

HURCO COMPANIES INC  
Form 10-Q  
September 03, 2010  
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, 2010 or  
 Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 0-9143

HURCO COMPANIES, INC.  
(Exact name of registrant as specified in its charter)

Indiana  
(State or other jurisdiction of  
incorporation or organization)

35-1150732  
(I.R.S. Employer Identification Number)

One Technology Way  
Indianapolis, Indiana  
(Address of principal executive offices)

46268  
(Zip code)

Registrant's telephone number, including area code (317) 293-5309

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to the filing requirements for the past 90 days:  
Yes  No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).  
Yes  No

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

Large accelerated filer  Accelerated filer

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

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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, 2010 was 6,440,851.

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HURCO COMPANIES, INC.  
July 2010 Form 10-Q Quarterly Report

Table of Contents

|                                       |  |
|---------------------------------------|--|
| <b>Part I - Financial Information</b> |  |
| <b>Item 1.</b>                        | <b>Financial Statements</b>  |
|                                       | Condensed Consolidated Statements of Operations<br>Three and nine months ended July 31, 2010 and 2009            |
|                                       | 3  |
|                                       | Condensed Consolidated Balance Sheets<br>As of July 31, 2010 and October 31, 2009                                |
|                                       | 4  |
|                                       | Condensed Consolidated Statements of Cash Flows<br>Three and nine months ended July 31, 2010 and 2009            |
|                                       | 5  |
|                                       | Condensed Consolidated Statements of Changes in Shareholders' Equity<br>Nine months ended July 31, 2010 and 2009 |
|                                       | 6  |
|                                       | Notes to Condensed Consolidated Financial Statements   |
|                                       | 7  |
| <b>Item 2.</b>                        | <b>Management's Discussion and Analysis of Financial<br/>Condition and Results of Operations</b>                 |
|                                       | 16   |
| <b>Item 3.</b>                        | <b>Quantitative and Qualitative Disclosures About Market Risk</b>  |
|                                       | 23   |
| <b>Item 4.</b>                        | <b>Controls and Procedures</b>   |
|                                       | 25   |
| <b>Part II - Other Information</b>    |  |
| <b>Item 1.</b>                        | <b>Legal Proceedings</b>   |
|                                       | 26   |
| <b>Item 1A.</b>                       | <b>Risk Factors</b>  |
|                                       | 26   |
| <b>Item 5.</b>                        | <b>Other Information</b>   |
|                                       | 26   |
| <b>Item 6.</b>                        | <b>Exhibits</b>  |
|                                       | 27   |
| <b>Signatures</b>                     | 28   |

## PART I - FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

HURCO COMPANIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share data)

|  | Three Months Ended<br>July 31 |            | Nine Months Ended<br>July 31 |                     |
|--|-------------------------------|------------|------------------------------|---------------------|
|  | 2010<br>(Unaudited)           | 2009       | 2010<br>(Unaudited)          | 2009<br>(Unaudited) |
| Sales and service fees                       | \$ 26,474                     | \$ 19,039  | \$ 71,178                    | \$ 67,835           |
| Cost of sales and service                    | 21,815                        | 13,788     | 57,862                       | 48,822              |
| Gross profit                                 | 4,659                         | 5,251      | 13,316                       | 19,013              |
| Selling, general and administrative expenses | 6,994                         | 7,200      | 20,757                       | 22,747              |
| Operating loss                               | (2,335)                       | (1,949)    | (7,441)                      | (3,734)             |
| Interest expense                             | 21                            | 6          | 43                           | 33                  |
| Interest income                              | 24                            | 36         | 49                           | 185                 |
| Investment income                            | 4                             | 3          | 12                           | 32                  |
| Other (income) expense, net                  | 55                            | (133)      | 448                          | (1,828)             |
| Loss before taxes                            | (2,383)                       | (1,783)    | (7,871)                      | (1,722)             |
| Benefit for income taxes                     | (1,210)                       | (552)      | (3,289)                      | (564)               |
| Net loss                                     | \$ (1,173)                    | \$ (1,231) | \$ (4,582)                   | \$ (1,158)          |
| Losses per common share                      |                               |            |                              |                     |
| Basic  | \$ (0.18)                     | \$ (0.19)  | \$ (0.71)                    | \$ (0.18)           |
| Diluted                                      | \$ (0.18)                     | \$ (0.19)  | \$ (0.71)                    | \$ (0.18)           |
| Weighted average common shares outstanding   |                               |            |                              |                     |
| Basic  | 6,441                         | 6,434      | 6,441                        | 6,425               |
| Diluted                                      | 6,441                         | 6,434      | 6,441                        | 6,425               |

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



HURCO COMPANIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share and per-share data)

|   | July 31<br>2010<br>(Unaudited) | October 31<br>2009<br>(Audited) |
|---|--------------------------------|---------------------------------|
| <b>ASSETS</b>   |                                |                                 |
| Current assets:   |                                |                                 |
| Cash and cash equivalents   | \$ 45,189                      | \$ 28,782                       |
| Accounts receivable, net  | 14,276                         | 13,988                          |
| Refundable taxes  | 796                            | 7,121                           |
| Inventories, net  | 51,027                         | 60,281                          |
| Deferred income taxes, net  | 2,532                          | 2,670                           |
| Derivative assets   | 1,287                          | 376                             |
| Other   | 8,221                          | 5,046                           |
| Total current assets  | 123,328                        | 118,264                         |
| Non-current assets:   |                                |                                 |
| Property and equipment:   |                                |                                 |
| Land  | 782                            | 782                             |
| Building  | 7,116                          | 7,116                           |
| Machinery and equipment   | 14,768                         | 14,995                          |
| Leasehold improvements  | 2,042                          | 2,021                           |
|   | 24,708                         | 24,914                          |
| Less accumulated depreciation and amortization  | (12,800)                       | (11,802)                        |
|   | 11,908                         | 13,112                          |
| Software development costs, less accumulated amortization   | 6,093                          | 6,503                           |
| Investments and other assets, net   | 6,284                          | 6,864                           |
|   | \$ 147,613                     | \$ 144,743                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                |                                 |
| Current liabilities:  |                                |                                 |
| Accounts payable  | \$ 20,561                      | \$ 8,262                        |
| Accrued expenses and other  | 6,786                          | 9,025                           |
| Accrued warranty expenses   | 1,183                          | 1,286                           |
| Derivative liabilities  | 1,516                          | 2,234                           |
| Total current liabilities   | 30,046                         | 20,807                          |
| Non-current liabilities:  |                                |                                 |
| Deferred income taxes, net  | 2,592                          | 2,570                           |
| Deferred credits and other  | 929                            | 990                             |
| Total liabilities   | 33,567                         | 24,367                          |
| 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, 13,250,000 shares authorized, 6,440,851 shares issued and outstanding, respectively | 644                            | 644                             |
| Additional paid-in capital  | 52,098                         | 52,003                          |

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|                                      |            |            |
|--------------------------------------|------------|------------|
| Retained earnings                    | 64,986     | 69,568     |
| Accumulated other comprehensive loss | (3,682)    | (1,839)    |
| Total shareholders' equity           | 114,046    | 120,376    |
|                                      | \$ 147,613 | \$ 144,743 |

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

HURCO COMPANIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|   | Three Months Ended<br>July 31 |            | Nine Months Ended<br>July 31 |            |
|---|-------------------------------|------------|------------------------------|------------|
|   | 2010<br>(Unaudited)           | 2009       | 2010<br>(Unaudited)          | 2009       |
| <b>Cash flows from operating activities:</b>  |                               |            |                              |            |
| Net income (loss)   | \$ (1,173)                    | \$ (1,231) | \$ (4,582)                   | \$ (1,158) |
| Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities: |                               |            |                              |            |
| Provision for doubtful accounts   | (74)                          | 329        | (263)                        | 845        |
| Changes in deferred income taxes  | 473                           | 217        | (310)                        | (1,029)    |
| Equity in (income) loss of affiliates   | (27)                          | 125        | 154                          | 213        |
| Depreciation and amortization   | 978                           | 846        | 2,811                        | 2,451      |
| Foreign currency (gain) loss  | 1,030                         | (4,366)    | 4,614                        | (5,227)    |
| Unrealized (gain) loss on derivatives   | 1,457                         | 1,232      | 622                          | 5,248      |
| Stock-based compensation  | 46                            | 72         | 95                           | 186        |
| <b>Change in assets and liabilities:</b>  |                               |            |                              |            |
| (Increase) decrease in accounts receivable and refundable taxes                                     | 4,078                         | 3,442      | 3,675                        | 19,337     |
| (Increase) decrease in inventories  | (1,034)                       | 2,905      | 6,379                        | 6,405      |
| Increase (decrease) in accounts payable   | 7,805                         | (3,672)    | 12,454                       | (21,185)   |
| Increase (decrease) in accrued expenses   | (782)                         | (1,925)    | (1,849)                      | (11,231)   |
| Net change in derivative assets and liabilities   | (733)                         | (153)      | (1,772)                      | 3,502      |
| Other   | (2,272)                       | 874        | (3,120)                      | (2,065)    |
| Net cash provided by (used for) operating activities  | 9,772                         | (1,305)    | 18,908                       | (3,708)    |
| <b>Cash flows from investing activities:</b>  |                               |            |                              |            |
| Proceeds from sale of property and equipment  | 7                             | 24         | 42                           | 245        |
| Purchase of property and equipment  | (188)                         | (169)      | (437)                        | (1,497)    |
| Sale of investments   | —                             | —          | —                            | 6,674      |
| Software development costs  | (310)                         | (472)      | (805)                        | (1,463)    |
| Other investments   | 73                            | (7)        | 56                           | (901)      |
| Net cash provided by (used for) investing activities  | (418)                         | (624)      | (1,144)                      | 3,058      |
| <b>Cash flows from financing activities:</b>  |                               |            |                              |            |
| Proceeds from exercise of common stock options  | —                             | 43         | —                            | 43         |
| Net cash provided by financing activities   | —                             | 43         | —                            | 43         |
| Effect of exchange rate changes on cash   | (183)                         | 732        | (1,357)                      | 909        |
| Net increase (decrease) in cash and cash equivalents  | 9,171                         | (1,154)    | 16,407                       | 302        |
| Cash and cash equivalents at beginning of period  | 36,018                        | 27,850     | 28,782                       | 26,394     |
| Cash and cash equivalents at end of period  | \$ 45,189                     | \$ 26,696  | \$ 45,189                    | \$ 26,696  |



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, 2010 and 2009

| (In thousands, except<br>shares issued and outstanding)   | Common stock                         |        | Additional         |                      | Accumulated<br>other<br>comprehensive |            |  |
|---|--------------------------------------|--------|--------------------|----------------------|---------------------------------------|------------|--|
|   | Shares<br>issued<br>&<br>outstanding | Amount | paid-in<br>capital | Retained<br>earnings | income<br>(loss)                      | Total      |  |
| Balances, October 31, 2008  | 6,420,851                            | \$ 642 | \$ 51,690          | \$ 71,889            | \$ (744)                              | \$ 123,477 |  |
| Net loss  | —                                    | —      | —                  | (1,158)              | —                                     | (1,158)    |  |
| Translation of foreign currency<br>financial statements   | —                                    | —      | —                  | —                    | 2,070                                 | 2,070      |  |
| Realized gains on derivative<br>instruments reclassified into<br>operations, net of tax of \$11 | —                                    | —      | —                  | —                    | 17                                    | 17         |  |
| Unrealized loss on derivative<br>instruments, net of tax of<br>(\$2,184)                        | —                                    | —      | —                  | —                    | (3,546)                               | (3,546)    |  |
| Reversal of unrealized loss on<br>investments, net of tax                                       | —                                    | —      | —                  | —                    | 202                                   | 202        |  |
| Comprehensive loss  | —                                    | —      | —                  | —                    | —                                     | (2,415)    |  |
| Exercise of common stock<br>options   | 20,000                               | 2      | 41                 | —                    | —                                     | 43         |  |
| Stock-based compensation<br>expense   | —                                    | —      | 186                | —                    | —                                     | 186        |  |
| Balances, July 31, 2009<br>(Unaudited)  | 6,440,851                            | \$ 644 | \$ 51,917          | \$ 70,731            | \$ (2,001)                            | \$ 121,291 |  |
| Balances, October 31, 2009  | 6,440,851                            | \$ 644 | \$ 52,003          | \$ 69,568            | \$ (1,839)                            | \$ 120,376 |  |
| Net loss  | —                                    | —      | —                  | (4,582)              | —                                     | (4,582)    |  |
| Translation of foreign currency<br>financial statements   | —                                    | —      | —                  | —                    | (2,262)                               | (2,262)    |  |
|   | —                                    | —      | —                  | —                    | (99)                                  | (99)       |  |

|  |           |        |           |           |            |            |  |
|--|-----------|--------|-----------|-----------|------------|------------|--|
| Realized losses on derivative instruments reclassified into operations, net of tax of \$(61) |           |        |           |           |            |            |  |
| Unrealized gain on derivative instruments, net of tax of \$319                               | —         | —      | —         | —         | 518        | 518        |  |
| Comprehensive loss   | —         | —      | —         | —         | —          | (6,425)    |  |
| Stock-based compensation expense   | —         | —      | 95        | —         | —          | 95         |  |
| Balances, July 31, 2010 (Unaudited)  | 6,440,851 | \$ 644 | \$ 52,098 | \$ 64,986 | \$ (3,682) | \$ 114,046 |  |

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, and unless the context indicates otherwise, the terms “we”, “us”, “our” and similar language refer to Hurco Companies, Inc. and its consolidated subsidiaries. We design and produce computerized machine tools, interactive computer control systems and software for sale through our distribution network to the worldwide metal cutting market. We also provide software options, computer control upgrades, accessories and replacement parts for our products, as well as customer service and training support.

The condensed financial information as of July 31, 2010 and for the three and nine months ended July 31, 2010 and July 31, 2009 is unaudited; however, in our opinion, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our consolidated financial position, results of operations, changes in shareholders’ equity and cash flows at the end of the interim periods. We suggest that you read these condensed consolidated financial statements in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended October 31, 2009.

Certain amounts in the 2009 condensed consolidated financial statements have been reclassified to conform to the July 31, 2010 presentation. These classifications had no effect on the previously reported net income (loss).

2. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

On February 1, 2009, we adopted FASB guidance related to disclosures about derivative instruments and hedging activities. The adoption of this guidance has not had a material impact on our consolidated financial position or results of operations, but does require increased disclosure of our derivative and hedging activities, including how derivative and hedging activities affect our consolidated financial statements. These disclosures are provided below.

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.

We operate on a global basis and are exposed to the risk that our financial condition, results of operations and cash flows could be adversely affected by changes in foreign currency exchange rates. To reduce the potential effects of foreign exchange rate movements on our net equity investment in one of our foreign subsidiaries, gross profit and net earnings, we enter into derivative financial instruments in the form of foreign exchange forward contracts with a major financial institution. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in Euros, Pounds Sterling, Canadian Dollars, South African Rand, Singapore Dollars and New Taiwan Dollars.

We record all derivative instruments as assets or liabilities at fair value.

Derivatives Designated as Hedging Instruments

We enter into foreign currency forward exchange contracts periodically to hedge certain forecasted inter-company sales and purchases denominated in foreign currencies (the Pound Sterling, Euro and New Taiwan Dollar). The purpose of these instruments is to mitigate the risk that the U.S. Dollar net cash inflows and outflows resulting from

sales and purchases denominated in foreign currencies will be adversely affected by changes in exchange rates. These forward contracts have been designated as cash flow hedge instruments, and are recorded in the Condensed Consolidated Balance Sheets at fair value in Derivative assets and Derivative liabilities. The effective portion of the gains and losses resulting from the changes in the fair value of these hedge contracts are deferred in Accumulated other comprehensive loss and recognized as an adjustment to Cost of sales and service in the period that the corresponding inventory 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, 2010, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from August 2010 through July 2011. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2010, were \$20.4 million for Euros, \$5.2 million for Pounds Sterling and \$22.1 million for New Taiwanese Dollars. At July 31, 2010, we had approximately \$42,000 of losses, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive loss. Of this amount, \$275,000 represents 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 2011, when the corresponding inventory that is the subject of the related hedge contract is sold, as described above.

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we have maintained a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro denominated assets. We selected the forward method under 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 matured on November 24, 2009 and we entered into a new forward contract for the same notional amount that is set to mature in November 2010. At July 31, 2010, we had \$23,000 of realized losses and \$343,000 of unrealized gains, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to this forward contract.

#### 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 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 Operations 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, 2010, in Euros, Pounds Sterling, Canadian Dollars, South African Rand, Singapore Dollars and New Taiwan Dollars with set maturity dates ranging from August 2010 through March 2011. The amounts of these contracts at forward rates in U.S. Dollars at July 31, 2010 for Euros, Pounds Sterling, Canadian Dollars, South African Rand, New Taiwan Dollars and Singapore Dollars totaled \$18.9 million.

## Fair Value of Derivative Instruments

We recognize the fair value of derivative instruments as assets and liabilities on a gross basis on our Condensed Consolidated Balance Sheets. As of July 31, 2010 and October 31, 2009, all derivative instruments were recorded at fair value on the balance sheets as follows (in thousands):

| Derivatives                                   | Balance sheet location | 2010       |                        | 2009       |                        |
|---|------------------------|------------|------------------------|------------|------------------------|
|   |                        | Fair value | Balance sheet location | Fair value | Balance sheet location |
| <b>Designated as hedging instruments:</b>     |                        |            |                        |            |                        |
| Foreign exchange forward contracts            | Derivative assets      | \$ 1,256   | Derivative assets      | \$ 74      |                        |
| Foreign exchange forward contracts            | Derivative liabilities | \$ 1,147   | Derivative liabilities | \$ 1,246   |                        |
| <b>Not designated as hedging instruments:</b> |                        |            |                        |            |                        |
| Foreign exchange forward contracts            | Derivative assets      | \$ 31      | Derivative assets      | \$ 302     |                        |
| Foreign exchange forward contracts            | Derivative liabilities | \$ 369     | Derivative liabilities | \$ 988     |                        |

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

Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Changes in Shareholders' Equity and Operations during the three months ended July 31, 2010 and 2009 (in thousands):

| Derivatives   | Amount of gain (loss) recognized in other comprehensive loss |                                  | Location of gain (loss) reclassified from other comprehensive loss | Amount of gain (loss) reclassified from other comprehensive loss |                                  |
|---|--|----------------------------------|--|--|----------------------------------|
|   | Three months ended July 31, 2010                             | Three months ended July 31, 2009 |  | Three months ended July 31, 2010                                 | Three months ended July 31, 2009 |
| <b>Designated as hedging instruments: (Effective portion)</b> |  |                                  |  |  |                                  |
| Foreign exchange forward contracts                            |  |                                  |  |  |                                  |
| – Intercompany sales/purchases                                | \$ (803)   | \$ (3,135)                       | Cost of sales and service  | \$ (39)  | \$ 687                           |
| Foreign exchange forward contract                             |  |                                  |  |  |                                  |
| – Net investment  | \$ 81  | \$ (300)                         |  |  |                                  |

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As a result of the global recession we had to close hedge contracts before maturity due to forecasted reductions in production and sales. Those contracts closed early were deemed ineffective for financial reporting purposes and as a result we recognized a gain of \$27,000 for the three months ended July 31, 2010, and a gain of \$225,000 for the three months ended July 31, 2009.

| Derivatives                                   | Location of gain (loss)<br>recognized in operations<br>Three months ended July 31, | Amount of gain (loss)<br>recognized in operations<br>Three months ended July 31, |            |
|---|--|--|------------|
|   |  | 2010   | 2009       |
| <b>Not designated as hedging instruments:</b> |  |  |            |
| Foreign exchange forward contracts            | Other (income) expense, net  | \$ (41)  | \$ (2,484) |



Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Changes in Shareholders' Equity and Operations during the nine months ended July 31, 2010 and 2009 (in thousands):

| Derivatives   | Amount of gain (loss)<br>recognized in other<br>comprehensive loss |            | Location of gain (loss)<br>reclassified from other<br>comprehensive loss | Amount of gain (loss)<br>reclassified from other<br>comprehensive loss |       |
|---|--|------------|--|--|-------|
|   | Nine months ended July 31,<br>2010                                 | 2009       |  | Nine months ended July 31,<br>2010                                     | 2009  |
| Designated as hedging instruments:<br>(Effective portion) |  |            |  |  |       |
| Foreign exchange forward contracts                        |  |            |  |  |       |
| – Intercompany sales/purchases                            | \$ 837   | \$ (5,730) | Cost of sales and service  | \$ (160)   | \$ 28 |
| Foreign exchange forward contract                         |  |            |  |  |       |
| – Net investment  | \$ 482   | \$ (448)   |  |  |       |

As a result of the global recession we had to close hedge contracts before maturity due to forecasted reductions in production and sales. Those contracts closed early were deemed ineffective for financial reporting purposes and as a result we recognized a loss of \$38,000 for the nine months ended July 31, 2010, and a gain of \$2.7 million for the nine months ended July 31, 2009.

| Derivatives                            | Location of gain (loss)<br>recognized in operations | Amount of gain (loss)<br>recognized in operations |            |
|--|---|---|------------|
|  | Nine months ended July 31,                          | Nine months ended July 31,                        | 2009       |
| Not designated as hedging instruments: |   |   |            |
| Foreign exchange forward contracts     |   |   |            |
|  | Other (income) expense, net                         | \$ 1,293  | \$ (3,592) |

### 3. STOCK OPTIONS

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

On December 18, 2009, the Compensation Committee granted a total of 30,000 stock options under the 2008 Plan to four executive employees. The fair value of the options was estimated on the date of grant using a Black-Scholes valuation model with assumptions for expected volatility based on the historical volatility of our common stock of 65%, expected term of the options, dividend yield rate of 0% and a risk-free interest rate of 2.3% based upon the five-year U.S. Treasury yield as of the date of grant. The options vest over a three-year period beginning one year from the date of grant. Based upon the foregoing factors, the grant date fair value of the stock options was determined to be \$8.29 per share.

On May 13, 2010, the Compensation Committee granted a total of 20,000 stock options under the 2008 Plan to four executive employees. The fair value of the options was estimated on the date of grant using a Black-Scholes valuation model with assumptions for expected volatility based on the historical volatility of our common stock of 63%, expected term of the options, dividend yield rate of 0% and a risk-free interest rate of 2.3% based upon the five-year U.S. Treasury yield as of the date of grant. The options vest over a three-year period beginning one year from the date of grant. Based upon the foregoing factors, the grant date fair value of the stock options was determined to be \$9.90 per share.

During the first nine months of fiscal 2010 and 2009, we recorded approximately \$95,000 and \$186,000, respectively, of stock-based compensation expense related to grants under the plans. As of July 31, 2010, there was approximately \$514,000 of total unrecognized stock-based compensation cost that we expect to recognize by the end of fiscal 2014.

A summary of stock option activity for the nine-month period ended July 31, 2010, is as follows:

|                                 | Stock options | Weighted average exercise price |
|---------------------------------|---------------|---------------------------------|
| Outstanding at October 31, 2009 | 65,369        | \$ 24.11                        |
| Options granted                 | 50,000        | 16.14                           |
| Options exercised               | —             | —                               |
| Options cancelled               | —             | —                               |
| Outstanding at July 31, 2010    | 115,369       | \$ 20.66                        |

Summarized information about outstanding stock options as of July 31, 2010, those are already vested and those that are expected to vest, as well as stock options that are currently exercisable, are as follows:

|   | Options already vested and expected to vest | Options currently exercisable |
|---|---|-------------------------------|
| Number of outstanding options                       | 115,369                                     | 51,369                        |
| Weighted average remaining contractual life (years) | 8.10  | 6.11                          |
| Weighted average exercise price per share           | \$ 20.66                                    | \$ 26.62                      |
| Intrinsic value                                     | \$ 111,000                                  | \$ 21,000                     |

The intrinsic value of a stock option is calculated as the difference between the stock price as of July 31, 2010 and the exercise price of the option.

## 4. EARNINGS (LOSSES) PER SHARE

Basic earnings (losses) per common share are based on the weighted average number of shares of our common stock outstanding during the period. Diluted earnings (losses) per common share give effect to shares underlying outstanding stock options using the treasury method when applied to our basic earnings (losses) per share. The following table presents a reconciliation of our basic and diluted earnings (losses) per share computation:

| (in thousands, except per share amount)     | Three months ended<br>July 31, |            |            |            | Nine months ended<br>July 31, |            |            |            |
|---|--------------------------------|------------|------------|------------|-------------------------------|------------|------------|------------|
|   | 2010                           |            | 2009       |            | 2010                          |            | 2009       |            |
|   | Basic                          | Diluted    | Basic      | Diluted    | Basic                         | Diluted    | Basic      | Diluted    |
| Net loss                                    | \$ (1,173)                     | \$ (1,173) | \$ (1,231) | \$ (1,231) | \$ (4,582)                    | \$ (4,582) | \$ (1,158) | \$ (1,158) |
| Weighted average shares outstanding         | 6,441                          | 6,441      | 6,434      | 6,434      | 6,441                         | 6,441      | 6,425      | 6,425      |
| Assumed issuances under stock options plans | —                              | —          | —          | —          | —                             | —          | —          | —          |
|   | 6,441                          | 6,441      | 6,434      | 6,434      | 6,441                         | 6,441      | 6,425      | 6,425      |
| Loss per share                              | \$ (0.18)                      | \$ (0.18)  | \$ (0.19)  | \$ (0.19)  | \$ (0.71)                     | \$ (0.71)  | \$ (0.18)  | \$ (0.18)  |

## 5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$546,000 as of July 31, 2010 and \$809,000 as of October 31, 2009.

## 6. INVENTORIES

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

|                                    | July 31, 2010 | October 31, 2009 |
|------------------------------------|---------------|------------------|
| Purchased parts and sub-assemblies | \$ 15,583     | \$ 14,961        |
| Work-in-process                    | 9,208         | 3,559            |
| Finished goods                     | 26,236        | 41,761           |
|                                    | \$ 51,027     | \$ 60,281        |

## 7. SEGMENT INFORMATION

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

## 8. GUARANTEES AND 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 contingencies with respect to these guarantees. As of July 31, 2010, we had 34 outstanding third party payment guarantees totaling approximately \$1.8

million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue for potential liabilities under these guarantees when we believe a loss is probable and can be estimated.

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

|  | Nine months ended |               |
|--|-------------------|---------------|
|  | July 31, 2010     | July 31, 2009 |
| Balance, beginning of period               | \$ 1,286          | \$ 2,536      |
| Provision for warranties during the period | 1,285             | 611           |
| Charges to the reserve                     | (1,329)           | (1,534)       |
| Impact of foreign currency translation     | (59)              | 22            |
| Balance, end of period                     | \$ 1,183          | \$ 1,635      |

#### 9. COMPREHENSIVE LOSS

A reconciliation of our net income (loss) to comprehensive loss is as follows (in thousands):

|   | Three months ended |               |
|---|--------------------|---------------|
|   | July 31, 2010      | July 31, 2009 |
| Net loss  | \$ (1,173)         | \$ (1,231)    |
| Translation of foreign currency financial statements                                    | (645)              | 2,005         |
| Realized (loss) gain on derivative instruments reclassified into operations, net of tax | (24)               | 425           |
| Unrealized loss on derivative instruments, net of tax                                   | (497)              | (1,940)       |
| Comprehensive loss  | \$ (2,339)         | \$ (741)      |

#### 10. DEBT AGREEMENTS

We are party to an unsecured domestic credit agreement that provides us with a \$15.0 million unsecured revolving credit facility and maximum outstanding letters of credit of \$3.0 million. The domestic credit agreement also provides for a separate uncommitted demand credit facility in the amount of 100.0 million New Taiwan Dollars. We also have a £1.0 million revolving credit facility in the United Kingdom and a €1.5 million revolving credit facility in Germany. The domestic and United Kingdom facilities mature on December 7, 2012. The revolving credit facility in Germany does not have an expiration date.

Borrowings under the domestic facility may be used for general corporate purposes and bear interest at a floating rate, based either on LIBOR or the prime rate, plus an applicable margin. The domestic credit agreement restricts our ability to declare and pay dividends, incur additional indebtedness other than under this facility and make acquisitions whenever we have a cumulative net loss for the most recent four consecutive quarters and for so long thereafter as the cumulative loss continues. These restrictions are currently in effect as we have a cumulative net loss for the most recent four consecutive quarters. The domestic credit agreement contains a financial covenant that requires no less than a 1:00 to 1:00 ratio of excess cash (defined as cash minus debt) to an annualized net loss (defined as a net loss for the two most recent consecutive quarters multiplied by two). After achieving cumulative income for four consecutive quarters we are required to maintain a ratio of 0.5 to 1.0 of total indebtedness to the sum of total indebtedness and net worth.

As of July 31, 2010 and October 31, 2009, we had no debt or borrowings outstanding under any of our credit facilities and no outstanding letters of credit. As of July 31, 2010, we had unutilized credit facilities of \$21.6 million available for either direct borrowings or commercial letters of credit.

## 11. INCOME TAXES

Our unrecognized tax benefits were \$195,000 as of July 31, 2010 and \$670,000 as of October 31, 2009, and in each case included accrued interest. During the third quarter of fiscal 2010, we recorded a benefit for income taxes of \$495,000 due to the expiration of statutes of limitations on uncertain tax benefits which resulted in an increase in our effective tax rate for the three and nine months ended July 31, 2010 compared to same periods in prior year.

We recognize accrued interest and penalties related to unrecognized tax benefits as components of our income tax provision. We believe our unrecognized tax positions meet the minimum statutory threshold to avoid payment of penalties and, therefore, no tax penalties have been estimated. As of July 31, 2010, the gross amount of interest accrued, reported in Accrued expenses and other, was approximately \$16,000, 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 2011 and August 2013.

## 12. FINANCIAL INSTRUMENTS

The carrying amounts for our trade receivables and payables approximate their fair values. We also have financial instruments in the form of foreign currency forward exchange contracts. The U.S. Dollar equivalent notional amount of these contracts was \$71.2 million and \$50.8 million at July 31, 2010 and October 31, 2009, respectively. The fair value of Derivative assets recorded on our Condensed Consolidated Balance Sheets at July 31, 2010 and October 31, 2009 was \$1.3 million and \$376,000, respectively. The fair value of Derivative liabilities recorded on our Condensed Consolidated Balance Sheets at July 31, 2010 and October 31, 2009 was \$1.5 million and \$2.2 million, respectively.

The future 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 counterparties to these contracts are substantial and creditworthy financial institutions. We do not consider the risks of counterparty non-performance to be material.

On November 1, 2008, we adopted FASB guidance related to fair value measurements as it relates to financial assets and liabilities recorded on a recurring basis.

This 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, 2010 and October 31, 2009 (in thousands):

|                       | Assets           |                     | Liabilities      |                     |
|-----------------------|------------------|---------------------|------------------|---------------------|
|                       | July 31,<br>2010 | October 31,<br>2009 | July 31,<br>2010 | October 31,<br>2009 |
| <b>Level 1</b>        |                  |                     |                  |                     |
| Deferred Compensation | \$ 621           | \$ 642              | \$ -             | \$ -                |
| <b>Level 2</b>        |                  |                     |                  |                     |
| Derivatives           | \$ 1,287         | \$ 376              | \$ 1,516         | \$ 2,234            |



|       |    |       |    |       |    |       |    |       |
|-------|----|-------|----|-------|----|-------|----|-------|
| Total | \$ | 1,908 | \$ | 1,018 | \$ | 1,516 | \$ | 2,234 |
|-------|----|-------|----|-------|----|-------|----|-------|

14

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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 which are readily available. Included as Level 2 fair value measurements are derivative assets and liabilities related to hedged and unhedged 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.

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

### EXECUTIVE OVERVIEW

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design and produce computerized machine tools, featuring our proprietary computer control systems and software, for sale through our own distribution network to the worldwide metal cutting market. We also provide 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 unaudited financial statements that appear elsewhere in this report.

Until the recent global recession, we had experienced a period of sustained growth in sales and earnings due to the strong worldwide demand for machine tools, the expansion of our product line to include higher-priced and higher-margin products, increased customer acceptance of our products, and the strength of our selling and manufacturing operations outside the United States. Since the end of fiscal 2008, our operational performance has been adversely affected by the global economic recession and its lingering effects on the market for machine tools.

The market for machine tools is international in scope. We have both significant foreign sales and foreign manufacturing operations. During the first nine months of fiscal 2009, approximately 68% of our revenues were attributable to customers located outside of North America. During the first nine months of fiscal 2010, 73% of our revenues were attributable to foreign customers. This increase in foreign revenues is driven by increased market demand in the Asia Pacific region where we sell more of our entry level, lower-priced VM series machines and where competitive price pressures exist. Due to the continued economic conditions in Europe we have seen a reduction in our sales to that region where we typically sell our higher performance VMX series machines at higher prices and margins. We sell our products through more than 100 independent agents and distributors in countries throughout North America, Europe and Asia. We also have our own direct sales and service organizations in Canada, China, France, Germany, Italy, Poland, Spain, Singapore, South Africa, the United Kingdom and certain parts of the United States. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly owned subsidiary in Taiwan, Hurco Manufacturing Limited (HML). Machine castings and components to support HML's production are manufactured at our facility in Ningbo, China. We also manufacture machine tools for the Chinese market at the Ningbo plant.

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

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

currency forward exchange contracts.

16

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In response to the global recession, beginning in the fourth quarter of fiscal 2008, we implemented various cost saving initiatives to reduce expenses while staying committed to our strategic plan of product innovation and penetration of developing markets.

During the third quarter of fiscal 2010, sales were 39% above those in the third quarter of fiscal 2009. Orders for the third quarter of fiscal 2010 were 56% higher than the third quarter of fiscal 2009. Based upon our current inventory position and order level, we have started increasing our production levels to be in line with the current trend of increasing order demand.

## RESULTS OF OPERATIONS

### Three Months Ended July 31, 2010 Compared to Three Months Ended July 31, 2009

**Sales and Service Fees.** Sales and service fees for the third quarter of fiscal 2010 totaled \$26.5 million, an increase of \$7.4 million, or 39%, from the third quarter of fiscal 2009. The effect of a stronger U.S. Dollar when translating foreign sales to U.S. Dollars for financial reporting purposes had an unfavorable impact of approximately 7%, or \$1.3 million, on the period-to-period comparison.

The following tables set forth net sales (in thousands) by geographic region and product category for the third quarter of 2010 and 2009, respectively:

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

|               | Three months ended July 31, |        |           |        | Change   |        |
|---------------|-----------------------------|--------|-----------|--------|----------|--------|
|               | 2010                        |        | 2009      |        | Amount   | %      |
| North America | \$ 7,208                    | 27.2%  | \$ 5,809  | 30.5%  | \$ 1,399 | 24.1%  |
| Europe        | 15,896                      | 60.1%  | 11,777    | 61.9%  | 4,119    | 35.0%  |
| Asia Pacific  | 3,370                       | 12.7%  | 1,453     | 7.6%   | 1,917    | 131.9% |
| Total         | \$ 26,474                   | 100.0% | \$ 19,039 | 100.0% | \$ 7,435 | 39.1%  |

The third quarter increase in sales was primarily driven by increased demand for vertical machining centers in all sales regions, with the largest percentage increase in the Asia Pacific region. Compared to the third quarter of fiscal 2009, unit shipments for the third quarter of fiscal 2010 increased in North America by 25%, in Europe by 38%, and in the Asia Pacific sales region by 123%. The increase in the Asia Pacific region during the third quarter of fiscal 2010 was primarily the result of increased shipments in China and India of our entry-level, lower-priced VM series machines and increased market demand in the other Asia Pacific territories.

#### Net Sales and Service Fees by Product Category

|                               | Three months ended July 31, |        |           |        | Change   |       |
|-------------------------------|-----------------------------|--------|-----------|--------|----------|-------|
|                               | 2010                        |        | 2009      |        | Amount   | %     |
| Computerized Machine Tools    | \$ 22,020                   | 83.2%  | \$ 15,552 | 81.7%  | \$ 6,468 | 41.6% |
| Service Fees, Parts and Other | 4,454                       | 16.8%  | 3,487     | 18.3%  | 967      | 27.7% |
| Total                         | \$ 26,474                   | 100.0% | \$ 19,039 | 100.0% | \$ 7,435 | 39.1% |

Unit shipments of computerized machine tools during the third quarter of fiscal 2010 increased by 46% from the corresponding period in fiscal 2009.

Orders. New order bookings in the third quarter of fiscal 2010 were \$28.0 million, an increase of \$10.1 million, or 56%, from the same period in fiscal 2009. Orders increased in North America by \$2.5 million, or 45%, in Europe by \$4.3 million, or 38%, and in Asia Pacific by \$3.3 million, or 285%, in each case as compared to the third quarter of fiscal 2009. The increase in orders reflected higher demand in China and India for our entry-level, lower-priced VM series machines and increased demand in the other Asia Pacific territories. The impact of currency translation on new orders booked in fiscal 2010 was consistent with its impact on sales.

**Gross Profit.** Hurco's gross profit for the third quarter of fiscal 2010 was 18%, compared to 28% for the same period in fiscal 2009. The decrease in profit as a percentage of sales was the result of machines sold during the period which were produced at a time of lower production levels that resulted in higher production costs per machine which increased this period's cost of sales. Also contributing to the decrease was a product mix that included a greater amount of our entry-level, lower margin machines that were in high demand in the Asia Pacific region where competitive pricing pressure also exists.

**Operating Expenses.** Selling, general and administrative expenses were \$7.0 million for the third quarter of fiscal 2010, a decrease of \$206,000, or 3%, from the same period of fiscal 2009. The decrease reflected the benefit of cost reduction initiatives and the favorable effect of a stronger U.S. dollar in the third quarter of fiscal 2010 when translating foreign operating expenses to U.S. dollars for financial reporting purposes, partially offset by an increase in sales commissions.

**Operating Income (Loss).** The operating loss for the third quarter of fiscal 2010 was \$2.3 million compared to an operating loss of \$1.9 million for the same period in fiscal 2009. The increase in the operating loss year-over-year was primarily the result of machines sold during the period which were produced at a time of lower production levels that resulted in higher production costs per machine which increased this period's cost of sales. Also contributing to the decrease was a product mix that included a greater amount of our entry-level, lower margin machines that were in high demand in the Asia Pacific region where competitive pricing pressure also exists.

**Other (Income) Expense, Net.** The decrease in other income of \$188,000 for the third quarter of fiscal 2010 compared to the same period in fiscal 2009 was primarily due to a reduction of \$225,000 in net realized gains on hedge contracts closed before maturity during the third quarter of fiscal 2009 as a result of forecasted reductions in production and sales.

**Income Taxes.** Our effective tax rate for the third quarter of fiscal 2010 was 51% in comparison to 31% for the same period in fiscal 2009. We recorded a benefit for income taxes during the third quarter of fiscal 2010 of approximately \$1.2 million compared to a benefit of \$552,000 for the same period in fiscal 2009. The increase in the effective tax rate relates primarily to the recognition of tax benefits of \$495,000 for uncertain tax positions due to expiration of statutes of limitations.

#### Nine Months Ended July 31, 2010 Compared to Nine Months Ended July 31, 2009

**Sales and Service Fees.** Sales and service fees for the nine months ended July 31, 2010, totaled \$71.2 million, an increase of \$3.3 million, or 5%, from the corresponding period in 2009. Currency translation had a favorable impact on sales for the first nine months of fiscal 2010 of approximately 2%, or \$1.1 million compared to the same period of fiscal 2009.

The following tables set forth net sales (in thousands) by geographic region and product category for the first nine months of 2010 and 2009, respectively:

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

|               | Nine months ended July 31, |        |           |        | Change     |         |
|---------------|----------------------------|--------|-----------|--------|------------|---------|
|               | 2010                       |        | 2009      |        | Amount     | %       |
| North America | \$ 19,114                  | 26.8%  | \$ 21,618 | 31.9%  | \$ (2,504) | (11.6)% |
| Europe        | 43,254                     | 60.8%  | 42,879    | 63.2%  | 375        | 0.9%    |
| Asia Pacific  | 8,810                      | 12.4%  | 3,338     | 4.9%   | 5,472      | 164.0%  |
| Total         | \$ 71,178                  | 100.0% | \$ 67,835 | 100.0% | \$ 3,343   | 4.9%    |

The increase in sales was primarily driven by higher demand for vertical machining centers in the Asia Pacific region. Unit shipments for the first nine months of fiscal 2010 decreased in North America by 27%, increased in Europe by 1% and increased in the Asia Pacific sales region by 212% compared to the same period in fiscal 2009. The increased sales in the Asia Pacific region during the first nine months of fiscal 2010 were primarily the result of increased shipments in China and India of our entry-level, lower-priced VM series machines and increased demand in the other Asia Pacific territories.



## Net Sales and Service Fees by Product Category

|                                  | Nine months ended July 31, |               |                  |               | Change          |             |
|----------------------------------|----------------------------|---------------|------------------|---------------|-----------------|-------------|
|                                  | 2010                       |               | 2009             |               | Amount          | %           |
| <b>Computerized</b>              |                            |               |                  |               |                 |             |
| Machine Tools                    | \$ 58,793                  | 82.6%         | \$ 56,019        | 82.6%         | \$ 2,774        | 5.0%        |
| Service Fees, Parts<br>and Other | 12,385                     | 17.4%         | 11,816           | 17.4%         | 569             | 4.8%        |
| <b>Total</b>                     | <b>\$ 71,178</b>           | <b>100.0%</b> | <b>\$ 67,835</b> | <b>100.0%</b> | <b>\$ 3,343</b> | <b>4.9%</b> |

Unit shipments of computerized machine tools during the first nine months of fiscal 2010 increased by 6% from the corresponding period in fiscal 2009.

Orders. New order bookings in the first nine months of fiscal 2010 were \$79.2 million, an increase of \$18.6 million, or 31%, from the same period in fiscal 2009. Orders increased in North America by \$2.9 million, or 16%, in Europe by \$7.0 million, or 18%, and in the Asia Pacific region by \$8.7 million, or 316%, compared to the same period of fiscal 2009. The increase in orders reflected higher demand in China and India for our entry-level, lower-priced VM series machines and increased demand in the other Asia Pacific territories. The impact of currency translation on new orders booked in fiscal 2010 was consistent with its impact on sales.

Gross Profit. Hurco's gross profit for the first nine months of fiscal 2010 was 19%, compared to 28% for the same period in fiscal 2009. The decrease in profit as a percentage of sales was the result of machines sold during the period which were produced at a time of lower production levels that resulted in higher production costs per machine which increased this period's cost of sales. Also contributing to the decrease was a product mix that included a greater amount of our entry-level, lower margin machines that were in high demand in the Asia Pacific region where competitive pricing pressure also exists.

Operating Expenses. Selling, general and administrative expenses were \$20.8 million for the first nine months of fiscal 2010, a decrease of \$2.0 million, or 9%, from the same period of fiscal 2009. The decrease reflected lower sales commissions and the benefit of cost reduction initiatives, partially offset by the unfavorable effect of a weaker U.S. Dollar in fiscal 2010 when translating foreign operating expenses to U.S. Dollars for financial reporting purposes.

Operating Income (Loss). The operating loss for the first nine months of fiscal 2010 was \$7.4 million compared to an operating loss of \$3.7 million for the same period in fiscal 2009. The increase in the operating loss year-over-year was primarily the result of machines sold during the period which were produced at a time of lower production levels that resulted in higher production costs per machine which increased this period's cost of sales. Also contributing to the decrease was a product mix that included a greater amount of our entry-level, lower margin machines that were in high demand in the Asia Pacific region where competitive pricing pressure also exists.

Other (Income) Expense, Net. The decrease in other income of \$2.3 million for the first nine months of fiscal 2010 compared to the same period in fiscal 2009 was primarily due to a reduction of \$2.7 million in net realized gains on hedge contracts closed before maturity during fiscal 2009 as a result of forecasted reductions in production and sales.

Income Taxes. Our effective tax rate for the first nine months of fiscal 2010 was 42% in comparison to 33% for the same period in fiscal 2009. We recorded a benefit for income taxes during the first nine months of fiscal 2010 of approximately \$3.3 million compared to a benefit of \$564,000 for the same period in fiscal 2009. The increase in the effective tax rate relates primarily to the recognition of tax benefits of \$495,000 for uncertain tax positions due to the expiration of statutes of limitations.



## LIQUIDITY AND CAPITAL RESOURCES

At July 31, 2010, our cash balance was \$45.2 million, compared to \$28.8 million at October 31, 2009. Approximately 76% of the \$45.2 million of cash is in U.S. Dollars. The balance is held outside the U.S. in the local currencies of our various foreign entities and is subject to fluctuations in currency exchange rates.

Working capital, excluding cash and cash equivalents, was \$48.1 million at July 31, 2010, compared to \$68.7 million at October 31, 2009.

Inventories were \$51.0 million at July 31, 2010, compared to \$60.3 million at October 31, 2009. The \$9.3 million decrease was due to a combination of lower production levels and an increase in market demand which decreased finished goods inventory by \$15.5 million or 37%. As a result of the recent increase in orders, we have started increasing production to meet current order levels and reduce our backlog. This increase in production has increased work-in-process inventory by \$5.6 million, or 159%. We continue to evaluate changes in production levels due to changes in customer demand.

We believe our cash resources will permit us to stay committed to our strategic plan of product innovation and targeted penetration of developing markets despite the lingering effects of the recent global recession. During the current recession we significantly reduced our production levels and implemented cost saving initiatives. We are increasing our production as demand for machine tools increases. However, we may face challenges due to the continuing economic uncertainties in Europe and the U.S., our largest markets and the longer term effect of a stronger U.S. Dollar against the Euro.

Capital expenditures during the first nine months of fiscal 2010 were primarily for implementation of operating systems and software development costs. We funded these expenditures with cash flow from operations.

Although we have not made any significant acquisitions in the recent past and we have no present plans for acquisitions, we continue to receive and review information on businesses and assets, including intellectual property assets, which are available for purchase. Because we have had four consecutive quarters of net losses, our domestic credit agreement has restrictions on us making acquisitions, declaring and paying dividends, and incurring additional indebtedness. These restrictions will remain in effect as long as this cumulative loss position exists.

## NEW ACCOUNTING PRONOUNCEMENTS

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements. Reporting entities will have to provide information about movements of assets among Levels 1 and 2; and a reconciliation of purchases, sales, issuance, and settlements of activity valued with a Level 3 method, of the three-tier fair value hierarchy established by previous FASB guidance. The guidance also clarifies the existing requirements for fair value measurement disclosures as it relates to each class of assets and liabilities. The guidance was effective for interim and annual reporting periods beginning after December 15, 2009 for Level 1 and 2 disclosure requirements and after December 15, 2010 for Level 3 disclosure requirements. We adopted this guidance in the third quarter of fiscal 2010 and it did not have a material impact on our consolidated financial statements.

In February 2010, the FASB issued various non-substantive amendments to the FASB Codification that do not fundamentally change existing GAAP; however, certain amendments altered the application of GAAP as it relates to derivatives and income taxes. The amended guidance was effective beginning in the first interim or annual period beginning after the release date, except for certain amendments. We adopted this guidance in the third quarter of fiscal 2010 and it did not have a material impact on our consolidated financial statements.

On February 2010, the FASB issued amendments to certain recognition and disclosure requirements. This guidance removes the requirement that SEC filers disclose the date through which subsequent events have been evaluated. This amendment alleviates potential conflicts between previous guidance and the SEC's requirements. The guidance became effective upon issuance and we adopted this guidance during the first quarter of fiscal 2010.

## CRITICAL ACCOUNTING POLICIES

Our accounting policies, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2009, require management to make significant estimates and assumptions using information available at the time the estimates are made. These estimates and assumptions significantly affect various reported amounts of assets, liabilities, revenues, and expenses. If our future experience differs materially from these estimates and assumptions, our results of operations and financial condition would be affected. There were no material changes to our critical accounting policies during the first nine months of fiscal 2010.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

There have been no material changes related to contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2009.

## 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 contingencies with respect to these guarantees. As of July 31, 2010, we had 34 outstanding third party payment guarantees totaling approximately \$1.8 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue for potential liabilities under these guarantees when we believe a loss is probable and can be estimated.

## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

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

- The impact of continuing economic uncertainty on demand for our products, particularly in Europe and the U.S.;
  - The cyclical nature of the machine tool industry;
  - 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;
  - The need to make technological advances;
- Competition with larger companies that have greater financial resources;
- Changes in the prices of raw materials, especially steel and iron products;
  - Possible obsolescence of our technology;
- Acquisitions that could disrupt our operations and affect operating results;
  - Impairment of our assets;
- The need to protect our intellectual property assets;
- The impact of the continuing downturn in the global economy;
- The impact of ongoing disruptions in the credit markets on our investment securities; and
  - The effect of the loss of key personnel.

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

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

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

## Interest Rate Risk

Interest on borrowings on our bank credit agreements are tied to prevailing U.S. and European interest rates. At July 31, 2010, there were no outstanding borrowings under our bank credit agreements.

## Foreign Currency Exchange Risk

In fiscal 2009, we derived more than 70% of our revenues from foreign markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

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

We enter into foreign currency forward exchange contracts from time to time to hedge the cash flow risk related to forecasted inter-company sales and purchases denominated in, or based on, foreign currencies (primarily the Euro, Pound Sterling, and New Taiwan Dollar). We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. We 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, 2010, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities were as follows:

| Forward Contracts          | Notional Amount in Foreign Currency | Weighted Avg. Forward Rate | Contract Amount at Forward Rates in U.S. Dollars<br>Contract Date | July 31, 2010 | Maturity Dates          |
|----------------------------|-------------------------------------|----------------------------|---|---------------|-------------------------|
| <b>Sale Contracts:</b>     |                                     |                            |   |               |                         |
| Euro                       | 15,650,000                          | 1.3124                     | 20,538,687  | 20,416,813    | August 2010 – July 2011 |
| Pound Sterling             | 3,330,000                           | 1.5312                     | 5,098,803   | 5,222,178     | August 2010 – July 2011 |
| <b>Purchase Contracts:</b> |                                     |                            |   |               |                         |
| New Taiwan Dollar          | 700,000,000                         | 31.06*                     | 22,534,733  | 22,091,397    | August 2010 – July 2011 |

\*NT Dollars per U.S. Dollar



Forward contracts for the sale or purchase of foreign currencies as of July 31, 2010, which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables and are not designated as hedges under this guidance denominated in foreign currencies, were as follows:

| Forward Contracts          | Notional Amount in Foreign Currency | Weighted Avg. Forward Rate | Contract Amount at Forward Rates in U.S. Dollars |               |                              |
|----------------------------|-------------------------------------|----------------------------|--|---------------|------------------------------|
|                            |                                     |                            | Contract Date                                    | July 31, 2010 | Maturity Dates               |
| <b>Sale Contracts:</b>     |                                     |                            |  |               |                              |
| Euro                       | 6,391,071                           | 1.2636                     | 8,075,757  | 8,341,141     | August 2010 – October 2010   |
| Pound Sterling             | 420,162                             | 1.5611                     | 655,913  | 659,444       | August 2010                  |
| Canadian Dollar            | 564,005                             | .9792                      | 552,274  | 547,864       | September 2010               |
| Singapore Dollar           | 2,047,912                           | .7132                      | 1,460,510  | 1,506,835     | March 2011                   |
| South African Rand         | 2,452,988                           | .1346                      | 330,172  | 331,642       | October 2010                 |
| <b>Purchase Contracts:</b> |                                     |                            |  |               |                              |
| New Taiwan Dollar          | 239,342,513                         | 31.85*                     | 7,514,896  | 7,492,023     | August 2010 – September 2010 |

\* NT Dollars per U.S. Dollar

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we entered into 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 forward 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 matured on November 24, 2009 and we entered into a new forward contract for the same notional amount that is set to mature in November 2010. At July 31, 2010, we had \$23,000 of realized losses and \$343,000 of unrealized gains, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to this forward contract.

Forward contracts for the sale or purchase of foreign currencies as of July 31, 2010, which are designated as net investment hedges under this guidance were as follows:

| Forward Contracts      | Notional Amount in Foreign Currency | Weighted Avg. Forward Rate | Contract Amount at Forward Rates in U.S. Dollars |               |               |
|------------------------|-------------------------------------|----------------------------|--|---------------|---------------|
|                        |                                     |                            | Contract Date                                    | July 31, 2010 | Maturity Date |
| <b>Sale Contracts:</b> |                                     |                            |  |               |               |
| Euro                   | 3,000,000                           | 1.4896                     | 4,468,800  | 3,914,670     | November 2010 |

Item 4. CONTROLS AND PROCEDURES

We carried out an evaluation under the supervision and with participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of July 31, 2010, pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the evaluation date.

There were no changes in our internal controls over financial reporting during the quarter ended July 31, 2010 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are involved in various claims and lawsuits arising in the normal course of our business. We believe it is remote that any of these claims will have a material adverse effect on our consolidated financial position or results of operations.

Item 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in Part I, Item 1A – Risk Factors in our Annual Report on Form 10-K for the year ended October 31, 2009.

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-15(b) under the Securities and Exchange Act of 1934, as amended.
- 31.2 Certification by the Chief Financial Officer, pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended.
- 32.1 Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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/ John G. Oblazney  
John G. Oblazney  
Vice President and  
Chief Financial Officer

By: /s/ Sonja K. McClelland  
Sonja K. McClelland  
Corporate Controller and  
Principal Accounting  
Officer

September 3, 2010