain market risks relating to our ongoing business operations, including foreign currency risk, interest rate risk and credit risk. We manage our exposure to these and other market risks through regular operating and financing activities. Currently, the only risk that we manage through the use of derivative instruments is foreign currency risk for which we enter into derivative instruments in the form of foreign currency forward exchange contracts with a major financial institution.

We enter into these forward exchange contracts to reduce the potential effects of foreign exchange rate movements on our net equity investment in one of our foreign subsidiaries, to reduce the impact on gross profit and net earnings from sales and purchases denominated in foreign currencies, and to reduce the impact on our net earnings of foreign currency fluctuations on receivables and payables denominated in foreign currencies that are different than our subsidiaries' functional currency. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in Euros, Pounds Sterling, Canadian Dollars, South African Rand, Singapore

Dollars, Indian Rupee, Chinese Yuan, South Korean Won, Polish Zloty, and New Taiwan Dollars. We record all derivative instruments as assets or liabilities at fair value.

#### Derivatives Designated as Hedging Instruments

We enter into foreign currency forward exchange contracts periodically to hedge certain forecasted inter-company sales and purchases denominated in foreign currencies (the Pound Sterling, Euro and New Taiwan Dollar). The purpose of these instruments is to mitigate the risk that the U.S. Dollar net cash inflows and outflows resulting from sales and purchases denominated in foreign currencies will be adversely affected by changes in exchange rates. These forward contracts have been designated as cash flow hedge instruments, and are recorded in the Condensed Consolidated Balance Sheets at fair value in Derivative assets and Derivative liabilities. The effective portion of the gains and losses resulting from the changes in the fair value of these hedge contracts are deferred in Accumulated other comprehensive loss and recognized as an adjustment to Cost of sales and service in the period that the corresponding inventory that is the subject of the related hedge contract is sold, thereby providing an offsetting economic impact against the corresponding change in the U.S. Dollar value of the inter-company sale or purchase being hedged. The ineffective portion of gains and losses resulting from the changes in the fair value of these hedge contracts is reported in Other (income) expense, net, immediately. We perform quarterly assessments of hedge effectiveness by verifying and documenting the critical terms of the hedge instrument and determining that forecasted transactions have not changed significantly. We also assess on a quarterly basis whether there have been adverse developments regarding the risk of a counterparty default.

We had forward contracts outstanding as of July 31, 2014, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from August 2014 through July 2015. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2014, were \$33.5 million for Euros, \$12.7 million for Pounds Sterling and \$23.9 million for New Taiwanese Dollars. At July 31, 2014, we had approximately \$838,000 of losses, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive loss. Included in this amount were \$36,000 of unrealized gains, net of tax, related to cash flow hedge instruments that remain subject to currency fluctuation risk. The majority of these deferred losses will be recorded as an adjustment to Cost of sales and service in periods through July 2015, when the corresponding inventory that is the subject of the related hedge contracts is sold, as described above.

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we have maintained a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro denominated assets. We selected the forward method under Financial Accounting Standards Board, or FASB, guidance related to the accounting for derivatives instruments and hedging activities. The forward method requires all changes in the fair value of the contract to be reported as a cumulative translation adjustment in Accumulated other comprehensive loss, net of tax, in the same manner as the underlying hedged net assets. This forward contract matures in November 2014. At July 31, 2014, we had \$238,000 of realized gains and \$27,000 of unrealized gains, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to these forward contracts.

#### Derivatives Not Designated as Hedging Instruments

We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. These derivative instruments are not designated as hedges under the FASB guidance and, as a result, changes in their fair value are reported currently as Other (income) expense, net, in the Condensed Consolidated Statements of Income consistent with the transaction gain or loss on the related receivables and payables denominated in foreign currencies.

We had forward contracts outstanding as of July 31, 2014, in Euros, Pounds Sterling, Canadian Dollars, the South African Rand, and the New Taiwan Dollar with set maturity dates ranging from August 2014 through October 2014. The contract amounts at forward rates in U.S. Dollars at July 31, 2014 totaled \$53.8 million.

#### Fair Value of Derivative Instruments

We recognize the fair value of derivative instruments as assets and liabilities on a gross basis on our Condensed Consolidated Balance Sheets. As of July 31, 2014 and October 31, 2013, all derivative instruments were recorded at



Edgar Filing: HURCO COMPANIES INC - Form 10-Q

fair value on the balance sheets as follows (in thousands):

Derivatives	July 31, 2014		October 31, 2013	
	Balance sheet location	Fair value	Balance sheet location	Fair value
Designated as hedging instruments:				
Foreign exchange forward contracts	Derivative assets	\$ 603	Derivative assets	\$ 244
Foreign exchange forward contracts	Derivative liabilities	\$ 505	Derivative liabilities	\$ 1,158
Not designated as hedging instruments:				
Foreign exchange forward contracts	Derivative assets	\$ 586	Derivative assets	\$ 455
Foreign exchange forward contracts	Derivative liabilities	\$ 163	Derivative liabilities	\$ 54

Effect of Derivative Instruments on the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Changes in Shareholders' Equity and Condensed Consolidated Statements of Income

Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Changes in Shareholders' Equity and Condensed Consolidated Statements of Income during the three months ended July 31, 2014 and 2013 (in thousands):

Derivatives	Amount of Gain (Loss) Recognized in Other Comprehensive Income Three months ended July 31, 2014      2013		Location of Gain (Loss) Reclassified from Other Comprehensive Income	Amount of Gain (Loss) Reclassified from Other Comprehensive Income Three months ended July 31, 2014      2013	
Designated as hedging instruments: (Effective portion)					
Foreign exchange forward contracts – Intercompany sales/purchases	\$ 959	\$ (675 )	Cost of sales and service	\$ (377 )	\$ 77
Foreign exchange forward contract – Net investment	\$ 143	\$ (49 )			

We recognized a gain of \$19,000 for the three months ended July 31, 2014 as a result of contracts closed early that were deemed ineffective for financial reporting purposes and did not qualify as cash flow hedges. We did not recognize gains or losses as a result of hedges deemed ineffective for the three months ended July 31, 2013. We recognized the following gains and losses in our Condensed Consolidated Statements of Income during the three months ended July 31, 2014 and 2013 (in thousands) on derivative instruments not designated as hedging instruments:

Derivatives	Location of gain (loss) recognized in operations	Amount of gain (loss) recognized in operations Three months ended July 31, 2014                      2013	
Not designated as hedging instruments:			
Foreign exchange forward contracts	Other (income) expense, net	\$ 971	\$ (561 )

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

The following table presents the changes in the components of Accumulated other comprehensive loss, net of tax, for the three months ended July 31, 2014 (in thousands):

	Foreign Currency Translation	Cash Flow Hedges	Total
Balance, April 30, 2014	\$ (502 )	\$ (1,698 )	\$ (2,200)
Other comprehensive income (loss) before reclassifications	(886 )	619	(267 )
Reclassifications	—	243	243
Balance, July 31, 2014	\$ (1,388 )	\$ (836 )	\$ (2,224)

Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Changes in Shareholders' Equity and Condensed Consolidated Statements of Income during the nine months ended July 31, 2014 and 2013 (in thousands):

Derivatives	Amount of Gain (Loss)	Location of Gain	Amount of Gain (Loss)
	Recognized in Other	(Loss) Reclassified from Other	Reclassified from Other
	Comprehensive Income	Comprehensive Income	Comprehensive Income
	Nine months ended July 31,		Nine months ended July 31,
	2014		2014
	2013		2013
Designated as hedging instruments: (Effective portion)			
Foreign exchange forward contracts – Intercompany sales/purchases	\$ (918 )	\$ (1,088 )	Cost of sales and service \$ (1,122 ) \$ 1,723
Foreign exchange forward contract – Net investment	\$ 61	\$ (100 )	

We recognized a loss of \$10,000 for the nine months ended July 31, 2014, and a loss of \$32,000 for the nine months ended July 31, 2013 as a result of contracts closed early that were deemed ineffective for financial reporting purposes and did not qualify as cash flow hedges. We recognized the following gains and losses in our Condensed Consolidated Statements of Income during the nine months ended July 31, 2014 and 2013 (in thousands) on derivative instruments not designated as hedging instruments:

Derivatives	Location of gain (loss) recognized in operations	Amount of gain (loss) recognized in operations
		Nine months ended July 31, 2014
		2013
Not designated as hedging instruments:		
Foreign exchange forward contracts	Other (income) expense, net	\$ (2 ) \$ (1,148 )

The following table presents the changes in the components of Accumulated other comprehensive loss, net of tax, for the nine months ended July 31, 2014 (in thousands):

Foreign

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

	Currency Translation	Cash Flow Hedges	Total
Balance, October 31, 2013	\$ (1,016 )	\$ (968 )	\$ (1,984)
Other comprehensive income (loss) before reclassifications	(372 )	(592 )	(964 )
Reclassifications	—	724	724
Balance, July 31, 2014	\$ (1,388 )	\$ (836 )	\$ (2,224)

## 3. EQUITY INCENTIVE PLAN

In March 2008, we adopted the Hurco Companies, Inc. 2008 Equity Incentive Plan, or the 2008 Plan, which allows us to grant awards of stock options, Stock Appreciation Rights settled in stock (SARs), restricted shares, performance shares and performance units. The 2008 Plan replaced the 1997 Stock Option and Incentive Plan, which expired in March 2007. The Compensation Committee of the Board of Directors has authority to determine the officers, directors and key employees who will be granted awards; designate the number of shares subject to each award; determine the terms and conditions upon which awards will be granted; and prescribe the form and terms of award agreements. We have granted stock options under both plans which are currently outstanding and restricted shares under the 2008 Plan which are outstanding. No stock option may be exercised more than ten years after the date of grant or such shorter period as the Compensation Committee may determine at the date of grant. The total number of shares of our common stock that may be issued as awards under the 2008 Plan is 750,000. The market value of a share of our common stock, for purposes of the 2008 Plan, is the closing sale price as reported by the Nasdaq Global Select Market on the date in question or, if not a trading day, on the last preceding trading date.

A summary of stock option activity for the nine-month period ended July 31, 2014, is as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding at October 31, 2013	168,712	\$ 20.73
Options granted	—	—
Options exercised	(16,306 )	(18.35 )
Options cancelled	(20,217 )	(25.59 )
Outstanding at July 31, 2014	132,189	\$ 20.28

Summarized information about outstanding stock options as of July 31, 2014, that have already vested and those that are expected to vest, as well as stock options that are currently exercisable, are as follows:

	Options already vested and expected to vest	Options currently exercisable
Number of outstanding options	132,189	105,677
Weighted average remaining contractual life (years)	6.19	4.81

Weighted average exercise price per share	\$ 20.28	\$ 19.74
Intrinsic value of outstanding options	\$ 1,601,000	\$ 1,344,000

The intrinsic value of an outstanding stock option is calculated as the difference between the stock price as of July 31, 2014 and the exercise price of the option.

On January 10, 2014, the Compensation Committee approved a long-term incentive compensation arrangement for our executive officers in the form of restricted shares and performance shares awarded under the 2008 Plan. The awards were 25% time-based vesting and 75% performance-based vesting. The three-year performance period is fiscal 2014 through fiscal 2016.

The Compensation Committee granted a total 12,182 shares of time-based restricted shares to our executive officers. The restricted shares vest in thirds over three years from the date of grant provided the recipient remains employed through that date. The grant date fair value of the restricted shares was based upon the closing sales price of our common stock on the date of grant.

The Compensation Committee also granted a total of 16,948 performance shares to our executive officers designated as “Performance Shares –TSR”. The shares were weighted as 40% of the overall long-term incentive compensation arrangement and will vest based upon the total shareholder return of our common stock over a three-year period, relative to the total shareholder return of the companies in a specified peer group over that period. Participants will have the ability to earn between 50% of the target number of shares for achieving threshold performance and 200% of the target number of shares for achieving maximum performance. The fair value of the market-based performance shares was calculated using the Monte Carlo approach.

The Compensation Committee also granted a total of 17,056 performance shares to our executive officers designated as “Performance Shares –ROIC”. These shares were weighted as 35% of the overall long-term incentive compensation arrangement and will vest based upon the achievement of pre-established goals related to our average return on invested capital over the three-year period. Participants will have the ability to earn between 50% of the target number of shares for achieving threshold performance and 200% of the target number of shares for achieving maximum performance. The grant date fair value of the ROIC performance shares was based on the closing sales price of our common stock on the grant date.

On March 13, 2014, the Compensation Committee granted a total of 11,235 shares of restricted stock to our non-employee directors. The restricted stock vests in full one year from the date of grant provided the recipient remains on the board of directors through that date. The grant date fair value of the restricted stock was based on the closing sales price of our common stock on the grant date which was \$24.92 per share.

A reconciliation of the activity relating to outstanding share awards made under the 2008 Plan and related information is as follows:

	Number of Shares	Grant Date Fair Value
Unvested at October 31, 2013	68,456	\$ 23.01
Shares granted	57,421	24.90
Shares vested	(23,520 )	(24.42 )
Shares cancelled	(13,609 )	(23.64 )
Shares withheld	(7,710 )	(23.10 )



Edgar Filing: HURCO COMPANIES INC - Form 10-Q

Unvested at July 31, 2014      81,038      \$ 23.83

During the first nine months of fiscal 2014 and 2013, we recorded \$657,000 and \$741,000, respectively, as stock-based compensation expense attributable to stock option and share awards. As of July 31, 2014, there was an estimated \$1.3 million of total unrecognized stock-based compensation expense that we expect to recognize by the end of the first quarter of fiscal 2017.

## 4. EARNINGS PER SHARE

Per share results have been computed based on the average number of common shares outstanding. The computation of basic and diluted net income per share is determined using net income applicable to common shareholders as the numerator and the number of shares outstanding as the denominator as follows (in thousands, except per share amounts):

	Three months ended				Nine months ended			
	July 31, 2014		2013		July 31, 2014		2013	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
Net income	\$4,375	\$4,375	\$854	\$854	\$10,280	\$10,280	\$6,291	\$6,291
Undistributed earnings allocated to participating shares	(35 )	(35 )	(9 )	(9 )	(83 )	(83 )	(66 )	(66 )
Net income applicable to common shareholders	\$4,340	\$4,340	\$845	\$845	\$10,197	\$10,197	\$6,225	\$6,225
Weighted average shares outstanding	6,505	6,505	6,458	6,458	6,493	6,493	6,452	6,452
Stock options	—	43	—	49	—	36	—	43
	6,505	6,548	6,458	6,507	6,493	6,529	6,452	6,495
Income per share	\$0.67	\$0.66	\$0.13	\$0.13	\$1.57	\$1.56	\$0.96	\$0.96

## 5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$492,000 as of July 31, 2014 and \$540,000 as of October 31, 2013.

## 6. INVENTORIES

Inventories, priced at the lower of cost (first-in, first-out method) or market, are summarized below (in thousands):

	July 31, 2014	October 31, 2013
Purchased parts and sub-assemblies	\$ 21,550	\$ 21,647
Work-in-process	16,470	15,996
Finished goods	61,318	57,617

\$ 99,338      \$ 95,260

## 7. ACQUISITION OF BUSINESS

On July 1, 2013, we acquired the machine tool component business of an Italian designer and manufacturer of electro-mechanical components and accessories for machine tools. We are operating this business through our wholly-owned Italian subsidiary, LCM Precision Technologies, or LCM. The purchase price was allocated to the assets acquired and the liabilities assumed based on their fair values. The purchase price for the acquired assets and the assumed liabilities was \$5.0 million. The allocation of the opening balance sheet of LCM as of July 1, 2013 is as follows (in thousands):

Current assets	\$6,723
Property plant and equipment	933
Intangibles	1,437
Goodwill	2,477
Total assets	\$11,570
Current liabilities	\$4,821
Short term debt	4,643
Non-current liabilities	1,726
Total Liabilities	\$11,190
Cash expended, net of cash acquired	380
Indebtedness assumed	4,643
Total purchase price	\$5,023

Intangible assets of \$1.4 million were recorded as a result of the transaction. The fair value of the intangible assets was based upon a discounted cash flow method that involves inputs that are not observable in the market (Level 3). Intangible assets are amortized primarily using a straight-line methodology. The intangible assets consisted of the following (in thousands):

		Remaining Economic Useful Life
Trademark/name	\$274	13 years
Technology and manufacturing know how	1,111	13 years
Customer relationships	52	16 years
	\$1,437	

The excess purchase price over the fair value of the assets acquired and the liabilities assumed was recorded as goodwill in the amount of \$2.5 million. Goodwill recognized in the acquisition relates primarily to advancing our machine tool technology and expanding our current product offering. We expect the amount recorded as goodwill to be fully deductible for tax purposes.

The results of operations of LCM have been included in our consolidated financial statements since July 1, 2013.

15

## 8. SEGMENT INFORMATION

We operate in a single segment: industrial automation systems. We design and produce computerized machine tools, machine tool components, interactive computer control systems and software for sale through our own distribution network to the worldwide metal-working market. We also provide software options, control upgrades, accessories and replacement parts for our products, as well as customer service and training support. The results of our subsidiary LCM are included within the industrial automation systems segment.

## 9. GUARANTEES AND WARRANTIES

We follow FASB guidance for accounting for contingencies relating to the guarantor's accounting for, and disclosures of, the issuance of certain types of guarantees.

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. As of July 31, 2014, we had 19 outstanding third party payment guarantees totaling approximately \$1.7 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue for potential liabilities under these guarantees when we believe a loss is probable and can be estimated.

We provide warranties on our products with respect to defects in material and workmanship. The terms of these warranties are generally one year for machines and certain components and shorter periods for service parts. We recognize a reserve with respect to this obligation at the time of product sale, with subsequent warranty claims recorded against the reserve. The amount of the warranty reserve is determined based on historical trend experience and any known warranty issues that could cause future warranty costs to differ from historical experience. A reconciliation of the changes in our warranty reserve is as follows (in thousands):

	Nine months ended	
	July 31, 2014	July 31, 2013
Balance, beginning of period	\$ 1,778	\$ 1,623
Provision for warranties during the period	2,825	2,743
Charges to the reserve	(2,745 )	(2,705 )
Impact of foreign currency translation	(9 )	(11 )
Balance, end of period	\$ 1,849	\$ 1,650

The year-over-year increase in the warranty reserve reflects higher sales volumes and anticipated claims for machines under warranty as well as the sale of a greater number of our higher-performance machines which have a higher cost per claim.

10.

DEBT AGREEMENTS

On December 7, 2012, we entered into an agreement with a financial institution that provided us with a \$12.5 million unsecured revolving credit and letter of credit facility, with a \$3.0 million maximum amount for outstanding letters of credit on the credit facility. On May 9, 2014, the maximum amount for outstanding letters of credit under our U.S. credit facility was increased from \$3.0 million to \$5.0 million in order to guarantee a new revolving credit facility in Taiwan. Borrowings under the U.S. credit facility bear interest at a LIBOR-based rate or a floating rate of 1% above the prevailing prime rate. The floating rate is not less than the greatest of (a) a one month LIBOR-based rate plus 1.00% per annum, (b) the federal funds effective rate plus 0.50% per annum, and (c) the prevailing prime rate. The rate we must pay for that portion of the U.S. credit facility which is not utilized is 0.05% per annum. On June 5, 2014, the maximum amount of cash dividends we are permitted to pay was increased from \$1.0 million to \$3.0 million per calendar year, and we can pay cash dividends up to this amount so long as we are not in default before and after giving effect to such dividends.

We have a £1.0 million revolving credit facility in the United Kingdom and a €1.5 million revolving credit facility in Germany. On May 12, 2014, we established a Taiwan credit facility in the amount of 100.0 million New Taiwan Dollars (approximately \$3.3 million) with an expiration date of May 12, 2015. Our Taiwan credit facility is backed by letters of credit under our U.S. credit facility. We also have a 40.0 million Chinese Yuan credit facility in China.

All of our credit facilities are unsecured except that borrowings under our Taiwan credit facility are backed by letters of credit drawn on our unsecured U.S. credit facility.

We had \$3.2 million and \$3.3 million of borrowings outstanding under our China credit facility at July 31, 2014 and October 31, 2013, respectively. We had no other debt or borrowings under any of our other credit facilities. At July 31, 2014 we were in compliance with all covenants contained in our credit agreements and, as of that date, we had total unutilized credit facilities of approximately \$18.8 million.

11.

INCOME TAXES

Our effective income tax rate for the first nine months of fiscal 2014 was 29% in comparison to 33% for the same period in fiscal 2013. The decrease in the effective rate was primarily due to changes in the geographic mix of income or loss between tax jurisdictions. We recorded income tax expense during the first nine months of fiscal 2014 of \$4.2 million compared to \$3.0 million for the same period in fiscal 2013, primarily as a result of the increase in pre-tax income period-over-period. We have not provided any U.S. income taxes on the undistributed earnings of our wholly-owned foreign subsidiaries based upon our determination that such earnings will be indefinitely reinvested in our foreign operations. In the event these earnings are later distributed to our U.S. operations, such distributions would likely result in additional U.S. tax that may be offset, at least in part by associated foreign tax credits.



Our unrecognized tax benefits were \$1.3 million as of July 31, 2014 and as of October 31, 2013, and in each case included accrued interest.

We recognize accrued interest and penalties related to unrecognized tax benefits as components of income tax expense. As of July 31, 2014, the gross amount of interest accrued, reported in Accrued expenses and other, was approximately \$10,000, which did not include the federal tax benefit of interest deductions.

We file U.S. federal and state income tax returns, as well as tax returns in several foreign jurisdictions. The statutes of limitations with respect to unrecognized tax benefits will expire between July 2015 and July 2018.

12.

## FINANCIAL INSTRUMENTS

*Fair Value Measurement of Financial Instruments*

FASB guidance establishes a three-tier fair value hierarchy, which categorizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exist, therefore requiring an entity to develop its own assumptions.

In accordance with this guidance, the following table represents the fair value hierarchy for our financial assets and liabilities measured at fair value as of July 31, 2014 and October 31, 2013 (in thousands):

	Assets		Liabilities	
	July 31, 2014	October 31, 2013	July 31, 2014	October 31, 2013
Level 1				
Deferred Compensation	\$1,184	\$ 1,073	\$-	\$ -
Level 2				
Derivatives	\$1,189	\$ 699	\$668	\$ 1,212

Included in Level 1 assets are mutual fund investments under a nonqualified deferred compensation plan. We estimate the fair value of these investments on a recurring basis using readily available market prices.

Included as Level 2 fair value measurements are derivative assets and liabilities related to gains and losses on foreign currency forward exchange contracts entered into with a third party. We estimate the fair value of these derivatives on a recurring basis using foreign currency exchange rates obtained from active markets. Derivative instruments are reported in the accompanying consolidated financial statements at fair value. We have derivative financial instruments in the form of foreign currency forward exchange contracts as described in Note 2 of Notes to the Condensed Consolidated Financial Statements in which the U.S. Dollar equivalent notional amounts of these contracts was \$129.2 million and \$105.0 million at July 31, 2014 and October 31, 2013, respectively. The fair value of Derivative assets recorded on our Condensed Consolidated Balance Sheets was \$1.2 million at July 31, 2014 and \$699,000 at October 31, 2013. The fair value of Derivative liabilities recorded on our Condensed Consolidated Balance Sheets was \$668,000 at July 31, 2014 and \$1.2 million at October 31, 2013.

The fair value of our foreign currency forward exchange contracts and the related currency positions are subject to offsetting market risk resulting from foreign currency exchange rate volatility. The counterparty to the forward exchange contracts is a substantial and creditworthy financial institution. We do not consider either the risk of counterparty non-performance or the economic consequences of counterparty non-performance as material risks.

### 13. CONTINGENCIES AND LITIGATION

We are involved in various claims and lawsuits arising in the normal course of business. We do not expect any of these claims, individually or in the aggregate, to have a material adverse effect on our consolidated financial position or results of operations.

#### 14. NEW ACCOUNTING PRONOUNCEMENTS

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, providing guidance on the presentation of unrecognized tax benefits, reflecting the manner in which an entity would settle, at the reporting date, any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. We do not expect that the adoption of this accounting standard update will have a material effect on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, establishing a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. This update provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services and will supersede most of the existing revenue recognition guidance, including industry-specific guidance. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is not permitted. We have the option of using either a full retrospective or modified approach to adopt this guidance. We are assessing the method of adoption and the impact this new accounting guidance will have on our consolidated financial statements.

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

**EXECUTIVE OVERVIEW**

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design and produce computerized machine tools, featuring our proprietary computer control systems and software, for sale through our own distribution network to the worldwide metal cutting market. We also produce machine tool components, software options, control upgrades, accessories and replacement parts for our products, as well as provide customer service and training support.

The following overview is intended to provide a brief explanation of the principal factors that have contributed to our recent financial performance. This overview is intended to be read in conjunction with the more detailed information included in our unaudited financial statements that appear elsewhere in this report.

The market for machine tools is international in scope. We have both significant foreign sales and significant foreign manufacturing operations. During the first nine months of fiscal 2014, approximately 63% of our revenues were attributable to customers in Europe, where we typically sell most of our higher-performance, higher-priced VMX series machines. Additionally, approximately 11% of our revenues in that period were attributable to customers in Asia, where we sell more of our entry-level, lower-priced machines, but also where we encounter greater price pressures. We sell our products through more than 100 independent agents and distributors in countries throughout North America, Europe and Asia. We also have our own direct sales and service organizations in China, France, Germany, India, Italy, Poland, Singapore, South Africa, the United Kingdom and certain parts of the United States. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly-owned subsidiary in Taiwan, Hurco Manufacturing Limited (HML). Machine castings and components to support HML's production are manufactured at our facility in Ningbo, China.

On July 1, 2013, we acquired the machine tool component business of an Italian designer and manufacturer of electro-mechanical components and accessories for machine tools. We are operating this business through our wholly-owned subsidiary, LCM Precision Technology S.r.l. (LCM). This business has been producing and selling mechanical and electro-mechanical components for machine tools since 1986. We use LCM components in our SRT line of five-axis machining centers that employ LCM's direct drive spindle, swivel head, and rotary torque table to achieve superior simultaneous five-axis machining.

Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies—primarily the Euro, Pound Sterling and Chinese Yuan—in the countries in which those customers are located.

Our product costs are incurred and paid primarily in the New Taiwan Dollar and the U.S. Dollar. Changes in currency exchange rates may have a material effect on our operating results and consolidated balance sheets as reported under U.S. Generally Accepted Accounting Principles. For example, when the U.S. Dollar weakens in value relative to a foreign currency, sales made, and expenses incurred, in that currency when translated to U.S. Dollars for reporting in our financial statements, are higher than would be the case when the U.S. Dollar is stronger. In the comparison of our period-to-period results, we discuss the effect of currency translation on those results including the increases or decreases in those results as reported in our financial statements (which reflect translation to U.S. Dollars at exchange rates prevailing during the period covered by those financial statements) and also the effect that changes in exchange rates had on those results.

Our high levels of foreign manufacturing and sales also subject us to cash flow risks due to fluctuating currency exchange rates. We seek to mitigate those risks through the use of various derivative instruments – principally foreign currency forward exchange contracts.

**RESULTS OF OPERATIONS**Three Months Ended July 31, 2014 Compared to Three Months Ended July 31, 2013

*Sales and Service Fees.* Sales and service fees for the third quarter of fiscal 2014 totaled \$55.4 million, an increase of \$10.2 million, or 23%, compared to the corresponding quarter of fiscal 2013. The year-over-year increase included a favorable currency impact of \$1.7 million, primarily due to a stronger Euro and Pound Sterling when translating foreign sales to U.S. Dollars for financial reporting purposes.

The following two tables set forth net sales (in thousands) by geographic region and product category, respectively, for the third quarter of fiscal 2014 and 2013:

**Sales and Service Fees by Geographic Region**

	Three months ended July 31,		Change		Amount	%
	2014	2013				
North America	\$13,643	25 %	\$14,730	33 %	\$(1,087)	(7)%
Europe	36,627	66 %	25,973	57 %	10,654	41 %
Asia Pacific	5,109	9 %	4,455	10 %	654	15 %
Total	\$55,379	100 %	\$45,158	100 %	\$10,221	23 %

Sales and service fees in Europe and the Asia Pacific region increased during the third quarter of fiscal 2014 by 41% and 15%, respectively, compared to the corresponding prior year period. The overall improvement in sales for these regions was primarily driven by increased shipments and a favorable mix of higher-performance machines. European sales and service fees for the third quarter of fiscal 2014 included \$2.6 million of sales from electro-mechanical components and accessories manufactured by LCM, compared to one month's sales of \$0.5 million in the corresponding quarter in fiscal 2013. North American sales in the third quarter of fiscal 2014, similar to the second quarter, reflected market softening when compared to the same periods in fiscal 2013. In general, the softening of sales in North America is not unusual in the months prior to the International Manufacturing Technology Show which is held in September of even-numbered years.

**Sales and Service Fees by Product Category**

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

	Three months ended July 31,		Change		Amount	%
	2014	2013				
Computerized Machine Tools	\$48,299	87 %	\$38,577	85 %	\$9,722	25 %
Service Fees, Parts and Other	7,080	13 %	6,581	15 %	499	8 %
Total	\$55,379	100 %	\$45,158	100 %	\$10,221	23 %

*Orders.* Orders for the third quarter of fiscal 2014 were \$56.4 million, an increase of \$10.2 million, or 22%, over the corresponding period in fiscal 2013. The impact of currency translation on orders booked in the third quarter of fiscal 2014 was consistent with the impact on sales.

Orders increased in Europe and the Asia Pacific region during the third quarter of fiscal 2014 by \$8.1 million, or 29%, and \$2.5 million, or 74%, respectively, while orders in North America decreased by \$0.4 million, or 3%, in comparison to the corresponding period in fiscal 2013. The increase in European orders for the third quarter of fiscal 2014 was primarily driven by increased orders in Germany and England. The year-over-year improvement in Asian Pacific orders for the third quarter of fiscal 2014 included the benefit of multiple machine orders and a favorable mix of higher-performance machines. European orders for the third quarter of fiscal 2014 included \$1.3 million of LCM products, compared to \$3.8 million in the corresponding period in fiscal 2013. LCM orders for the third quarter of fiscal 2013 included backlog orders existing at the date of acquisition of LCM and one month of new orders booked subsequent to the acquisition.



*Gross Profit.* Gross profit for the third quarter of fiscal 2014 was \$18.0 million, or 33% of sales, compared to \$11.7 million, or 26% of sales, for the corresponding period in fiscal 2013. The increase in gross profit was primarily attributable to a higher sales volume, particularly in Europe, the primary market for our higher-performance machines, and the increased cost efficiencies realized from higher production levels during the fiscal 2014 period.

*Operating Expenses.* Selling, general and administrative expenses in the third quarter of fiscal 2014 were \$11.9 million, an increase of \$1.9 million over the corresponding prior year period. The increase in selling, general and administrative expenses was due primarily to incremental operating expenses associated with the acquisition of the LCM business and increased incentive compensation expense.

*Operating Income (Loss).* Operating income for the third quarter of fiscal 2014 was \$6.1 million compared to \$1.7 million for the prior year period. The improvement in operating income period-over-period was due primarily to the increase in sales.

*Other (Income) Expense, Net.* Other expense decreased by \$0.5 million in the third quarter of fiscal 2014 compared to the corresponding period in fiscal 2013, primarily due to net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts.

*Income Taxes.* Our effective tax rate for the third quarter of fiscal 2014 was 28% in comparison to 24% for the same period in fiscal 2013. The increase in the effective income tax rate was primarily due to changes in the geographic mix of income or loss among tax jurisdictions. We recorded income tax expense during the third quarter of fiscal 2014 of \$1.7 million compared to an income tax expense of \$0.3 million for the same period in fiscal 2013.

#### Nine Months Ended July 31, 2014 Compared to Nine Months Ended July 31, 2013

*Sales and Service Fees.* Sales and service fees for the first nine months ended July 31, 2014 totaled \$160.1 million, an increase of \$21.2 million, or 15%, over the corresponding period in fiscal 2013. The year-over-year increase included a favorable currency impact of \$4.0 million, primarily due to a stronger Euro and Pound Sterling when translating foreign sales to U.S. Dollars for financial reporting purposes.

The following tables set forth net sales (in thousands) by geographic region and product category for the first nine months of fiscal 2014 and 2013, respectively:

**Net Sales and Service Fees by Geographic Region**

	Nine months ended July 31,			Change		
	2014		2013		Amount	%
North America	\$42,223	26 %	\$44,062	32 %	\$(1,839 )	(4 )%
Europe	100,898	63 %	82,539	59 %	18,359	22 %
Asia Pacific	16,959	11 %	12,261	9 %	4,698	38 %
Total	\$160,080	100 %	\$138,862	100 %	\$21,218	15 %

Sales in Europe and the Asian Pacific regions increased during the first nine months of fiscal 2014 by 22% and 38%, respectively, compared to the corresponding prior year period. European sales and service fees included \$6.4 million attributable to sales of LCM products, compared to one month's sales of \$0.5 million in the corresponding prior year period. The year-over-year increase in Asian Pacific sales was primarily attributable to increased shipments in China. Sales in North America during the first nine months of fiscal 2014 softened in comparison to the record level sales achieved in the same period in fiscal 2013. In general, the softening of sales in North America is not unusual in the months prior to the International Manufacturing Technology Show which is held in September of even-numbered years.

**Sales and Service Fees by Product Category**

	Nine months ended July 31,		Change		
	2014	2013	Amount	%	
Computerized Machine Tools	\$ 139,276	87 % \$ 119,934	86 %	\$ 19,342	16 %
Service Fees, Parts and Other	20,804	13 % 18,928	14 %	1,876	10 %
Total	\$ 160,080	100 % \$ 138,862	100 %	\$ 21,218	15 %

*Orders.* Orders for the first nine months of fiscal 2014 were \$167.2 million, an increase of \$21.1 million, or 14%, over the corresponding period in fiscal 2013. The impact of currency translation on orders booked in the 2014 period was consistent with the impact on sales.

Orders increased in Europe and the Asia Pacific region during the first nine months of fiscal 2014 by \$21.0 million, or 23%, and \$2.2 million, or 15%, respectively, while orders in North America decreased by \$2.0 million, or 5%, in comparison to the corresponding period in fiscal 2013. The increase in European orders for the first nine months of fiscal 2014 was primarily driven by increased orders in Germany and England. The year-over-year improvement in Asian Pacific orders for the nine month period included the benefit of multiple machine orders and a favorable mix of higher-performance machines. European orders for the first nine months of fiscal 2014 included \$7.3 million of LCM products, compared to \$3.8 million in the corresponding period in fiscal 2013. LCM orders in fiscal 2013 included backlog orders existing at the date of acquisition of LCM and one month of new orders booked subsequent to the acquisition.

*Gross Profit.* Gross profit for the first nine months of fiscal 2014 was \$48.6 million, or 30% of sales, compared to \$39.9 million, or 29% of sales, for the corresponding period in fiscal 2013. The increase in gross profit was attributable to a higher sales volume, particularly in Europe, the primary market for our higher-performance machines, and the increased cost efficiencies realized from higher production levels.

*Operating Expenses.* Selling, general and administrative expenses were \$33.7 million for the first nine months of fiscal 2014 compared to \$29.6 million for the prior year period. The increase in selling, general and administrative expenses was due primarily to incremental operating expenses associated with the acquisition of the LCM business and increased incentive compensation expense.

*Operating Income (Loss).* Operating income for the first nine months of fiscal 2014 was \$14.9 million compared to \$10.3 million for the same prior year period. The improvement in operating income year-over-year was primarily due to the increase in sales.

*Other (Income) Expense, Net.* Other expense decreased by \$0.5 million in the first nine months of fiscal 2014 compared to the corresponding period in fiscal 2013, primarily due to net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts.

*Income Taxes.* Our effective tax rate for the first nine months of fiscal 2014 was 29% in comparison to 33% for the corresponding period in fiscal 2013. The decrease in the effective income tax rate was primarily due to changes in the geographic mix of income or loss among tax jurisdictions. We recorded income tax expense during the first nine months of fiscal 2014 of \$4.2 million compared to \$3.0 million for the corresponding period in fiscal 2013.

## **LIQUIDITY AND CAPITAL RESOURCES**

We depend upon cash resources to fund dividends on our common stock, our working capital needs and acquisitions. At July 31, 2014, we had cash and cash equivalents of \$51.3 million, compared to \$42.8 million at October 31, 2013. Approximately 48% of the \$51.3 million of cash and cash equivalents is denominated in U.S. Dollars. The balance is attributable to our foreign operations and is held in the local currencies of our various foreign entities, subject to fluctuations in currency exchange rates. We do not believe that the indefinite reinvestment of these funds in our foreign operations impairs our ability to meet our domestic working capital needs.

Working capital, excluding cash and cash equivalents, was \$88.3 million at July 31, 2014, compared to \$86.5 million at October 31, 2013. The increase in working capital, excluding cash and cash equivalents, was primarily due to the increase in accounts receivable.

Capital expenditures of \$2.1 million during the first nine months of fiscal 2014 were primarily for capital improvements and software development costs. We funded these expenditures with cash on hand.

At July 31, 2014, we had \$3.2 million of borrowings outstanding under our China credit facility. We had no other debt or borrowings under any of our other credit facilities. At July 31, 2014, we had an aggregate of \$18.8 million available for borrowing under our credit facilities and were in compliance with all covenants.

We believe our cash position and borrowing capacity under our credit facilities provide adequate liquidity to fund our operations and allow us to remain committed to our strategic plan of product innovation and targeted penetration of developing markets.

We continue to receive and review information on businesses and assets for potential acquisition, including intellectual property assets, which are available for purchase.

## **CRITICAL ACCOUNTING POLICIES**

Our accounting policies, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, require management to make significant estimates and assumptions using information available at the time the estimates are made. These estimates and assumptions significantly affect various reported amounts of assets,

liabilities, revenues, and expenses. If our future experience differs materially from these estimates and assumptions, our results of operations and financial condition would be affected. There were no material changes to our critical accounting policies during the first nine months of fiscal 2014.

## **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

There have been no material changes related to contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013.

## **OFF BALANCE SHEET ARRANGEMENTS**

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. We follow Financial Accounting Standards Board, or FASB, guidance for accounting for contingencies with respect to these guarantees. As of July 31, 2014, we had 19 outstanding third party payment guarantees totaling approximately \$1.7 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue for potential liabilities under these guarantees when we believe a loss is probable and can be estimated.

## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

Certain statements made in this report constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by the statements. These risks, uncertainties and other factors include:

- The cyclical nature of the machine tool industry;
- Uncertain economic conditions, which may adversely affect overall demand, particularly in Europe;
- The risks of our international operations;
- The limited number of our manufacturing sources;
- The effects of changes in currency exchange rates;
- Our dependence on new product development;
- Possible obsolescence of our technology and the need to make technological advances;
- Competition with larger companies that have greater financial resources;
- Increases in the prices of raw materials, especially steel and iron products;
- Acquisitions that could disrupt our operations and affect operating results;
- Impairment of our assets;
- Negative or unforeseen tax consequences;
- Our ability to protect our intellectual property assets;
- Our ability to integrate acquisitions;
- Uncertainty concerning our ability to use tax loss carryforwards;
- The effect of the loss of members of senior management and key personnel; and
- Governmental actions, initiatives and regulations, including import and export restrictions and tariffs.

We discuss these and other important risks and uncertainties that may affect our future operation in Part I, Item 1A – Risk Factors in our most recent Annual Report on Form 10-K and may update that discussion in Part II, Item 1A – Risk Factors in this report or a Quarterly Report on Form 10-Q we file hereafter.

Readers are cautioned not to place undue reliance on these forward-looking statements. While we believe the assumptions on which the forward-looking statements are based are reasonable, there can be no assurance that these forward-looking statements will prove to be accurate. This cautionary statement is applicable to all forward-looking statements contained in this report.

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

#### Interest Rate Risk

Interest on borrowings on our credit facilities are variable and tied to prevailing domestic and foreign interest rates. At July 31, 2014, we had \$3.2 million of borrowings outstanding under our China credit facility. We had no other debt or borrowings under any of our other credit facilities.

#### Foreign Currency Exchange Risk

In the first nine months of fiscal 2014, we derived approximately 63% of our revenues from European markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our European sales and service subsidiaries, primarily in their functional currencies.



Our products are sourced from foreign suppliers or built to our specifications by either our wholly owned subsidiaries in Taiwan, China and Italy or an affiliated contract manufacturer in Taiwan. Our purchases are predominantly in foreign currencies and in some cases our arrangements with these suppliers include foreign currency risk sharing agreements, which reduce (but do not eliminate) the effects of currency fluctuations on product costs. The predominant portion of the exchange rate risk associated with our product purchases relates to the New Taiwan Dollar.

We enter into foreign currency forward exchange contracts from time to time to hedge the cash flow risk related to forecasted inter-company sales and purchases denominated in, or based on, foreign currencies (primarily the Euro, Pound Sterling, and New Taiwan Dollar). We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. We also enter into foreign currency forward contracts to hedge a portion of our net investment in Euro-denominated assets. We do not speculate in the financial markets and, therefore, do not enter into these contracts for trading purposes.

Forward contracts for the sale or purchase of foreign currencies as of July 31, 2014, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities were as follows:

Forward Contracts	Notional Amount in in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars Contract Date	July 31, 2014	Maturity Dates
Sale Contracts:					
Euro	25,025,000	1.3604	34,045,095	33,526,459	August 2014 – July 2015
Pound Sterling	7,515,000	1.6542	12,431,649	12,667,262	August 2014 – July 2015
Purchase Contracts:					
New Taiwan Dollar	718,000,000	29.712 *	24,164,985	23,938,024	August 2014 – July 2015

\*NT Dollars per U.S. Dollar

Forward contracts for the sale or purchase of foreign currencies as of July 31, 2014, which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables and are not designated as hedges under this guidance denominated in foreign currencies, were as follows:

Notional Amount in	Weighted Avg.	Contract Amount at Forward Rates in U.S. Dollars
--------------------	---------------	--

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

Forward Contracts	Foreign Currency	Forward Rate	Contract Date	July 31, 2014	Maturity Dates
<b>Sale Contracts:</b>					
Euro	21,981,086	1.3651	30,005,320	29,439,086	August 2014 – October 2014
Pound Sterling	1,026,174	1.6901	1,734,376	1,732,196	August 2014
Canadian Dollar	997,485	0.9103	907,963	913,008	October 2014
South African Rand	9,696,864	0.0913	885,224	891,592	October 2014
<b>Purchase Contracts:</b>					
New Taiwan Dollar	627,439,185	29.866	* 21,008,194	20,872,431	August 2014 – October 2014

\* NT Dollars per U.S. Dollar

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we have maintained a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro-denominated assets. We selected the forward method under FASB guidance related to the accounting for derivatives instruments and hedging activities. The forward method requires all changes in the fair value of the contract to be reported as a cumulative translation adjustment in Accumulated other comprehensive loss, net of tax, in the same manner as the underlying hedged net assets. This forward contract matures in November 2014. At July 31, 2014, we had \$238,000 of realized gains and \$27,000 of unrealized gains, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to the hedging of our net investment in Euro-denominated assets. Forward contracts for the sale or purchase of foreign currencies as of July 31, 2014, which are designated as net investment hedges under this guidance were as follows:

	Notional Amount	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Date
Forward Contracts	in Foreign Currency		Contract Date	July 31, 2014	
Sale Contracts:					
Euro	3,000,000	1.3533	4,059,900	4,018,230	November 2014

Item 4. CONTROLS AND PROCEDURES

We carried out an evaluation under the supervision and with participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of July 31, 2014, pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the evaluation date.

There were no changes in our internal controls over financial reporting during the three months ended July 31, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. LEGAL PROCEEDINGS**

We are involved in various claims and lawsuits arising in the normal course of our business. We do not expect any of these claims will have a material adverse effect on our consolidated financial position or results of operations.

### **Item 1A. RISK FACTORS**

There have been no material changes from the risk factors disclosed in Part I, Item 1A – Risk Factors in our Annual Report on Form 10-K for the year ended October 31, 2013.

### **Item 5. OTHER INFORMATION**

During the period covered by this report, the Audit Committee of our Board of Directors engaged our independent registered public accounting firm to perform non-audit, tax planning services. This disclosure is made pursuant to Section 10A9(i)(2) of the Securities Exchange Act of 1934, as added by Section 202 of the Sarbanes-Oxley Act of 2002.

Item  
6. EXHIBITS

- 10.1 First Amendment to Credit Agreement dated as of May 9, 2014 between Hurco Companies, Inc., JPMorgan Chase Bank, N.A. and the lenders signatory thereto.
- 10.2 Second Amendment to Credit Agreement dated as of June 5, 2014 between Hurco Companies, Inc., JPMorgan Chase Bank, N.A. and the lenders signatory thereto.
- 31.1 Certification by the Chief Executive Officer pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended.
- 31.2 Certification by the Chief Financial Officer pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended.
- 32.1 Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document\*
- 101.SCH XBRL Taxonomy Extension Schema Document\*
- 101.CAL XBRL Taxonomy Extension Schema Document\*
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document\*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\*
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document\*

\*Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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 thereunto duly authorized.

HURCO COMPANIES, INC.

By: /s/ Sonja K. McClelland  
Sonja K. McClelland  
Vice President, Secretary, Treasurer  
and Chief Financial Officer

September 5, 2014