

HURCO COMPANIES INC  
Form 10-Q  
September 08, 2017

**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, 2017 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** **35-1150732**  
(State or other jurisdiction of (I.R.S. Employer Identification Number)  
incorporation or organization)

**One Technology Way**  
**Indianapolis, Indiana** **46268**  
(Address of principal executive offices) (Zip code)

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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

The number of shares of the Registrant's common stock outstanding as of September 1, 2017 was 6,624,197.

**HURCO COMPANIES, INC.**

Form 10-Q Quarterly Report for Fiscal Quarter Ended July 31, 2017

**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, 2017 and 2016</u>                | 3  |
|         | <u>Condensed Consolidated Statements of Comprehensive Income Three and nine months ended July 31, 2017 and 2016</u>  | 4  |
|         | <u>Condensed Consolidated Balance Sheets As of July 31, 2017 and October 31, 2016</u>                                | 5  |
|         | <u>Condensed Consolidated Statements of Cash Flows Three and nine months ended July 31, 2017 and 2016</u>            | 6  |
|         | <u>Condensed Consolidated Statements of Changes in Shareholders' Equity Nine months ended July 31, 2017 and 2016</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>                         | 19 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 27 |
| Item 4. | <u>Controls and Procedures</u>   | 29 |

**Part II - Other Information**

|          |  |    |
|----------|--|----|
| Item 1.  | <u>Legal Proceedings</u>   | 30 |
| Item 1A. | <u>Risk Factors</u>  | 30 |
| Item 2.  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 30 |
| Item 5.  | <u>Other Information</u>   | 30 |
| Item 6.  | <u>Exhibits</u>  | 31 |

Signatures

2

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

(In thousands, except per share data)

|  | <b>Three Months Ended<br/>July 31,</b> |             | <b>Nine Months Ended<br/>July 31,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2017</b>                            | <b>2016</b> | <b>2017</b>                           | <b>2016</b> |
|  | <b>(Unaudited)</b>                     |             | <b>(Unaudited)</b>                    |             |
| Sales and service fees                       | \$ 60,770                              | \$ 52,403   | \$ 167,736                            | \$ 160,935  |
| Cost of sales and service                    | 43,230                                 | 36,268      | 120,541                               | 110,492     |
| Gross profit                                 | 17,540                                 | 16,135      | 47,195                                | 50,443      |
| Selling, general and administrative expenses | 12,395                                 | 12,042      | 35,276                                | 35,946      |
| Operating income                             | 5,145                                  | 4,093       | 11,919                                | 14,497      |
| Interest expense                             | 21                                     | 23          | 66                                    | 72          |
| Interest income                              | 14                                     | 12          | 32                                    | 34          |
| Investment income                            | 5                                      | 4           | 85                                    | 110         |
| Other (income) expense, net                  | (98 )                                  | 246         | 193                                   | 226         |
| Income before taxes                          | 5,241                                  | 3,840       | 11,777                                | 14,343      |
| Provision for income taxes                   | 1,353                                  | 1,120       | 3,363                                 | 4,054       |
| Net income                                   | \$ 3,888                               | \$ 2,720    | \$ 8,414                              | \$ 10,289   |
| Income per common share                      |  |             |                                       |             |
| Basic  | \$ 0.58                                | \$ 0.41     | \$ 1.26                               | \$ 1.56     |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Diluted                                    | \$ 0.58 | \$ 0.40 | \$ 1.25 | \$ 1.54 |
| Weighted average common shares outstanding |         |         |         |         |
| Basic                                      | 6,624   | 6,573   | 6,608   | 6,567   |
| Diluted                                    | 6,695   | 6,645   | 6,674   | 6,639   |
| <b>Dividends paid per share</b>            | \$ 0.10 | \$ 0.09 | \$ 0.29 | \$ 0.26 |

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

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

(In thousands)

|  | <b>Three Months Ended<br/>July 31,</b> |             | <b>Nine Months Ended<br/>July 31,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2017</b>                            | <b>2016</b> | <b>2017</b>                           | <b>2016</b> |
|  | <b>(Unaudited)</b>                     |             | <b>(Unaudited)</b>                    |             |
| Net income   | \$ 3,888                               | \$ 2,720    | \$ 8,414                              | \$ 10,289   |
| Other comprehensive income (loss):   |  |             |                                       |             |
| Translation of foreign currency financial statements   | 3,263                                  | (1,428 )    | 5,419                                 | (416 )      |
| (Gain) / loss on derivative instruments reclassified into operations,<br>net of tax of \$(310), \$(126), \$(369) and \$(937), respectively | (562 )                                 | (229 )      | (670 )                                | (1,703 )    |
| (Loss)/ gain on derivative instruments, net of tax of (\$842), \$703,<br>(\$609) and \$391, respectively                                   | (1,531 )                               | 1,277       | (1,107 )                              | 710         |
| Total other comprehensive income (loss)  | 1,170                                  | (380 )      | 3,642                                 | (1,409 )    |
| Comprehensive income   | \$ 5,058                               | \$ 2,340    | \$ 12,056                             | \$ 8,880    |

*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)

|   | <b>July 31,<br/>2017<br/>(Unaudited)</b> | <b>October 31,<br/>2016<br/>(Audited)</b> |
|---|--|---|
| <b>ASSETS</b>   |  |   |
| Current assets:   |  |   |
| Cash and cash equivalents                                 | \$ 61,145                                | \$ 41,217                                 |
| Accounts receivable, net                                  | 39,258                                   | 48,631                                    |
| Inventories, net  | 128,231                                  | 117,025                                   |
| Derivative assets   | 382                                      | 1,725                                     |
| Prepaid assets  | 8,007                                    | 8,207                                     |
| Other   | 2,445                                    | 1,576                                     |
| Total current assets                                      | 239,468                                  | 218,381                                   |
| Property and equipment:                                   |  |   |
| Land  | 841                                      | 841                                       |
| Building  | 7,352                                    | 7,352                                     |
| Machinery and equipment                                   | 25,599                                   | 23,515                                    |
| Leasehold improvements                                    | 3,665                                    | 3,487                                     |
|   | 37,457                                   | 35,195                                    |
| Less accumulated depreciation and amortization            | (25,112 )                                | (22,898 )                                 |
| Total property and equipment                              | 12,345                                   | 12,297                                    |
| Non-current assets:                                       |  |   |
| Software development costs, less accumulated amortization | 5,888                                    | 4,926                                     |
| Goodwill  | 2,477                                    | 2,314                                     |
| Intangible assets, net                                    | 1,118                                    | 1,150                                     |
| Deferred income taxes                                     | 6,318                                    | 6,138                                     |
| Investments and other assets, net                         | 6,863                                    | 6,743                                     |
| Total non-current assets                                  | 22,664                                   | 21,271                                    |
| Total assets  | \$ 274,477                               | \$ 251,949                                |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>               |  |   |
| Current liabilities:                                      |  |   |
| Accounts payable  | \$ 48,560                                | \$ 37,200                                 |
| Accrued expenses and other                                | 12,950                                   | 17,231                                    |
| Accrued warranty expenses                                 | 1,701                                    | 1,523                                     |
| Derivative liabilities                                    | 4,698                                    | 538                                       |
| Short-term debt   | 1,487                                    | 1,476                                     |
| Total current liabilities                                 | 69,396                                   | 57,968                                    |
| Non-current liabilities:                                  |  |   |
| Deferred income taxes                                     | 3,253                                    | 4,294                                     |



Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|   |            |            |
|---|------------|------------|
| Accrued tax liability   | 1,168      | 963        |
| Deferred credits and other  | 3,692      | 3,249      |
| Total non-current liabilities   | 8,113      | 8,506      |
| 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, 6,782,006 and 6,720,453 shares issued; and 6,624,197 and 6,573,103 shares outstanding, as of July 31, 2017 and October 31, 2016, respectively | 663        | 657        |
| Additional paid-in capital  | 60,470     | 59,119     |
| Retained earnings   | 143,236    | 136,742    |
| Accumulated other comprehensive loss  | (7,401 )   | (11,043 )  |
| Total shareholders' equity  | 196,968    | 185,475    |
| Total liabilities and shareholders' equity  | \$ 274,477 | \$ 251,949 |

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

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

(In thousands)

|  | <b>Three Months Ended<br/>July 31,</b> |             | <b>Nine Months Ended<br/>July 31,</b> |             |
|--|--|-------------|---------------------------------------|-------------|
|  | <b>2017</b>                            | <b>2016</b> | <b>2017</b>                           | <b>2016</b> |
|  | <b>(Unaudited)</b>                     |             | <b>(Unaudited)</b>                    |             |
| Cash flows from operating activities:  |  |             |                                       |             |
| Net income   | \$ 3,888                               | \$ 2,720    | \$ 8,414                              | \$ 10,289   |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities: |  |             |                                       |             |
| Provision for doubtful accounts  | 7                                      | (12 )       | (4 )                                  | (57 )       |
| Deferred income taxes  | 32                                     | (153 )      | (515 )                                | 756         |
| Equity in (income) loss of affiliates  | (131 )                                 | (114 )      | (323 )                                | (372 )      |
| Depreciation and amortization  | 936                                    | 962         | 2,718                                 | 2,896       |
| Foreign currency (gain) loss   | (2,745 )                               | 1,585       | (1,381 )                              | 377         |
| Unrealized (gain) loss on derivatives  | 2,050                                  | (892 )      | 1,523                                 | (340 )      |
| Stock-based compensation   | 441                                    | 424         | 1,088                                 | 1,183       |
| Change in assets and liabilities:  |  |             |                                       |             |
| (Increase) decrease in accounts receivable   | (1,700 )                               | 2,231       | 11,274                                | 4,192       |
| (Increase) decrease in inventories   | (5,017 )                               | (5,620 )    | (4,624 )                              | (21,893 )   |
| (Increase) decrease in prepaid expenses  | 324                                    | 424         | 551                                   | (1,281 )    |
| Increase (decrease) in accounts payable  | 3,943                                  | (2,980 )    | 9,415                                 | (580 )      |
| Increase (decrease) in accrued expenses  | (35 )                                  | 222         | (4,669 )                              | (2,953 )    |
| Net change in deferred tax assets and liabilities  | (1,346 )                               | 311         | (1,140 )                              | (817 )      |
| Net change in derivative assets and liabilities  | 1,051                                  | (665 )      | 1,418                                 | 42          |
| Other  | 254                                    | 494         | (56 )                                 | 575         |
| Net cash provided by (used for) operating activities   | 1,952                                  | (1,063 )    | 23,689                                | (7,983 )    |
| Cash flows from investing activities:  |  |             |                                       |             |
| Purchase of property and equipment   | (668 )                                 | (456 )      | (1,666 )                              | (1,601 )    |
| Proceeds from sale of equipment  | —                                      | 28          | —                                     | 264         |
| Software development costs   | (593 )                                 | (527 )      | (1,701 )                              | (1,649 )    |
| Net cash provided by (used for) investing activities   | (1,261 )                               | (955 )      | (3,367 )                              | (2,986 )    |
| Cash flows from financing activities:  |  |             |                                       |             |
| Dividends paid   | (667 )                                 | (592 )      | (1,920 )                              | (1,712 )    |
| Proceeds of exercise of common stock options   | —                                      | —           | 269                                   | —           |
| Repayment of short-term debt   | —                                      | —           | —                                     | —           |
| Net cash provided by (used for) financing activities   | (667 )                                 | (592 )      | (1,651 )                              | (1,712 )    |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Effect of exchange rate changes on cash              | 507       | (514 )    | 1,257     | (355 )    |
| Net increase (decrease) in cash and cash equivalents | 531       | (3,124 )  | 19,928    | (13,036 ) |
| Cash and cash equivalents at beginning of period     | 60,614    | 45,325    | 41,217    | 55,237    |
| Cash and cash equivalents at end of period           | \$ 61,145 | \$ 42,201 | \$ 61,145 | \$ 42,201 |

*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, 2017 and 2016**

| (In thousands, except<br>shares outstanding)  | Common Stock          |        | Additional         | Retained<br>Earnings | Accumulated<br>Other           | Total      |
|---|-----------------------|--------|--------------------|----------------------|--------------------------------|------------|
|   | Shares<br>Outstanding | Amount | Paid-in<br>Capital |                      | Comprehensive<br>Income (Loss) |            |
| Balances, October 31, 2015                    | 6,551,718             | \$ 655 | \$ 57,539          | \$ 125,760           | \$ (9,386 )                    | \$ 174,568 |
| Net income                                    | —                     | —      | —                  | 10,289               | —                              | 10,289     |
| Other comprehensive income (loss)             | —                     | —      | —                  | —                    | (1,409 )                       | (1,409 )   |
| Stock-based compensation                      | 21,385                | 2      | 1,181              | —                    | —                              | 1,183      |
| Dividends paid                                | —                     | —      | —                  | (1,712 )             | —                              | (1,712 )   |
| <b>Balances, July 31, 2016</b> (Unaudited)    | 6,573,103             | \$ 657 | \$ 58,720          | \$ 134,337           | \$ (10,795 )                   | \$ 182,919 |
| Balances, October 31, 2016                    | 6,573,103             | \$ 657 | \$ 59,119          | \$ 136,742           | \$ (11,043 )                   | \$ 185,475 |
| Net income                                    | —                     | —      | —                  | 8,414                | —                              | 8,414      |
| Other comprehensive income (loss)             | —                     | —      | —                  | —                    | 3,642                          | 3,642      |
| Exercise of common stock options              | 12,164                | 1      | 268                | —                    | —                              | 269        |
| Stock-based compensation                      | 38,930                | 5      | 1,083              | —                    | —                              | 1,088      |
| Dividends paid                                | —                     | —      | —                  | (1,920 )             | —                              | (1,920 )   |
| <b>Balances, July 31, 2017</b><br>(Unaudited) | 6,624,197             | \$ 663 | \$ 60,470          | \$ 143,236           | \$ (7,401 )                    | \$ 196,968 |

*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, manufacture and sell computerized (i.e., Computer Numeric Control) machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service and distribution network. Although the majority of our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, software options, 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, 2017 and for the three and nine months ended July 31, 2017 and July 31, 2016 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 for and 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, 2016.

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 the 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, Indian Rupee, South African Rand, Singapore Dollars, Chinese Yuan, 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 the following 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 is deferred in Accumulated other comprehensive loss and recognized as an adjustment to Cost of sales and service in the period that the corresponding inventory sold that is the subject of the related hedge contract is recognized, 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, 2017, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from August 2017 through July 2018. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2017, were \$32.9 million for Euros, \$10.3 million for Pounds Sterling and \$30.7 million for New Taiwan Dollars. At July 31, 2017, we had approximately \$504,000 of losses, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive loss. Included in this amount were \$1.4 million of unrealized losses, 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 2018, 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 entered into a forward contract with a notional amount of €3.0 million in November 2016. 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 2017. As of July 31, 2017, we had \$809,000 of realized gains and \$186,000 of unrealized losses, 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, 2017, denominated in Euros, Pounds Sterling, South African Rand, and New Taiwan Dollar with set maturity dates ranging from August 2017 through November 2017. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2017 totaled \$55.7 million.

#### Fair Value of Derivative Instruments



Edgar Filing: HURCO COMPANIES INC - Form 10-Q

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, 2017 and October 31, 2016, all derivative instruments were recorded at fair value on the balance sheets as follows (in thousands):

| Derivatives                            | July 31, 2017          |            | October 31, 2016       |            |
|--|------------------------|------------|------------------------|------------|
|  | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Designated as Hedging Instruments:     |                        |            |                        |            |
| Foreign exchange forward contracts     | Derivative assets      | \$352      | Derivative assets      | \$1,721    |
| Foreign exchange forward contracts     | Derivative liabilities | \$2,782    | Derivative liabilities | \$173      |
| Not Designated as Hedging Instruments: |                        |            |                        |            |
| Foreign exchange forward contracts     | Derivative assets      | \$30       | Derivative assets      | \$4        |
| Foreign exchange forward contracts     | Derivative liabilities | \$1,916    | Derivative liabilities | \$365      |

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, net of tax, during the three months ended July 31, 2017 and 2016 (in thousands):

| Derivatives  | Amount of Gain<br>(Loss) Recognized in<br>Other Comprehensive<br>Income (Loss) |          | Location of<br>Gain (Loss)<br>Reclassified<br>from Other<br>Comprehensive<br>Income (Loss) | Amount of Gain<br>(Loss) Reclassified<br>from Other<br>Comprehensive<br>Income (Loss) |        |
|--|--|----------|--|---|--------|
|  | Three Months Ended<br>July 31,   |          |  | Three Months Ended<br>July 31,  |        |
|  | 2017   | 2016     |  | 2017  | 2016   |
| Designated as Hedging Instruments:<br>(Effective portion)            |  |          |  |   |        |
| Foreign exchange forward contracts<br>– Intercompany sales/purchases | \$ (1,531 )  | \$ 1,277 | Cost of sales and service  | \$ 562  | \$ 229 |
| Foreign exchange forward contract<br>– Net investment                | \$ (172 )  | \$ 59    |  |   |        |

We recognized losses of \$58,000 and \$17,000 for the three months ended July 31, 2017 and 2016, respectively, as a result of hedges 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 three months ended July 31, 2017 and 2016 on derivative instruments not designated as hedging instruments (in thousands):

| Derivatives | Location of Gain<br>(Loss) Recognized<br>in Operations | Amount of Gain (Loss)<br>Recognized in Operations |
|-------------|--|---|
|             |  |   |

**Three Months Ended****July 31,**

2017                      2016

Not Designated as Hedging Instruments:

|                                    |                             |             |          |
|------------------------------------|-----------------------------|-------------|----------|
| Foreign exchange forward contracts | Other (income) expense, net | \$ (2,402 ) | \$ 1,156 |
|------------------------------------|-----------------------------|-------------|----------|

The following table presents the changes in the components of Accumulated other comprehensive loss, net of tax, for the three months ended July 31, 2017 (in thousands):

|  | Foreign<br>Currency<br>Translation | Cash Flow<br>Hedges | Total      |
|--|------------------------------------|---------------------|------------|
| Balance, April 30, 2017                                    | \$ (10,169 )                       | \$ 1,598            | \$ (8,571) |
| Other comprehensive income (loss) before reclassifications | 3,263                              | (1,531 )            | 1,732      |
| Reclassifications  | —                                  | (562 )              | (562 )     |
| Balance, July 31, 2017                                     | \$ (6,906 )                        | \$ (495 )           | \$ (7,401) |

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, net of tax, during the nine months ended July 31, 2017 and 2016 (in thousands):

| Derivatives  | Amount of Gain<br>(Loss) Recognized in<br>Other Comprehensive<br>Income (Loss) |          | Location of<br>Gain (Loss)<br>Reclassified<br>from Other<br>Comprehensive<br>Income (Loss) | Amount of Gain<br>(Loss) Reclassified<br>from Other<br>Comprehensive<br>Income (Loss) |          |
|--|--|----------|--|---|----------|
|  | <b>Nine Months Ended</b>   |          |  | <b>Nine Months Ended</b>  |          |
|  | <b>July 31,</b><br>2017  | 2016     |  | <b>July 31</b><br>2017  | 2016     |
| Designated as Hedging Instruments:<br>(Effective portion)            |  |          |  |   |          |
| Foreign exchange forward contracts<br>– Intercompany sales/purchases | \$ (1,107 )  | \$ 710   | Cost of sales<br>and service   | \$ 670  | \$ 1,703 |
| Foreign exchange forward contract<br>– Net investment                | \$ (142 )  | \$ (21 ) |  |   |          |

We recognized gains of \$110,000 and \$15,000 for the nine months ended July 31, 2017 and 2016, respectively, as a result of hedges 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, 2017 and 2016 on derivative instruments not designated as hedging instruments (in thousands):

| Derivatives                            | Location of Gain<br>(Loss) Recognized<br>in Operations | Amount of Gain (Loss)<br>Recognized in Operations |       |
|--|--|---|-------|
|  |  | <b>Nine Months Ended</b>                          |       |
|  |  | <b>July 31,</b><br>2017                           | 2016  |
| Not designated as hedging instruments: |  |   |       |
| Foreign exchange forward contracts     | Other (income) expense, net                            | \$ (1,447 )                                       | \$ 56 |

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 nine months ended July 31, 2017 (in thousands):

|  | Foreign<br>Currency<br>Translation | Cash Flow<br>Hedges | Total      |
|--|------------------------------------|---------------------|------------|
| Balance, October 31, 2016                                  | \$ (12,325 )                       | \$ 1,282            | \$(11,043) |
| Other comprehensive income (loss) before reclassifications | 5,419                              | (1,107 )            | 4,312      |
| Reclassifications  | —                                  | (670 )              | (670 )     |
| Balance, July 31, 2017                                     | \$ (6,906 )                        | \$ (495 )           | \$(7,401 ) |

### 3. EQUITY INCENTIVE PLAN

In March 2016, we adopted the Hurco Companies, Inc. 2016 Equity Incentive Plan (the “2016 Equity Plan”), which allows us to grant awards of stock options, stock appreciation rights, restricted stock, stock units and other stock-based awards. The 2016 Equity Plan replaced the Hurco Companies, Inc. 2008 Equity Incentive Plan (the “2008 Plan”) and is the only active plan under which equity awards may be made by us to our employees and non-employee directors. No further awards will be made under our 2008 Plan. The total number of shares of our common stock that may be issued pursuant to awards under the 2016 Equity Plan is 856,048, which includes 386,048 shares remaining available for future grants under the 2008 Plan as of March 10, 2016, the date our shareholders approved the 2016 Equity Plan.

The Compensation Committee of our Board of Directors has the authority to determine the officers, directors and key employees who will be granted awards under the 2016 Equity Plan; 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 restricted shares and performance units under the 2016 Equity Plan that are currently outstanding, and we have granted stock options, restricted shares and performance shares under the 2008 Plan that are currently 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 market value of a share of our common stock, for purposes of the 2016 Equity 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, 2017, is as follows:

|                                 | <b>Stock</b>   | <b>Weighted Average</b> |
|---------------------------------|----------------|-------------------------|
|                                 | <b>Options</b> | <b>Exercise Price</b>   |
| Outstanding at October 31, 2016 | 107,889        | \$ 20.25                |
| Options granted                 | —              | —                       |
| Options exercised               | (12,164 )      | 22.11                   |
| Options cancelled               | —              | —                       |
| Outstanding at July 31, 2017    | 95,725         | \$ 20.01                |

Summarized information about outstanding stock options as of July 31, 2017, that have already vested and are currently exercisable, are as follows:

**Options Already****Vested and Currently  
Exercisable**

|   |              |
|---|--------------|
| Number of outstanding options                       | 95,725       |
| Weighted average remaining contractual life (years) | 3.48         |
| Weighted average exercise price per share           | \$ 20.01     |
| Intrinsic value of outstanding options              | \$ 1,253,000 |

The intrinsic value of an outstanding stock option is calculated as the difference between the stock price as of July 31, 2017 and the exercise price of the option.

On January 5, 2017, the Compensation Committee determined the degree to which the long-term incentive compensation arrangement approved for the fiscal 2014-2016 performance period was attained, and the resulting payout level relative to the target amount for each of the metrics that were established by the Compensation Committee in 2014. As a result, the Compensation Committee determined that a total of 30,683 performance shares were earned by our executive officers, which performance shares vested on January 5, 2017. The vesting date fair value of the performance shares was based on the closing sales price of our common stock on the vesting date, which was \$33.90 per share. All related stock-based compensation cost for these vested performance shares was expensed accordingly during the three year performance period ending October 31, 2016.

On January 5, 2017, the Compensation Committee also approved a long-term incentive compensation arrangement for our executive officers in the form of restricted shares and performance stock units (“PSUs”) under the 2016 Equity Plan, which will be payable in shares of our common stock if earned and vested. The awards were 25% time-based vesting and 75% performance-based vesting. The three-year performance period for the PSUs is fiscal 2017 through fiscal 2019.

On that date, the Compensation Committee granted a total of 14,747 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, which was \$33.90 per share.

On January 5, 2017, the Compensation Committee also granted a total target number of 18,496 PSUs to our executive officers designated as “PSU – TSR”. These PSUs were weighted as approximately 40% of the overall 2017 executive long-term incentive compensation arrangement and will vest and be paid based upon the total shareholder return of our common stock over the three-year period of fiscal 2017-2019, 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 the PSUs – TSR for achieving threshold performance and 200% of the target number of the PSUs – TSR for achieving maximum performance. The grant date fair value of the PSUs – TSR was \$43.25 per PSU and was calculated using the Monte Carlo approach.

On January 5, 2017, the Compensation Committee also granted a total target number of 20,647 PSUs to our executive officers designated as “PSU – ROIC”. These PSUs were weighted as approximately 35% of the overall 2017 executive long-term incentive compensation arrangement and will vest and be paid based upon the achievement of pre-established goals related to our average return on invested capital over the three-year period of fiscal 2017-2019. Participants will have the ability to earn between 50% of the target number of the PSUs - ROIC for achieving threshold performance and 200% of the target number of the PSUs - ROIC for achieving maximum performance. The grant date fair value of the PSUs – ROIC was based on the closing sales price of our common stock on the grant date, which was \$33.90 per share.

On March 9, 2017, the Compensation Committee granted a total of 14,920 shares of time-based restricted stock to our non-employee directors. The restricted shares vest 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 shares was based on the closing sales price of our common stock on the grant date, which was \$26.80 per share.

A reconciliation of the Company’s restricted stock, performance share and PSU activity and related information for the nine-month period ended July 31, 2017 is as follows:



|                              | <b>Number of<br/>Shares or Units</b> | Weighted Average<br>Grant Date Fair Value |
|------------------------------|--------------------------------------|---|
| Unvested at October 31, 2016 | 147,350                              | \$ 28.79                                  |
| Shares or units granted      | 71,011                               | 34.61                                     |
| Shares or units vested       | (38,930 )                            | 26.98                                     |
| Shares or units cancelled    | (7,678 )                             | 29.98                                     |
| Shares withheld              | (13,944 )                            | 25.89                                     |
| Unvested at July 31, 2017    | 157,809                              | \$ 32.05                                  |

During the nine months of fiscal 2017 and 2016, we recorded \$1.1 million and \$1.2 million, respectively, as stock-based compensation expense related to grants under our equity plans. As of July 31, 2017, there was an estimated \$2.4 million of total unrecognized stock-based compensation cost that we expect to recognize by the end of the first quarter of fiscal 2020.

## 4. EARNINGS PER SHARE

Per share results have been computed based on the average number of common shares outstanding over the period in question. 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, 2017      |         | 2016    |         | July 31, 2017     |         | 2016     |          |
|  | Basic              | Diluted | Basic   | Diluted | Basic             | Diluted | Basic    | Diluted  |
| Net income   | \$3,888            | \$3,888 | \$2,720 | \$2,720 | \$8,414           | \$8,414 | \$10,289 | \$10,289 |
| Undistributed earnings allocated to participating shares | (26 )              | (26 )   | (16 )   | (16 )   | (56 )             | (56 )   | (59 )    | (59 )    |
| Net income applicable to common shareholders             | \$3,862            | \$3,862 | \$2,704 | \$2,704 | \$8,358           | \$8,358 | \$10,230 | \$10,230 |
| Weighted average shares outstanding                      | 6,624              | 6,624   | 6,573   | 6,573   | 6,608             | 6,608   | 6,567    | 6,567    |
| Stock options and contingently issuable shares           | —                  | 71      | —       | 72      | —                 | 66      | —        | 72       |
|  | 6,624              | 6,695   | 6,573   | 6,645   | 6,608             | 6,674   | 6,567    | 6,639    |
| Income per share   | \$0.58             | \$0.58  | \$0.41  | \$0.40  | \$1.26            | \$1.25  | \$1.56   | \$1.54   |

## 5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$660,000 as of July 31, 2017 and \$664,000 as of October 31, 2016.

## 6. INVENTORIES

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

|                                    | July 31, | October 31, |
|------------------------------------|----------|-------------|
|                                    | 2017     | 2016        |
| Purchased parts and sub-assemblies | \$34,779 | \$ 25,661   |
| Work-in-process                    | 19,476   | 17,724      |

|                |           |            |
|----------------|-----------|------------|
| Finished goods | 73,976    | 73,640     |
|                | \$128,231 | \$ 117,025 |

## 7. SEGMENT INFORMATION

We operate in a single segment: industrial automation equipment. We design, manufacture and sell computerized machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service and distribution network. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, software options, control upgrades, accessories and replacement parts for our products, as well as customer service and training support.

## 8. GUARANTEES AND PRODUCT WARRANTIES

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 FASB guidance for accounting for guarantees (codified in ASC 460). As of July 31, 2017, we had 27 outstanding third party payment guarantees totaling approximately \$1.2 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer assumes the risk of ownership. The customer does not obtain title, however, until the customer 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 liabilities under these guarantees at fair value, which amounts are insignificant.

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):

|  | <b>Nine Months Ended</b> |          |
|--|--------------------------|----------|
|  | <b>July 31,</b>          |          |
|  | 2017                     | 2016     |
| Balance, beginning of period               | \$ 1,523                 | \$ 2,186 |
| Provision for warranties during the period | 2,442                    | 1,916    |
| Charges to the reserve                     | (2,317 )                 | (2,315 ) |
| Impact of foreign currency translation     | 53                       | (11 )    |
| Balance, end of period                     | \$ 1,701                 | \$ 1,776 |

The year-over-year decrease in our warranty reserve was primarily due to a reduction in average warranty cost per machine as our machines under warranty shifted from more complex, higher-performance machines.

## 9. DEBT AGREEMENTS

On December 7, 2012, we entered into an agreement (the “U.S. credit agreement”) with a financial institution that provided us with an unsecured revolving credit and letter of credit facility. The U.S. credit agreement contains customary financial covenants, including covenants (1) restricting us from making certain investments, loans, advances and acquisitions (but permitting us to make investments in subsidiaries of up to \$5.0 million), (2) requiring

that we maintain a minimum working capital, and (3) requiring that we maintain a minimum tangible net worth. The U.S. credit agreement permits us to pay certain cash dividends, so long as we are not in default under the U.S. credit agreement before and after giving effect to such dividends.

Borrowings under our U.S. credit agreement bear interest either at a LIBOR-based rate or a floating rate, in each case with an interest rate floor of 0.00%. The floating rate equals 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, (c) the prevailing prime rate and (d) 0.00%. The rate we must pay for that portion of the U.S. credit agreement which is not utilized is 0.05% per annum.

On December 6, 2016, we entered into a fourth amendment to our U.S. credit agreement to, among other things, increase the unsecured revolving credit facility from \$12.5 million to \$15.0 million, to increase the cash dividend allowance from \$4.0 million per calendar year to \$5.0 million per calendar year, and to extend the scheduled maturity date to December 31, 2018. The U.S. credit agreement, as amended, provides for the issuance of up to \$5.0 million in letters of credit. We also amended the U.S. credit agreement to increase the minimum working capital and minimum tangible net worth requirements from \$90.0 million to \$105.0 million and \$120.0 million to \$125.0 million, respectively.

On February 16, 2017, we amended our credit facility in China to decrease the credit facility from 40.0 million Chinese Yuan to 20.0 million Chinese Yuan (approximately \$3.0 million) and renewed the facility with an expiration date of February 15, 2018. We had \$1.5 million of borrowings under our China credit facility at each of July 31, 2017 and October 31, 2016, which bears interest at variable rates of 4.4% and 4.6% annually, respectively. We also have a £1.0 million revolving credit facility in the United Kingdom and a €1.5 million revolving credit facility in Germany. We had no other debt or borrowings under any of our other credit facilities at either of those dates.

All of our credit facilities are unsecured. At July 31, 2017, we were in compliance with all covenants contained in the related credit agreements and, as of that date, we had unutilized credit facilities of \$19.6 million.

## 10. INCOME TAXES

Our effective tax rate for the nine months of fiscal 2017 was 29% compared to 28% for the same period in fiscal 2016. The increase in the effective income tax rate was due primarily to changes in the geographic mix of income or loss between tax jurisdictions.

We recorded income tax expense of \$3.4 million during the nine months of fiscal 2017, compared to \$4.1 million for the corresponding period in fiscal 2016, primarily as a result of a decrease in pre-tax income period-over-period. We have not provided for 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 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 \$1.2 million as of July 31, 2017 and \$1.1 million as of October 31, 2016, 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, 2017, the gross amount of interest accrued, reported in Accrued expenses and other, was approximately \$62,000, 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 2018 and July 2019. We are under audit by the Internal Revenue Service (IRS) for our federal income tax return for fiscal year 2015.

## 11. FINANCIAL INSTRUMENTS

FASB fair value guidance established 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, 2017 and October 31, 2016 (in thousands):

|                       | Assets        |                  | Liabilities   |                  |
|-----------------------|---------------|------------------|---------------|------------------|
|                       | July 31, 2017 | October 31, 2016 | July 31, 2017 | October 31, 2016 |
| Level 1               |               |                  |               |                  |
| Deferred Compensation | \$1,572       | \$ 1,363         | \$-           | \$ -             |
| Level 2               |               |                  |               |                  |
| Derivatives           | \$382         | \$ 1,725         | \$4,698       | \$ 538           |

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 market prices that are readily available.

Included in 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 condensed 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. The U.S. Dollar equivalent notional amounts of these contracts was \$128.5 million and \$125.6 million at July 31, 2017 and October 31, 2016, respectively. The fair value of Derivative assets recorded on our Condensed Consolidated Balance Sheets was \$0.4 million at July 31, 2017 and \$1.7 million at October 31, 2016. The fair value of Derivative liabilities recorded on our Condensed Consolidated Balance Sheets was \$4.7 million at July 31, 2017 and \$0.5 million at October 31, 2016.

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 to be material risks.

## 12. CONTINGENCIES AND LITIGATION

From time to time, we are involved in various claims and lawsuits arising in the normal course of business. Pursuant to applicable accounting rules, we accrue the minimum liability for each known claim when the estimated outcome is a range of possible loss and no one amount within that range is more likely than another. We maintain insurance policies for such matters, and we record insurance recoveries when we determine such recovery to be probable. 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. We believe that the ultimate resolution of claims for any losses will not exceed our insurance policy coverages.

## 13. NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 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 standard 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.



Between August 2015 and December 2016, the FASB issued five additional updates to Topic 606 to provide further guidance and clarification in accounting for revenue arising from contracts with customers under ASU 2014-09. We have the option of applying this new standard retrospectively to each prior period presented (“full retrospective approach”) or retrospectively with the cumulative effect recognized in retained earnings as of the date of adoption (“modified retrospective approach”). The new guidance is effective for annual reporting periods beginning after December 15, 2017 (and any interim periods included therein) and, therefore, for our fiscal year ending October 31, 2019. We have not yet determined the impact this new accounting standard may have on our consolidated financial statements. During the second and third quarters of fiscal 2017, we developed a project plan and timeline to complete an assessment of the potential impact that this accounting standard will have on our consolidated financial statements. During the third quarter of fiscal 2017, this assessment included training of our key personnel, sampling of our customer contracts and revenue stream evaluation. At this time, we expect to use the modified retrospective approach. In the fourth quarter of fiscal 2017 and in fiscal 2018, we expect to implement and test any changes in policy, processes, systems and internal controls and to compute required transition adjustments and disclosures related to our implementation of this new accounting standard.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which establishes a comprehensive new lease accounting model. ASU 2016-02 clarifies the definition of a lease, requires a dual approach to lease classification similar to current lease classifications, and requires lessees to recognize leases on the balance sheet as a lease liability with a corresponding right-of-use asset for leases with a lease-term of more than twelve months. ASU 2016-02 is effective for our fiscal year 2020, including interim periods within the fiscal year, and requires modified retrospective application. Early adoption is permitted. We are assessing the impact this new accounting guidance will have on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, which provides guidance to assist companies in evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment provides a more robust framework to use in determining when a set of transferred assets and activities (“set”) is a business. ASU 2017-01 is effective for our fiscal year 2019, including interim periods within the fiscal year. We do not expect that the adoption of this accounting standard update will have a material effect on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test of Goodwill Impairment*, which eliminates Step 2 from the goodwill impairment test, (i.e., the requirement for an entity to calculate the implied fair value of goodwill in measuring a goodwill impairment loss). ASU 2017-04 provides that a company should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying value and should recognize an impairment charge if the carrying value exceeds the fair value of the reporting unit, but only to the extent of the goodwill amount allocated to that reporting unit. Companies will still have the option to perform a qualitative assessment to determine if the quantitative impairment test is necessary. ASU 2017-04 is effective for our fiscal year 2021, including interim periods within the fiscal year. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates on or after January 1, 2017. We do not expect that the adoption of this accounting standard update will have a material effect on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*, to provide clarity and to reduce diversity in practice and cost and complexity when applying the guidance in Topic 718 to the modification of the terms and conditions of a share-based payment award. ASU 2017-09 includes guidance on determining which changes to the terms and conditions of share-based payment awards require a company to apply modification accounting under Topic 718. This update requires the entity to account for the effects of a modification unless specific conditions are met. ASU 2017-09 applies to entities that change the terms or conditions of a share-based payment award and is effective for our fiscal year 2019. Early adoption is permitted, including adoption in any interim period. We do not expect that the adoption of this accounting standard update will have a material effect on our consolidated financial statements.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contains information intended to help provide an understanding of our financial condition and other related matters, including our liquidity, capital resources and results of operations. The MD&A is provided as a supplement to, and should be read in conjunction with, our unaudited financial statements and the notes accompanying our unaudited financial statements appearing elsewhere in this report, as well as our audited financial statements, the accompanying notes and the MD&A included in our Annual Report on Form 10-K for the year ended October 31, 2016.

**EXECUTIVE OVERVIEW**

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design, manufacture and sell computerized (i.e., Computer Numeric Control, or CNC) machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service and distribution network. Although the majority of our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, software options, control upgrades, accessories and replacement parts for our products, as well as 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 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 nine months of fiscal 2017, approximately 54% of our revenues was attributable to customers in Europe, where we typically sell more of our higher-performance, higher-priced VMX series machines. Additionally, approximately 15% of our revenues were attributable to customers in Asia, where we generally sell more of our entry-level, lower-priced machines, and where we also encounter greater price pressures.

We have three brands of CNC machine tools in our product portfolio: Hurco is the premium brand focused on sophisticated technology; Milltronics is the entry-level brand with a simplified control and straightforward feature sets; and Takumi is an industry-standard brand with machines that are equipped with industry-standard controls instead of the proprietary controls found on Hurco and Milltronics machines. Typically, manufacturing facilities that

use industry standard controls focus on medium to high production, wherein they run large batches of a few types of parts instead of small batches of many different types of parts. The Hurco, Milltronics and Takumi product lines represent a comprehensive product portfolio of more than 150 different models. In addition, through our wholly-owned subsidiary LCM Precision Technology S.r.l. (“LCM”), we produce machine tool components and accessories.

We sell our products through more than 170 independent agents and distributors throughout the Americas, Europe and Asia. Although some distributors carry competitive products, we are the primary line for the majority of our distributors globally. We also have our own direct sales and service organizations in China, France, Germany, India, Italy, Poland, Singapore, South Africa, Taiwan, the United Kingdom and certain parts of the United States, which are among the world’s principal machine tool consuming markets. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly-owned subsidiary in Taiwan, Hurco Manufacturing Ltd. (“HML”). Machine castings and components to support HML’s production are manufactured by our wholly-owned subsidiary in Ningbo, China, Ningbo Machine Tool Co., Ltd. Components to support our SRT line of five-axis machining centers, such as the direct drive spindle, swivel head and rotary table, are manufactured by LCM.

Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies in the countries in which those customers are located (primarily the Euro, Pound Sterling and Chinese Yuan). 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 financial statements 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, which reflect translation to U.S. Dollars at exchange rates prevailing during the period covered by those financial statements.

Our high levels of foreign manufacturing and sales also expose 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, as discussed in Note 2 of Notes to the Condensed Consolidated Financial Statements.

## RESULTS OF OPERATIONS

### Three Months Ended July 31, 2017 Compared to Three Months Ended July 31, 2016

*Sales and Service Fees.* Sales and service fees for the third quarter of fiscal 2017 were \$60.8 million, an increase of \$8.4 million, or 16%, compared to the corresponding period in fiscal 2016, and included a favorable currency impact of \$0.3 million, or less than 1%, when translating foreign sales to U.S. dollars for financial reporting purposes.

### Sales and Service Fees by Geographic Region

The following table sets forth net sales and service fees by geographic region for the third quarter of fiscal 2017 and 2016 (dollars in thousands):

|              | Three Months Ended July 31, |      |          |      | Change  |      |
|--------------|-----------------------------|------|----------|------|---------|------|
|              | 2017                        |      | 2016     |      | Amount  | %    |
| Americas     | \$17,184                    | 28 % | \$13,224 | 25 % | \$3,960 | 30 % |
| Europe       | 33,813                      | 56 % | 31,211   | 60 % | 2,602   | 8 %  |
| Asia Pacific | 9,773                       | 16 % | 7,968    | 15 % | 1,805   | 23 % |

|       |          |      |          |      |         |     |
|-------|----------|------|----------|------|---------|-----|
| Total | \$60,770 | 100% | \$52,403 | 100% | \$8,367 | 16% |
|-------|----------|------|----------|------|---------|-----|

Sales in the Americas for the third quarter of fiscal 2017 increased by 30% compared to the corresponding period in fiscal 2016, due primarily to increased sales of vertical milling machines from all product lines (Hurco, Takumi and Milltronics) in the U.S. The increased sales in the U.S. reflect improved market conditions and demand from customers in all regions of the country. European sales for the third quarter of fiscal 2017 increased by 8%, compared to the corresponding period in fiscal 2016, and included a favorable currency impact of less than 1%, when translating foreign sales to U.S. dollars for financial reporting purposes. The increase in European sales for the third quarter of fiscal 2017 was primarily attributable to an increased sales volume of Hurco and Takumi machines in Italy, Germany and the United Kingdom. Asian Pacific sales for the third quarter of fiscal 2017 increased by 23% compared to the corresponding period in fiscal 2016, primarily due to increased sales of Hurco and Takumi machines in China and India.

**Sales and Service Fees by Product Category**

The following table sets forth net sales and service fees by product category for the third quarter of fiscal 2017 and 2016 (dollars in thousands):

|   | Three Months Ended July 31, |       |          |       | Change  |      |
|---|-----------------------------|-------|----------|-------|---------|------|
|   | 2017                        |       | 2016     |       | Amount  | %    |
| Computerized Machine Tools              | \$52,244                    | 86 %  | \$44,419 | 85 %  | \$7,825 | 18 % |
| Computer Control Systems and Software † | 549                         | 1 %   | 499      | 1 %   | 50      | 10 % |
| Service Parts                           | 5,930                       | 10 %  | 5,587    | 11 %  | 343     | 6 %  |
| Service Fees                            | 2,047                       | 3 %   | 1,898    | 3 %   | 149     | 8 %  |
| Total                                   | \$60,770                    | 100 % | \$52,403 | 100 % | \$8,367 | 16 % |

†Amounts shown do not include computer control systems and software sold as an integrated component of computerized machine systems.

Sales of computerized machine tools during the third quarter of fiscal 2017 included a favorable currency impact of less than 1% compared to the corresponding prior year period. The increase in sales of computerized machine tools year-over-year was driven primarily by an increase in sales volume of Hurco and Takumi machines in the Americas, Italy and Asia Pacific. Sales of computer control systems and software, service parts and service fees increased during the third quarter of fiscal 2017 compared to the corresponding prior year period due primarily to the increase in demand for software and aftermarket sales and service in Germany.

*Orders.* Orders for the third quarter of fiscal 2017 were \$62.5 million, an increase of \$15.0 million, or 31%, compared to the corresponding period in fiscal 2016, and included a favorable currency impact of \$0.3 million, or less than 1%, when translating foreign orders to U.S. dollars.

The following table sets forth new orders booked by geographic region for the third quarter of fiscal 2017 and 2016 (dollars in thousands):

|          | Three Months Ended July 31, |      |          |      | Change  |      |
|----------|-----------------------------|------|----------|------|---------|------|
|          | 2017                        |      | 2016     |      | Amount  | %    |
| Americas | \$19,728                    | 32 % | \$13,449 | 28 % | \$6,279 | 47 % |
| Europe   | 35,821                      | 57 % | 27,696   | 58 % | 8,125   | 29 % |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|              |          |      |          |      |          |      |
|--------------|----------|------|----------|------|----------|------|
| Asia Pacific | 6,996    | 11 % | 6,425    | 14 % | 571      | 9 %  |
| Total        | \$62,545 | 100% | \$47,570 | 100% | \$14,975 | 31 % |

Orders in the Americas for the third quarter of fiscal 2017 increased by 47%, compared to the corresponding period in fiscal 2016, due primarily to increased demand in the U.S. for vertical milling machines and lathes. The increase in demand has come from all product lines (Hurco, Takumi and Milltronics). European orders for the third quarter of fiscal 2017 increased by 29%, compared to the corresponding period in fiscal 2016. The year-over-year increase in European orders for the third quarter was driven primarily by increased demand for Hurco vertical milling machines in Italy and Germany, as well as increased demand for LCM machine tool components and accessories. Asian Pacific orders for the third quarter of fiscal 2017 increased by 9%, compared to the corresponding prior year period, driven primarily by increased demand for Hurco and Takumi machines in all Asian Pacific countries in which our customers are located, with the largest increase coming from China.

*Gross Profit.* Gross profit for the third quarter of fiscal 2017 was \$17.5 million, or 29% of sales, compared to \$16.1 million, or 31% of sales, for the corresponding prior year period. The year-over-year decrease in gross profit as a percentage of sales for the third quarter of fiscal 2017 primarily reflected a sales mix comprised of more entry-level machines, such as those under the Milltronics and Takumi brands, in price competitive geographic regions, such as the Americas and Asia Pacific.



*Operating Expenses.* Selling, general and administrative expenses for the third quarter of fiscal 2017 were \$12.4 million, or 20% of sales, compared to \$12.0 million, or 23% of sales, in the corresponding period in fiscal 2016, and included an unfavorable currency impact of \$0.1 million when translating foreign expenses to U.S. dollars for financial reporting purposes.

*Operating Income.* Operating income for the third quarter of fiscal 2017 was \$5.1 million compared to \$4.1 million for the corresponding period in fiscal 2016. The increase in operating income year-over-year was driven primarily by an increase in the volume of sales of vertical milling machines from all product lines and across all regions.

*Other (Income) Expense, Net.* Other (income) expense, net in the third quarter of fiscal 2017 increased by \$0.3 million from the corresponding period in fiscal 2016 due to net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts.

*Income Taxes.* We recorded income tax expense during the third quarter of fiscal 2017 of \$1.4 million compared to \$1.1 million for the corresponding period in fiscal 2016. Our effective tax rate for the third quarter of fiscal 2017 was 26%, compared to 29% in the corresponding prior year period. The decrease in the effective tax rate year-over-year was due to changes in the geographic mix of income and loss among tax jurisdictions.

Nine Months Ended July 31, 2017 Compared to Nine Months Ended July 31, 2016

*Sales and Service Fees.* Sales and service fees for the nine months of fiscal 2017 were \$167.7 million, an increase of \$6.8 million, or 4%, compared to the corresponding period in fiscal 2016, and included a negative currency impact of \$2.9 million, or 2%, when translating foreign sales to U.S. dollars for financial reporting purposes.

**Sales and Service Fees by Geographic Region**

The following table sets forth net sales and service fees by geographic region for the nine months of fiscal 2017 and 2016 (dollars in thousands):

| Nine Months Ended July 31, |      | Change |   |
|----------------------------|------|--------|---|
| 2017                       | 2016 | Amount | % |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|              |           |       |           |       |         |      |
|--------------|-----------|-------|-----------|-------|---------|------|
| Americas     | \$51,943  | 31 %  | \$47,098  | 29 %  | \$4,845 | 10 % |
| Europe       | 90,957    | 54 %  | 92,221    | 57 %  | (1,264) | -1 % |
| Asia Pacific | 24,836    | 15 %  | 21,616    | 14 %  | 3,220   | 15 % |
| Total        | \$167,736 | 100 % | \$160,935 | 100 % | \$6,801 | 4 %  |

Sales in the Americas for the nine months of fiscal 2017 increased by 10%, compared to the corresponding period in fiscal 2016, due primarily to increased sales of vertical milling machines from all product lines (Hurco, Takumi and Milltronics) in the U.S. The increased sales in the U.S. reflect improved market conditions and demand from customers in all regions of the country. European sales for the nine months of fiscal 2017 decreased by 1%, compared to the corresponding period in fiscal 2016, and included a negative currency impact of 3% when translating foreign sales to U.S. dollars for financial reporting purposes. Excluding the negative impact of currency, the year-over-year increase in European sales for the nine months of fiscal 2017 was driven primarily by increased sales of Hurco machines in the United Kingdom and increased sales of machine tool components and accessories manufactured by LCM. Asian Pacific sales for the nine months of fiscal 2017 increased by 15% compared to the corresponding period in fiscal 2016, primarily due to increased sales of Hurco and Takumi machines in China and India.

**Sales and Service Fees by Product Category**

The following table sets forth net sales and service fees by product category for the nine months of fiscal 2017 and 2016 (dollars in thousands):

|                                | Nine Months Ended July 31, |                 | Change        |     |
|--------------------------------|----------------------------|-----------------|---------------|-----|
|                                | 2017                       | 2016            | Amount        | %   |
| Computerized Machine Tools     | \$ 142,771                 | 85 % \$ 137,258 | 85 % \$ 5,513 | 4 % |
| Control Systems and Software † | 1,685                      | 1 % 1,678       | 1 % 7         | 0 % |
| Service Parts                  | 17,583                     | 11 % 16,215     | 10 % 1,368    | 8 % |
| Service Fees                   | 5,697                      | 3 % 5,784       | 4 % (87 )     | -2% |
| Total                          | \$ 167,736                 | 100% \$ 160,935 | 100% \$ 6,801 | 4 % |

† Amounts shown do not include computer control systems and software sold as an integrated component of computerized machine systems.

Sales of computerized machine tools and computer control systems and software during the nine months of fiscal 2017 included a negative currency impact of 2% compared to the corresponding prior year period. The increase in sales of computerized machine tools year-over-year was driven primarily by an increase in sales volume of Hurco and Takumi machines in the Americas and Asia Pacific, particularly China. Sales of service parts increased in the nine months of fiscal 2017 compared to the corresponding prior year period due primarily to an increase in aftermarket sales of Hurco and Milltronics components in Germany and the Americas. Service fees decreased in the nine months of fiscal 2017 compared to the corresponding prior year period due primarily to decreased demand for aftermarket service in the Americas.

*Orders.* Orders for the nine months of fiscal 2017 were \$186.9 million, an increase of \$34.8 million, or 23%, compared to the corresponding period in fiscal 2016, and included a negative currency impact of \$3.5 million, or 2%, when translating foreign orders to U.S. dollars.

The following table sets forth new orders booked by geographic region for the nine months of fiscal 2017 and 2016 (dollars in thousands):

|  | Nine Months Ended July 31, |      | Change |   |
|--|----------------------------|------|--------|---|
|  | 2017                       | 2016 | Amount | % |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

|              |           |       |           |       |          |      |
|--------------|-----------|-------|-----------|-------|----------|------|
| Americas     | \$58,544  | 31 %  | \$42,418  | 28 %  | \$16,126 | 38 % |
| Europe       | 100,741   | 54 %  | 89,604    | 59 %  | 11,137   | 12 % |
| Asia Pacific | 27,644    | 15 %  | 20,058    | 13 %  | 7,586    | 38 % |
| Total        | \$186,929 | 100 % | \$152,080 | 100 % | \$34,849 | 23 % |

Orders in the Americas for the nine months of fiscal 2017 increased by 38%, compared to the corresponding period in fiscal 2016, due primarily to increased demand in the U.S. for vertical milling machines and lathes. The increase in demand has come from all product lines (Hurco, Takumi and Milltronics). European orders for the nine months of fiscal 2017 increased by 12%, compared to the corresponding prior year period, and included a negative currency impact of 4%, when translating foreign orders to U.S. dollars. The year-over-year increase in European orders for the nine months of fiscal 2017 was primarily due to increased customer demand for Hurco and Takumi vertical milling machines in the United Kingdom and Germany. Asian Pacific orders for the nine months of fiscal 2017 increased by 38%, compared to the corresponding prior year period, driven primarily by increased demand for Hurco and Takumi machines in all Asian Pacific countries in which our customers are located, with the largest increase coming from China.

*Gross Profit.* Gross profit for the nine months of fiscal 2017 was \$47.2 million, or 28% of sales, compared to \$50.4 million, or 31% of sales, for the corresponding prior year period. The year-over-year decrease in gross profit as a percentage of sales for the nine months of fiscal 2017 primarily reflected the negative impact of foreign currency translation compared to the corresponding prior year period and a sales mix comprised of more entry-level machines, such as those under the Milltronics and Takumi brands, in price competitive geographic regions, such as the Americas and Asia Pacific. The decrease in gross profit as a percentage of sales year to date was the biggest driver in the year-over-year reduction in earnings per share.

*Operating Expenses.* Selling, general and administrative expenses for the nine months of fiscal 2017 were \$35.3 million, or 21% of sales, compared to \$35.9 million, or 22% of sales, in the corresponding period in fiscal 2016, and included a favorable currency impact of \$0.5 million when translating foreign expenses to U.S. dollars for financial reporting purposes.

*Operating Income.* Operating income for the nine months of fiscal 2017 was \$11.9 million compared to \$14.5 million for the corresponding period in fiscal 2016. The year-over-year decrease in operating income for the nine months of fiscal 2017 primarily reflected the negative impact of foreign currency translation compared to the corresponding prior year period and a sales mix comprised of more entry-level machines, such as those under the Milltronics and Takumi brands, in price competitive geographic regions, such as the Americas and Asia Pacific.

*Other (Income) Expense, Net.* Other (income) expense, net in the nine months of fiscal 2017 was approximately \$0.2 million, which was relatively unchanged compared to the corresponding prior year period.

*Income Taxes.* We recorded income tax expense during the nine months of fiscal 2017 of \$3.4 million compared to \$4.1 million for the corresponding period in fiscal 2016. Our effective tax rate for the nine months of fiscal 2017 was 29%, compared to 28% in the corresponding prior year period. The increase in the effective tax rate year-over-year was due to changes in the geographic mix of income and loss among tax jurisdictions.

## **LIQUIDITY AND CAPITAL RESOURCES**

At July 31, 2017, we had cash and cash equivalents of \$61.1 million, compared to \$41.2 million at October 31, 2016. Approximately 53% of the \$61.1 million of cash and cash equivalents is denominated in U.S. Dollars. The balance is attributable to our foreign operations, is held in the local currencies of our various foreign entities and is subject to fluctuations in currency exchange rates. We have not provided for 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 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. We do not believe that the indefinite reinvestment of these funds offshore impairs our ability to meet our domestic working capital needs.

Working capital was \$170.1 million at July 31, 2017, compared to \$160.4 million at October 31, 2016. The increase in working capital was primarily due to the increase in cash and inventories, partially offset by a reduction in accounts receivable.

Capital expenditures of \$3.4 million during the nine months of fiscal 2017 were primarily for software development costs, purchase of equipment for our production facilities and capital improvements in existing facilities. We funded these expenditures with cash on hand.

At July 31, 2017, we had \$1.5 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, 2017, we had an aggregate of \$19.6 million available for borrowing under our credit facilities and were in compliance with all covenants relating thereto.

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 that 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, 2016, 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 nine months of fiscal 2017.

### **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

There have been no material changes related to our contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2016.

### **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 FASB guidance for accounting for guarantees (codified in ASC 460). As of July 31, 2017, we had 27 outstanding third party payment guarantees totaling approximately \$1.2 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer assumes 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 liabilities under these guarantees at fair value, which amounts are insignificant.

**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, but are not limited to:

- The cyclical nature of the machine tool industry;
- Uncertain economic conditions, which may adversely affect overall demand, in the Americas, Europe and/or Asia Pacific markets;
- 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;
- The need and/or ability to protect our intellectual property assets;



Our ability to integrate acquisitions;  
Uncertainty concerning our ability to use tax loss carryforwards;  
Breaches of our network and system security measures;  
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 and changes to tax laws.

We discuss these and other important risks and uncertainties that may affect our future operations 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, 2017, we had \$1.5 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 nine months of fiscal 2017, we derived approximately 69% of our revenues from customers located outside of the Americas. 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 foreign sales and service subsidiaries, primarily in their functional currencies.

Our products are primarily sourced from foreign suppliers or built to our specifications by either our wholly-owned subsidiaries in Taiwan, the U.S., Italy and China 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 and the Euro.

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 denominated in Euros. 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, 2017, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities, were as follows:

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

| Forward Contracts          | Notional Amount<br><b>in Foreign Currency</b> | Weighted Average<br><b>Forward Rate</b> | Contract Amount at Forward Rates in U.S. Dollars<br><b>Contract Date</b> | <b>July 31, 2017</b> | Maturity Dates      |
|----------------------------|---|---|--|----------------------|---------------------|
| <b>Sale Contracts:</b>     |   |   |  |                      |                     |
| Euro                       | 27,570,000                                    | 1.1181                                  | 30,826,308   | 32,894,700           | Aug 2017 – Jul 2018 |
| Pound Sterling             | 7,760,000                                     | 1.2838                                  | 9,962,150  | 10,289,410           | Aug 2017 – Jul 2018 |
| <b>Purchase Contracts:</b> |   |   |  |                      |                     |
| New Taiwan Dollar          | 923,500,000                                   | 30.311 *                                | 30,467,529   | 30,721,741           | Aug 2017 – Jul 2018 |

\*New Taiwan Dollars per U.S. Dollar

Forward contracts for the sale or purchase of foreign currencies as of July 31, 2017, which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies and are not designated as hedges under FASB guidance, were as follows:

| Forward Contracts   | Notional Amount<br>in Foreign<br>Currency | Weighted<br>Average<br>Forward<br>Rate | Contract<br>Amount at<br>Forward Rates in<br>U.S. Dollars<br>Contract<br>Date | July 31,<br>2017 | Maturity Dates      |
|---------------------|---|--|---|------------------|---------------------|
| Sale Contracts:     |   |  |   |                  |                     |
| Euro                | 24,560,772                                | 1.1176                                 | 27,448,938  | 29,200,024       | Aug 2017 – Oct 2017 |
| Pound Sterling      | 510,870                                   | 1.3144                                 | 671,464   | 674,761          | Aug 2017            |
| South African Rand  | 16,917,100                                | 0.0740                                 | 1,251,307   | 1,263,967        | Oct 2017            |
| Purchase Contracts: |   |  |   |                  |                     |
| New Taiwan Dollar   | 739,143,303                               | 30.015                                 | * 24,625,908  | 24,520,387       | Aug 2017 – Nov 2017 |

\* New Taiwan 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 2017. As of July 31, 2017, we had \$809,000 of realized gains and \$186,000 of unrealized losses, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to these forward contracts.

| Forward Contracts | Notional Amount<br>in Foreign<br>Currency | Weighted<br>Average<br>Forward<br>Rate | Contract<br>Amount at<br>Forward Rates in<br>U.S. Dollars<br>Contract<br>Date | July 31,<br>2017 | Maturity Date |
|-------------------|---|--|---|------------------|---------------|
| Sale Contracts:   |   |  |   |                  |               |
| Euro              | 3,000,000                                 | 1.0935                                 | 3,280,500   | 3,569,340        | November 2017 |



Item 4. CONTROLS AND PROCEDURES

We conducted 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, 2017, 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 control over financial reporting during the three months ended July 31, 2017 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

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

From time to time, we are involved in various claims and lawsuits arising in the normal course of business. Pursuant to applicable accounting rules, we accrue the minimum liability for each known claim when the estimated outcome is a range of possible loss and no one amount within that range is more likely than another. We maintain insurance policies for such matters, and we record insurance recoveries when we determine such recovery to be probable. 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. We believe that the ultimate resolution of claims for any losses will not exceed our insurance policy coverages.

### **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, 2016.

### **Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

We did not repurchase any shares of our common stock in the third quarter of fiscal 2017.

### **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

31.1 Certification by the Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as amended.

31.2 Certification by the Chief Financial Officer pursuant to Rule 13a-14(a) 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.CALXBRL Taxonomy Extension Calculation Linkbase

101.LABXBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

31



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  
Executive Vice President, Secretary, Treasurer  
& Chief Financial Officer

September 8, 2017