

HURCO COMPANIES INC
Form 10-Q
March 04, 2016

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 January 31, 2016 or
 Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission File No. 0-9143

HURCO COMPANIES, INC.

(Exact name of registrant as specified in its charter)

Indiana

(State or other jurisdiction of
incorporation or organization)

35-1150732

(I.R.S. Employer Identification Number)

One Technology Way

Indianapolis, Indiana

(Address of principal executive offices) (Zip code)

46268

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

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

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

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

Yes No

The number of shares of the Registrant's common stock outstanding as of February 22, 2016 was 6,564,017

HURCO COMPANIES, INC.

January 2016 Form 10-Q Quarterly Report

Table of Contents

Part I - Financial Information

| | | |
|----------|--|----|
| Item 1. | <u>Financial Statements</u> | |
| | <u>Condensed Consolidated Statements of Income Three months ended January 31, 2016 and 2015</u> | 3 |
| | <u>Condensed Consolidated Statements of Comprehensive Income Three months ended January 31, 2016 and 2015</u> | 4 |
| | <u>Condensed Consolidated Balance Sheets As of January 31, 2016 and October 31, 2015</u> | 5 |
| | <u>Condensed Consolidated Statements of Cash Flows Three months ended January 31, 2016 and 2015</u> | 6 |
| | <u>Condensed Consolidated Statements of Changes in Shareholders' Equity Three months ended January 31, 2016 and 2015</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> | 24 |
| Item 4. | <u>Controls and Procedures</u> | 26 |
| | <u>Part II - Other Information</u> | |
| Item 1. | <u>Legal Proceedings</u> | 27 |
| Item 1A. | <u>Risk Factors</u> | 27 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 27 |
| Item 5. | <u>Other Information</u> | 27 |
| Item 6. | <u>Exhibits</u> | 28 |
| | <u>Signatures</u> | 29 |

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

(In thousands, except per share data)

| | Three Months Ended January 31, 2016 2015 (Unaudited) | |
|--|--|-----------|
| Sales and service fees | \$ 56,503 | \$ 50,972 |
| Cost of sales and service | 38,805 | 34,425 |
| Gross profit | 17,698 | 16,547 |
| Selling, general and administrative expenses | 11,961 | 10,454 |
| Operating income | 5,737 | 6,093 |
| Interest expense | 24 | 69 |
| Interest income | 15 | 21 |
| Investment income (expense) | 102 | 65 |
| Other (income) expense, net | 226 | 307 |
| Income (loss) before taxes | 5,604 | 5,803 |
| Provision for income taxes | 1,709 | 2,037 |
| Net income (loss) | \$ 3,895 | \$ 3,766 |
| Income per common share | | |
| Basic | \$ 0.59 | \$ 0.57 |
| Diluted | \$ 0.58 | \$ 0.57 |

Weighted average common shares outstanding

| | | |
|--------------------------|---------|---------|
| Basic | 6,558 | 6,523 |
| Diluted | 6,623 | 6,569 |
| Dividends paid per share | \$ 0.08 | \$ 0.07 |

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

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

(In thousands)

| | Three Months Ended January 31, 2016 2015 (Unaudited) | |
|--|--|----------|
| Net income | \$ 3,895 | \$ 3,766 |
| Other comprehensive income (loss): | | |
| Translation of foreign currency financial statements | (2,411) | (5,056) |
| (Gain) / loss on derivative instruments reclassified into operations, net of tax \$(510) and \$200, respectively | (928) | 364 |
| Gain / (loss) on derivative instruments, net of tax \$93 and \$856, respectively | 169 | 1,556 |
| Total other comprehensive income (loss) | (3,170) | (3,136) |
| Comprehensive income | \$ 725 | \$ 630 |

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)

| | January 31, 2016 (Unaudited) | October 31, 2015 (Audited) |
|---|------------------------------------|----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 51,786 | \$ 55,237 |
| Accounts receivable, net | 38,402 | 41,766 |
| Inventories, net | 109,294 | 106,308 |
| Derivative assets | 1,596 | 1,228 |
| Prepaid assets | 10,333 | 9,769 |
| Other | 2,008 | 1,804 |
| Total current assets | 213,419 | 216,112 |
| Property and equipment: | | |
| Land | 841 | 841 |
| Building | 7,352 | 7,314 |
| Machinery and equipment | 24,162 | 24,026 |
| Leasehold improvements | 3,219 | 3,323 |
| | 35,574 | 35,504 |
| Less accumulated depreciation and amortization | (22,555) | (22,362) |
| Total property and equipment | 13,019 | 13,142 |
| Non-current assets: | | |
| Software development costs, less accumulated amortization | 4,063 | 3,905 |
| Goodwill | 2,286 | 2,319 |
| Intangible assets, net | 1,236 | 1,289 |
| Deferred income taxes | 4,701 | 4,721 |
| Investments and other assets, net | 7,296 | 7,089 |
| Total non-current assets | 19,582 | 19,323 |
| Total assets | \$ 246,020 | \$ 248,577 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 43,543 | \$ 43,458 |
| Accrued expenses and other | 13,716 | 16,788 |
| Accrued warranty expenses | 2,056 | 2,186 |
| Derivative liabilities | 1,631 | 1,071 |
| Short-term debt | 1,521 | 1,583 |
| Total current liabilities | 62,467 | 65,086 |
| Non-current liabilities: | | |
| Deferred income taxes | 3,600 | 3,998 |
| Accrued tax liability | 941 | 953 |
| Deferred credits and other | 3,909 | 3,972 |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

| | | |
|--|------------|------------|
| Total non-current liabilities | 8,450 | 8,923 |
| 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, 6,711,283 and 6,650,517 shares issued; and 6,564,017 and 6,551,718 shares outstanding, as of January 31, 2016 and October 31, 2015, respectively | 656 | 655 |
| Additional paid-in capital | 57,873 | 57,539 |
| Retained earnings | 129,130 | 125,760 |
| Accumulated other comprehensive loss | (12,556) | (9,386) |
| Total shareholders' equity | 175,103 | 174,568 |
| Total liabilities and shareholders' equity | \$ 246,020 | \$ 248,577 |

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 January 31, | |
|--|-----------------------------------|----------|
| | 2016 | 2015 |
| | (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 3,895 | \$ 3,766 |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities: | | |
| Provision for doubtful accounts | (52) | (52) |
| Deferred income taxes | 469 | (329) |
| Equity in income of affiliates | (150) | (43) |
| Depreciation and amortization | 962 | 726 |
| Foreign currency (gain) loss | 436 | 2,812 |
| Unrealized (gain) loss on derivatives | (60) | (2,625) |
| Stock-based compensation | 334 | 257 |
| Change in assets and liabilities: | | |
| (Increase) decrease in accounts receivable | 2,483 | 5,695 |
| (Increase) decrease in inventories | (6,256) | (360) |
| (Increase) decrease in prepaid expenses | (1,017) | (931) |
| Increase (decrease) in accounts payable | 1,457 | 236 |
| Increase (decrease) in accrued expenses | (2,887) | (2,026) |
| Net change in derivative assets and liabilities | 333 | 100 |
| Other | (681) | 1,259 |
| Net cash provided by (used for) operating activities | (734) | 8,485 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (635) | (321) |
| Proceeds from sale of equipment | 4 | 51 |
| Software development costs | (477) | (203) |
| Other investments | — | (155) |
| Net cash provided by (used for) investing activities | (1,108) | (628) |
| Cash flows from financing activities: | | |
| Dividends paid | (525) | (457) |
| Proceeds from exercise of common stock options | — | 189 |
| Restricted shares vested | 1 | 2 |
| Net cash provided by (used for) financing activities | (524) | (266) |
| Effect of exchange rate changes on cash | (1,085) | (1,582) |
| Net increase (decrease) in cash and cash equivalents | (3,451) | 6,009 |

| | | |
|--|-----------|-----------|
| Cash and cash equivalents at beginning of period | 55,237 | 53,846 |
| Cash and cash equivalents at end of period | \$ 51,786 | \$ 59,855 |

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 Three Months Ended January 31, 2016 and 2015**

| (In thousands, except shares outstanding) | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|--|-----------------------|--------|----------------------------------|----------------------|--|------------|
| | Shares Outstanding | Amount | | | | |
| Balances, October 31, 2014 | 6,508,880 | \$ 651 | \$ 55,974 | \$ 111,580 | \$ (3,560) | \$ 164,645 |
| Net income | — | — | — | 3,766 | — | 3,766 |
| Other comprehensive loss | — | — | — | — | (3,136) | (3,136) |
| Exercise of common stock options | 12,800 | 1 | 189 | — | — | 190 |
| Stock-based compensation | 16,303 | 2 | 255 | — | — | 257 |
| Dividends paid | — | — | — | (457) | — | (457) |
| Balances, January 31, 2015 (Unaudited) | 6,537,983 | \$ 654 | \$ 56,418 | \$ 114,889 | \$ (6,696) | \$ 165,265 |
| Balances, October 31, 2015 | 6,551,718 | \$ 655 | \$ 57,539 | \$ 125,760 | \$ (9,386) | \$ 174,568 |
| Net income | — | — | — | 3,895 | — | 3,895 |
| Other comprehensive loss | — | — | — | — | (3,170) | (3,170) |
| Stock-based compensation | 12,299 | 1 | 334 | — | — | 335 |
| Dividends paid | — | — | — | (525) | — | (525) |
| Balances, January 31, 2016 (Unaudited) | 6,564,017 | \$ 656 | \$ 57,873 | \$ 129,130 | \$ (12,556) | \$ 175,103 |

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 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 January 31, 2016 and for the three months ended January 31, 2016 and January 31, 2015 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, 2015.

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 in 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 which 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, Canadian Dollars, 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 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 January 31, 2016, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from February 2016 through December 2016. The contract amounts, expressed at forward rates in U.S. Dollars at January 31, 2016, were \$31.2 million for Euros, \$8.3 million for Pounds Sterling and \$21.9 million for New Taiwan Dollars. At January 31, 2016, we had approximately \$731,000 of gains, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive loss. Included in this amount were \$71,000 of unrealized losses, net of tax, related to cash flow hedge instruments that remain subject to currency fluctuation risk. The majority of these deferred gains will be recorded as an adjustment to Cost of sales and service in periods through December 2016, when the corresponding inventory that is the subject of the related hedge contracts is sold, as described above.

We are 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 2015. 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 2016. As of January 31, 2016, we had \$803,000 of realized gains and \$31,000 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 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 January 31, 2016, in Euros, Pounds Sterling, Canadian Dollars, South African Rand, and New Taiwan Dollars with set maturity dates ranging from February 2016 through April 2016. The contract amounts at forward rates in U.S. Dollars at January 31, 2016 totaled \$46.4 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 January 31, 2016 and October 31, 2015, all derivative instruments were recorded at fair value on the balance sheets as follows (in thousands):

| Derivatives | January 31, 2016 | | October 31, 2015 | |
|--|------------------------|------------|------------------------|------------|
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Designated as Hedging Instruments: | | | | |
| Foreign exchange forward contracts | Derivative assets | \$ 1,096 | Derivative assets | \$ 1,079 |
| Foreign exchange forward contracts | Derivative liabilities | \$ 1,206 | Derivative liabilities | \$ 1,027 |
| Not Designated as Hedging Instruments: | | | | |
| Foreign exchange forward contracts | Derivative assets | \$ 500 | Derivative assets | \$ 149 |
| Foreign exchange forward contracts | Derivative liabilities | \$ 425 | Derivative liabilities | \$ 44 |

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 January 31, 2016 and 2015 (in thousands):

| Derivatives | Amount of Gain (Loss) Recognized in Other Comprehensive Income (Loss) Three Months Ended January 31, <u>2016</u> <u>2015</u> | | Location of Gain (Loss) Reclassified from Other Comprehensive Income (Loss) | Amount of Gain (Loss) Reclassified from Other Comprehensive Income (Loss) Three Months Ended January 31, <u>2016</u> <u>2015</u> | |
|---|--|----------|---|--|-----------|
| | <u>Designated as Hedging Instruments:</u> (Effective portion) | | | | |
| Foreign exchange forward contracts – Intercompany sales/purchases | \$ 169 | \$ 1,556 | Cost of sales and service | \$ 928 | \$ (364) |
| Foreign exchange forward contract – Net investment | \$ 36 | \$ 239 | | | |

We did not recognize gains or losses as a result of hedges deemed ineffective for the three months ended January 31, 2016 or 2015. We recognized the following gains in our Condensed Consolidated Statements of Income during the three months ended January 31, 2016 and 2015 on derivative instruments not designated as hedging instruments (in thousands):

| Derivatives | Location of Gain (Loss) Recognized in Operations | Amount of Gain (Loss) Recognized in Operations | |
|---|--|---|----------|
| | | Three Months Ended January 31, | |
| | | 2016 | 2015 |
| <u>Not Designated as Hedging Instruments:</u> | | | |
| Foreign exchange forward contracts | Other (income) expense, net | \$ 139 | \$ 2,712 |

The following table presents the changes in the components of Accumulated other comprehensive loss, net of tax, for the three months ended January 31, 2016 (in thousands):

| | Foreign Currency Translation | Cash Flow Hedges | Total |
|--|------------------------------------|------------------------|------------|
| Balance, October 31, 2015 | \$ (10,884) | \$ 1,498 | \$(9,386) |
| Other comprehensive income (loss) before reclassifications | (2,411) | 169 | (2,242) |
| Reclassifications | — | (928) | (928) |
| Balance, January 31, 2016 | \$ (13,295) | \$ 739 | \$(12,556) |

3. EQUITY INCENTIVE PLAN

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, 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, restricted shares and performance shares under the 2008 Plan 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.

A summary of stock option activity for the three-month period ended January 31, 2016, is as follows:

| | Stock Options | Weighted Average Exercise Price |
|---------------------------------|------------------|--|
| Outstanding at October 31, 2015 | 107,889 | \$ 20.25 |
| Options granted | — | — |
| Options exercised | — | — |
| Options cancelled | — | — |
| Outstanding at January 31, 2016 | 107,889 | \$ 20.25 |

Summarized information about outstanding stock options as of January 31, 2016, that have already vested and those that are expected to vest, as well as stock options that are currently exercisable, are as follows:

| | Options Already Vested and Expected to Vest | Options Currently Exercisable |
|---|---|-------------------------------|
| Number of outstanding options | 107,889 | 107,889 |
| Weighted average remaining contractual life (years) | 5.12 | 5.12 |
| Weighted average exercise price per share | \$ 20.25 | \$ 20.25 |
| Intrinsic value of outstanding options | \$ 772,000 | \$ 772,000 |

The intrinsic value of an outstanding stock option is calculated as the difference between the stock price as of January 31, 2016 and the exercise price of the option.

On January 4, 2016, the Compensation Committee approved a long-term incentive compensation arrangement for our executive officers in the form of restricted shares and performance shares awarded under the 2008 Plan. The awards were 25% time-based vesting and 75% performance-based vesting. The three-year performance period is fiscal 2016 through fiscal 2018.

On this date, the Compensation Committee granted a total of 17,684 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 \$26.04 per share.

The Compensation Committee also granted a total target number of 24,023 performance shares to our executive officers designated as “Performance Shares – TSR”. The shares were weighted as 40% of the overall long-term incentive compensation arrangement and will vest and be paid based upon our total shareholder return of our common stock over a three-year period, relative to the total shareholder return of the companies in a specified peer group over that period. Participants will have the ability to earn between 50% of the target number of shares for achieving threshold performance and 200% of the target number of shares for achieving maximum performance. The fair value of the market-based performance shares was \$30.67 per share and was calculated using the Monte Carlo approach.

The Compensation Committee also granted a total target number of 24,759 performance shares to our executive officers designated as “Performance Shares – ROIC”. These shares were weighted as 35% of the overall long-term incentive compensation arrangement and will vest and be paid based upon the achievement of pre-established goals

related to our average return on invested capital over the three-year period. Participants will have the ability to earn between 50% of the target number of shares for achieving threshold performance and 200% of the target number of shares for achieving maximum performance. The grant date fair value of the ROIC performance shares was based on the closing sales price of our common stock on the grant date which was \$26.04 per share.

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

| | Number of Shares | Weighted Average Grant Date Fair Value |
|------------------------------|---------------------|--|
| Unvested at October 31, 2015 | 98,799 | \$ 28.89 |
| Shares granted | 66,466 | 27.71 |
| Shares vested | (12,299) | 25.28 |
| Shares withheld | (5,700) | 25.29 |
| Unvested at January 31, 2016 | 147,266 | \$ 28.80 |

During the first three months of fiscal 2016 and 2015, we recorded \$335,000 and \$257,000, respectively, as stock-based compensation expense related to grants under the 2008 plans. As of January 31, 2016, there was an estimated \$3.0 million of total unrecognized stock-based compensation cost that we expect to recognize by the end of the first quarter of fiscal 2019.

4. EARNINGS PER SHARE

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

| | Three Months Ended January 31, | | | |
|--|-----------------------------------|---------|---------|---------|
| | 2016 | | 2015 | |
| | Basic | Diluted | Basic | Diluted |
| Net income | \$3,895 | \$3,895 | \$3,766 | \$3,766 |
| Undistributed earnings allocated to participating shares | (22) | (22) | (23) | (23) |
| Net income applicable to common shareholders | \$3,873 | \$3,873 | \$3,743 | \$3,743 |
| Weighted average shares outstanding | 6,558 | 6,558 | 6,523 | 6,523 |
| Stock options and contingently issuable securities | — | 65 | — | 46 |
| | 6,558 | 6,623 | 6,523 | 6,569 |
| Income per share | \$0.59 | \$0.58 | \$0.57 | \$0.57 |

5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$688,000 as of January 31, 2016 and \$739,000 as of October 31, 2015.

6. INVENTORIES

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

| | January 31, 2016 | October 31, 2015 |
|------------------------------------|---------------------|---------------------|
| Purchased parts and sub-assemblies | \$ 26,214 | \$ 25,914 |
| Work-in-process | 21,287 | 20,575 |
| Finished goods | 61,793 | 59,819 |
| | \$ 109,294 | \$ 106,308 |

7. ACQUISITIONS OF BUSINESSES

On July 14, 2015, we acquired the assets of the machine tool business of Milltronics Manufacturing Company, Inc., a U.S.-based manufacturer of CNC mills, lathes, and vertical and horizontal machining centers. We are operating this U.S. business through our newly-formed subsidiary, Milltronics USA, Inc. (“Milltronics”). Also, on July 28, 2015, we acquired the assets of the machine tool business of Takumi Machinery Co., Ltd. (“Takumi”), a Taiwan-based designer and manufacturer of CNC vertical machining centers, double column machining centers, high speed bridge machines and other machine tools equipped with industrial controls. We are operating this Taiwan business through our subsidiary, Hurco Manufacturing Limited. These acquisitions contribute to our efforts to expand our consolidated product range, customer base and global platform, and accelerate emerging market penetration, particularly in strategic markets such as China and South America. The combined Hurco, Milltronics and Takumi businesses represent a comprehensive product portfolio with more than 150 different models. The combined machine tool product lines also provide benefits from the development of product enhancements, technologies and models due to leverage of shared resources and cross-utilization of proven engineering designs, allowing us to achieve manufacturing cost reductions from economies of scale and manufacturing efficiencies.

The acquisitions were accounted for in accordance with Accounting Standards Codification (“ASC”) Topic 805, Business Combinations. Accordingly, the total purchase price was allocated on a provisional basis to assets acquired and net liabilities assumed in connection with the acquisitions based on their estimated fair values as of the completion of the acquisitions. These allocations reflected various provisional estimates that were available at the time and were subject to change during the purchase price allocation period as valuations were finalized. All valuations are now final.

The following table summarizes the fair value of assets acquired and liabilities assumed as of the closing dates. The adjustments were due to the step-up in inventory and final valuation of property, plant and equipment. The total fair value of the net assets acquired was approximately \$17.7 million, which equated the total purchase prices of \$12.5 million for Milltronics and \$5.1 million for Takumi.

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

| (in thousands) | Initial Valuation | Adjustments | Adjusted Values |
|--|------------------------------|-------------|----------------------------|
| Current assets | \$ 22,091 | \$ 105 | \$ 22,196 |
| Property plant and equipment | 1,099 | (105) | 994 |
| Total assets | 23,190 | — | 23,190 |
| Current liabilities | 5,540 | — | 5,540 |
| Total purchase price and cash expended | \$ 17,650 | \$ — | \$ 17,650 |

The results of operations of Milltronics and Takumi have been included in our condensed consolidated financial statements from the respective dates of acquisitions.

8. 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.

9. 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 January 31, 2016, we had 16 outstanding third party payment guarantees totaling approximately \$1.1 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 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 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):

| | Three Months Ended January 31, | |
|--|-----------------------------------|----------|
| | 2016 | 2015 |
| Balance, beginning of period | \$ 2,186 | \$ 2,048 |
| Provision for warranties during the period | 688 | 782 |
| Charges to the reserve | (771) | (693) |
| Impact of foreign currency translation | (47) | (75) |
| Balance, end of period | \$ 2,056 | \$ 2,062 |

The year-over-year decrease in our warranty reserve reflected a reduction in sales volume and average warranty cost per claim in the North American and Asian Pacific regions.

10. DEBT AGREEMENTS

On December 7, 2012, we entered into an agreement (the “U.S. credit agreement”) with a financial institution that provided us with a \$12.5 million unsecured revolving credit and letter of credit facility. The U.S. credit agreement permitted the issuance of up to \$3.0 million in letters of credit. On May 9, 2014, the maximum amount for outstanding letters of credit under our U.S. credit agreement was increased from \$3.0 million to \$5.0.

On December 5, 2014, we amended our U.S. credit agreement to increase the cash dividend allowance from \$3.0 million per calendar year to \$4.0 million per calendar year and to extend the scheduled maturity date to December 7, 2016.

Borrowings under our U.S. credit agreement bear interest at a LIBOR-based rate or a floating rate of 1% above the prevailing prime rate. The floating rate will not be less than the greatest of (a) a one month LIBOR-based rate plus 1.00% per annum, (b) the federal funds effective rate plus 0.50% per annum, or (c) the prevailing prime rate. The rate we must pay for that portion of the U.S. credit agreement which is not utilized is 0.05% per annum.

The U.S. credit agreement contains customary financial covenants, including a covenant that permits us to make investments in subsidiaries of up to \$5.0 million, a minimum working capital of \$90.0 million and a minimum tangible net worth of \$120.0 million. The U.S. credit agreement permits us to pay cash dividends in an amount not to exceed \$4.0 million per calendar year, so long as we are not in default before and after giving effect to such dividends.

We have a £1.0 million revolving credit facility in the United Kingdom and a €1.5 million revolving credit facility in Germany. We also have a 40.0 million Chinese Yuan (approximately \$6.1 million) credit facility in China that was renewed on February 17, 2016 with an expiration date of February 16, 2017. We had \$1.5 million and \$1.6 million of borrowings under our China credit facility, which bears interest at 4.9% and 5.6% annually (variable rate), at January 31, 2016 and October 31, 2015, respectively. 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 January 31, 2016, we were in compliance with all covenants contained in the related credit agreements and, as of that date, we had unutilized credit facilities of \$20.1 million.

11. INCOME TAXES

Our effective tax rate for the first three months of fiscal 2016 was 31% in comparison to 35% for the same period in fiscal 2015. The decrease in the effective income tax rate was primarily due to changes in geographic mix of income and loss among tax jurisdictions. We recorded income tax expense during the first three months of fiscal 2016 of \$1.7 million compared to \$2.0 million for the same period in fiscal 2015, primarily as a result of a change in geographic mix of income period-over-period. We have not provided any U.S. income taxes on the undistributed earnings of our wholly-owned foreign subsidiaries based upon our determination that such earnings will be indefinitely reinvested. In 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 \$1.1 million as of January 31, 2016 and \$1.1 million as of October 31, 2015, 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 January 31, 2016, the gross amount of interest accrued, reported in Accrued expenses and other, was approximately \$41,000, 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 2017 and July 2019.

12. 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.

The following table represents the fair value hierarchy for our financial assets and liabilities measured at fair value as of January 31, 2016 and October 31, 2015 (in thousands):

| | Assets | | Liabilities | |
|-----------------------|------------------|------------------|------------------|------------------|
| | January 31, 2016 | October 31, 2015 | January 31, 2016 | October 31, 2015 |
| Level 1 | | | | |
| Deferred Compensation | \$1,242 | \$ 1,310 | \$- | \$ - |
| Level 2 | | | | |
| Derivatives | \$1,596 | \$ 1,228 | \$1,631 | \$ 1,071 |

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 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 consolidated financial statements at fair value. We have derivative financial instruments in the form of foreign currency forward exchange contracts as described in Note 2 of Notes to the Condensed Consolidated Financial Statements in which the U.S. Dollar equivalent notional amounts of these contracts was \$113.7 million and \$109.6 million at January 31, 2016 and October 31, 2015, respectively. The fair value of Derivative assets recorded on our Condensed Consolidated Balance Sheets was \$1.6 million at January 31, 2016 and \$1.2 million at October 31, 2015. The fair value of Derivative liabilities recorded on our Condensed Consolidated Balance Sheets was \$1.6 million at January 31, 2016 and \$1.1 million at October 31, 2015.

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

Certain assets and liabilities are measured at fair value on a nonrecurring basis and are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment. Assets and liabilities acquired in business combinations are recorded at their fair value as of the date of acquisition and are recognized as Level 3 measurements due to the subjective nature of the unobservable inputs used to determine the fair values. Refer to Note 7 for the fair values of assets acquired and liabilities assumed in connection with the Milltronics and Takumi acquisitions.

13. CONTINGENCIES AND LITIGATION

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.

14. NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncement:

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, which requires companies to present deferred income tax assets and deferred income tax liabilities as noncurrent in a classified balance sheet instead of the current requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts. ASU 2015-17 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted either prospectively or retrospectively. We adopted this accounting update in the first quarter of fiscal 2016 and applied it retrospectively to prior periods. The impact on our Condensed Consolidated Balance Sheets was a reduction in Total current assets of \$2.0 million and an increase in Total assets, Total non-current liabilities and Total liabilities and shareholders' equity of \$2.7 million as of October 31, 2015.

New Accounting Pronouncement:

In January 2016, the FASB issued ASU 2016-01 *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends the guidance on the classification and measurement of financial instruments under the fair value option, as well as the presentation and disclosure requirements for financial instruments. Among other things, ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. In addition, ASU 2016-01 requires public companies to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, to separate presentation of financial assets and financial liabilities by measurement category and form of financial asset, and to eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. ASU 2016-01 is effective for our fiscal year 2019, including interim periods within the fiscal year. We are assessing the impact this new accounting guidance will have on our consolidated financial statements.

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

EXECUTIVE OVERVIEW

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design, 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 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 first three months of fiscal 2016, approximately 51% of our revenues were 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 sell more of our entry-level, lower-priced machines, but where we also encounter greater price pressures.

During the third quarter of fiscal 2015, we acquired the assets of the machine tool business of Milltronics Manufacturing Company, Inc. and we are operating this U.S. business through our newly-formed wholly-owned subsidiary, Milltronics USA, Inc. ("Milltronics"). Milltronics manufactures and sells CNC knee mills, tool room bed mills, vertical machining centers, combination lathes, slant-bed lathes, horizontal machining centers, and bed mills. During the third quarter of fiscal 2015, we also acquired the assets of the machine tool business of Takumi Machinery Co., Ltd. ("Takumi"), a Taiwanese company that designs and manufactures CNC vertical machining centers, double column machining centers, high speed bridge machines and other machine tools, with sales primarily in Taiwan, China and Europe. Takumi machines are equipped with industrial controls from Fanuc, Siemens, Mitsubishi or Heidenhain which can be used in high-volume parts manufacturing. We are operating this Taiwanese business through our wholly-owned subsidiary Hurco Manufacturing Limited ("HML"). These acquisitions contribute to our efforts to expand our consolidated product range, customer base and global platform, and we believe may accelerate emerging market penetration, particularly in strategic markets such as China and South America. The combined Hurco, Milltronics and Takumi businesses represent a comprehensive product portfolio with more than 150 different models. The combined machine tool product lines also provides benefits related to the development of product enhancements, technologies and models due to leverage of shared resources and cross-utilization of proven engineering designs that

allow us to achieve manufacturing cost reductions from economies of scale and manufacturing efficiencies.

We sell our products through more than 170 independent agents and distributors throughout North and South America, Europe and Asia. 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. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly-owned subsidiary in Taiwan, HML. Machine castings and components to support HML's production are manufactured at our facility in Ningbo, China. Components to support our SRT line of five-axis machining center, such as the direct drive spindle, swivel head and rotary table, are manufactured by our wholly-owned subsidiary in Italy, LCM Precision Technology S.r.l. ("LCM").

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

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

RESULTS OF OPERATIONS

Three Months Ended January 31, 2016 Compared to Three Months Ended January 31, 2015

Sales and Service Fees. Sales and service fees for the first quarter of fiscal 2016 were \$56.5 million, an increase of \$5.5 million, or 11%, compared to the corresponding period in fiscal 2015. Excluding a negative currency impact of \$3.5 million, sales and service fees for the first quarter of fiscal 2016 reflected growth of \$9.1 million, or 18%, over the corresponding period in fiscal 2015. Sales for the first quarter of fiscal 2016 included \$11.0 million from the recently acquired businesses of Milltronics and Takumi.

The following two tables set forth net sales (in thousands) by geographic region and product category, respectively, for the first quarter of fiscal 2016 and 2015:

Sales and Service Fees by Geographic Region

| | Three Months Ended January 31, | | | | Change | |
|---------------|--------------------------------|------|----------|------|---------|------|
| | 2016 | | 2015 | | Amount | % |
| North America | \$18,941 | 34 % | \$14,851 | 29 % | \$4,090 | 28 % |
| Europe | 29,004 | 51 % | 31,800 | 62 % | (2,796) | -9 % |

Edgar Filing: HURCO COMPANIES INC - Form 10-Q

| | | | | | | |
|--------------|----------|-------|----------|-------|---------|------|
| Asia Pacific | 8,558 | 15 % | 4,321 | 9 % | 4,237 | 98 % |
| Total | \$56,503 | 100 % | \$50,972 | 100 % | \$5,531 | 11 % |

North American sales for the first quarter of fiscal 2016 increased by 28% compared to the corresponding period in fiscal 2015, primarily due to sales from the acquired business of Milltronics. Milltronics sales totaled \$6.1 million for the first quarter of fiscal 2016. Hurco acquired the assets of this business in July 2015 and is operating it through its newly-formed subsidiary, Milltronics USA, Inc. Milltronics manufactures and sells knee mills, tool room bed mills, vertical machining centers, combination lathes, slant-bed lathes, and horizontal machining centers. European sales for the first quarter of fiscal 2016 decreased by 9% compared to the corresponding period in fiscal 2015, reflecting sales growth of 1% offset by a negative currency impact of 10%. The year-over-year growth in European sales was driven by increased shipments of higher-performance machines in France and Italy. Asian Pacific sales for the first quarter of fiscal 2016 increased by 98% compared to the corresponding period in fiscal 2015, primarily due to sales from the acquired business of Takumi. Takumi sales totaled \$4.9 million for the first quarter of fiscal 2016. Hurco acquired certain assets of this Taiwan-based business in July 2015 and is operating it through its subsidiary, Hurco Manufacturing Limited. Takumi designs and manufactures CNC vertical machining centers, double column machining centers, high speed bridge machines and other machine tools equipped with industrial controls.

Sales and Service Fees by Product Category

| | Three Months Ended January 31, | | Change | |
|-------------------------------|--------------------------------|----------------|---------------|------|
| | 2016 | 2015 | Amount | % |
| Computerized Machine Tools | \$48,698 | 86 % \$43,746 | 86 % \$4,952 | 11 % |
| Service Fees, Parts and Other | 7,805 | 14 % 7,226 | 14 % 579 | 8 % |
| Total | \$56,503 | 100 % \$50,972 | 100 % \$5,531 | 11 % |

Orders. Orders for the first quarter of fiscal 2016 were \$51.3 million, an increase of \$6.3 million, or 14%, compared to the corresponding period in fiscal 2015. Excluding a negative currency impact of \$3.4 million, or 8%, orders reflected growth of \$9.7 million, or 22%, over the corresponding period in fiscal 2015. Orders for the first quarter of fiscal 2016 included \$6.2 million from the recently acquired businesses of Milltronics and Takumi.

Excluding the \$4.0 million of orders related to the recently acquired Milltronics business, orders for North America for the first quarter of fiscal 2016 were \$12.9 million, a decrease of \$1.1 million, or 8%, from the corresponding prior year period due to soft customer demand. European orders for the first quarter of fiscal 2016 were \$28.6 million, an increase of \$2.6 million, or 10%, compared to the corresponding prior year period, reflecting order growth of 21% offset by a negative currency impact of 11%. The year-over-year increase in orders was due to strong customer demand for our higher-performance machines in Germany, France and Italy. Asian Pacific orders for the first quarter of fiscal 2016 included \$2.2 million of orders related to the recently acquired Takumi business. Excluding the orders related to the Takumi business, Asian Pacific orders for the first quarter of fiscal 2016 was \$3.6 million, a decrease of \$1.5 million, or 30%, from the corresponding prior year period, primarily due to weaker market conditions, particularly in Southeast Asia.

Gross Profit. Gross profit for the first quarter of fiscal 2016 was \$17.7 million, or 31% of sales, compared to \$16.5 million, or 32% of sales, for the corresponding prior year period. The year-over-year variance in gross profit as a percentage of sales was due to the new mix of value and industrial brand Milltronics and Takumi machines with the higher-performance Hurco machines. In addition, increased pricing pressure and the negative impact of foreign currency also contributed to the slight decrease in gross profit as a percentage of sales.

Operating Expenses. Selling, general and administrative expenses for the first quarter of fiscal 2016 were \$12.0 million, or 21% of sales, compared to \$10.5 million, or 21% of sales, in the corresponding period in fiscal 2015. The year-over-year increase in selling, general and administrative expenses was driven primarily by increased agent commissions, marketing and tradeshow expenses and employee support costs for the global sales operations. The first quarter of fiscal 2016 amount included approximately \$1.2 million of Milltronics and Takumi operating expenses. Selling, general and administrative expenses were favorably impacted by approximately \$0.5 million, or 5%, when translating foreign expenses to U.S. Dollars for financial reporting purposes.

Operating Income. Operating income for the first quarter of fiscal 2016 was \$5.7 million compared to \$6.1 million for the corresponding period in fiscal 2015. The decrease in operating income year-over-year was primarily due to the new mix of value and industrial brand Milltronics and Takumi machines with the higher-performance Hurco machines, and increased agent commissions, marketing and tradeshow expenses and employee support costs for the global sales operations.

Other (Income) Expense, Net. Other expense in the first quarter of fiscal 2016 decreased by \$0.2 million from the corresponding period in fiscal 2015 as a result of increased income recorded under the equity method from a related party, Hurco Automation Limited.

Income Taxes. Our effective tax rate for the first quarter of fiscal 2016 was 30%, compared to 35% in the corresponding prior year period. The decrease in the effective income tax rate was primarily due to changes in geographic mix of income and loss among tax jurisdictions. We recorded income tax expense during the first quarter of fiscal 2016 of \$1.7 million compared to \$2.0 million for the corresponding period in fiscal 2015.

LIQUIDITY AND CAPITAL RESOURCES

At January 31, 2016, we had cash and cash equivalents of \$51.8 million, compared to \$55.2 million at October 31, 2015. Approximately 45% of the \$51.8 million of cash and cash equivalents is denominated in U.S. Dollars. The balance is attributable to our foreign operations and is held in the local currencies of our various foreign entities, subject to fluctuations in currency exchange rates. We do not believe that the indefinite reinvestment of these funds offshore impairs our ability to meet our domestic working capital needs.

Working capital, excluding cash and cash equivalents, was \$99.2 million at January 31, 2016 compared to \$95.8 million at October 31, 2015. The increase in working capital, excluding cash and cash equivalents, was primarily due to increased inventories and a reduction of accrued expenses due to payment of year-end employee bonuses during the first quarter of fiscal 2016.

Capital expenditures of \$1.1 million during the first three months of fiscal 2016 were primarily for capital improvements in existing facilities and software development costs. We funded these expenditures with cash on hand.

At January 31, 2016, 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 January 31, 2016, we had an aggregate of \$20.1 million available for borrowing under our credit facilities and were in compliance with all covenants.

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

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

CRITICAL ACCOUNTING POLICIES

Our accounting policies, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2015, 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 three months of fiscal 2016.

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, 2015.

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 January 31, 2016, we had 16 outstanding third party payment guarantees totaling approximately \$1.1 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 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:

- The cyclical nature of the machine tool industry;
- Uncertain economic conditions, which may adversely affect overall demand, particularly in Europe and Asia;
- 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 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.

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 January 31, 2016, 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 first three months of fiscal 2016, we derived approximately 66% 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 subsidiaries in Taiwan, 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 January 31, 2016, 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 in Foreign Currency | Weighted Avg. Forward Rate | Contract Amount at Forward Rates in U.S. Dollars Contract Date | January 31, 2016 | Maturity Dates |
|---------------------|--|-------------------------------|---|---------------------|-------------------------------|
| Sale Contracts: | | | | | |
| Euro | 28,700,000 | 1.1035 | \$31,669,425 | \$31,215,947 | February 2016 – December 2016 |
| Pound Sterling | 5,850,000 | 1.5174 | \$8,876,738 | \$8,335,752 | February 2016 – December 2016 |
| Purchase Contracts: | | | | | |
| New Taiwan Dollar | 735,000,000 | 31.964 | * \$22,994,478 | \$21,889,868 | February 2016 – December 2016 |

*NT Dollars per U.S. Dollar

Forward contracts for the sale or purchase of foreign currencies as of January 31, 2016, 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 | January 31, 2016 | Maturity Dates |
|----------------------------|--|-------------------------------|---|---------------------|--------------------------|
| Sale Contracts: | | | | | |
| Euro | 26,052,617 | 1.0927 | \$ 28,467,854 | \$ 28,276,964 | April 2016 |
| Pound Sterling | 236,400 | 1.4328 | \$ 338,714 | \$ 336,691 | February 2016 |
| Canadian Dollar | 645,180 | 0.7606 | \$ 490,697 | \$ 460,448 | April 2016 |
| South African Rand | 10,870,800 | 0.0676 | \$ 735,388 | \$ 672,388 | April 2016 |
| Purchase Contracts: | | | | | |
| New Taiwan Dollar | 559,375,954 | 33.090 | * \$ 16,904,720 | \$ 16,682,561 | February 2016–April 2016 |

* NT Dollars per U.S. Dollar

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we have maintained a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro-denominated assets. We selected the forward method under FASB guidance related to the accounting for derivatives instruments and hedging activities. The forward method requires all changes in the fair value of the contract to be reported as a cumulative translation adjustment in Accumulated other comprehensive loss, net of tax, in the same manner as the underlying hedged net assets. This forward contract matures in November 2016. At January 31, 2016, had \$803,000 of realized gains and \$31,000 of unrealized losses, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to the hedging of our net investment in Euro-denominated assets. Forward contracts for the sale or purchase of foreign currencies as of January 31, 2016, 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 | January 31, 2016 | Maturity Date |
|------------------------|--|-------------------------------|---|---------------------|---------------|
| Sale Contracts: | | | | | |
| Euro | 3,000,000 | 1.0775 | \$ 3,232,500 | \$ 3,279,867 | November 2016 |

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 January 31, 2016, 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 January 31, 2016 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. 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. Any claims that have been filed against us are properly reflected on our consolidated financial position and results of operations and 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, 2015.

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

The following table summarizes the purchases of common stock made by us during the three months ended January 31, 2016:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾ | Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs ⁽¹⁾ |
|---------------|---|------------------------------------|---|---|
| November 2015 | 0 | \$ 0 | 0 | \$ 0 |
| December 2015 | 3,429 | ⁽²⁾ \$ 23.30 | ⁽²⁾ 0 | \$ 0 |
| January 2016 | 2,271 | ⁽³⁾ \$ 28.28 | ⁽³⁾ 0 | \$ 0 |
| Total | 5,700 | \$ 25.29 | 0 | \$ 0 |

- (1) The Company does not have any publicly announced share repurchase plans or programs.
- (2) Represents shares of our common stock that were withheld to satisfy the income tax obligations of recipients of awards of 10,837 restricted shares granted under the 2008 Plan in connection with the vesting of such awards.
- (3) Represents shares of our common stock that were withheld to satisfy the income tax obligations of recipients of awards of 7,162 restricted shares granted under the 2008 Plan in connection with the vesting of such awards.

Item 5. OTHER INFORMATION

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

Item 6. EXHIBITS

10.1 Fiscal 2016 Short-Term Incentive Compensation Plan.

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.CAL XBRL Taxonomy Extension Calculation Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

SIGNATURES

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

HURCO COMPANIES, INC.

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

March 4, 2016