HURCO COMPANIES INC
Form 10-Q
September 03, 2010
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x 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	35-1150732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
One Technology Way Indianapolis, Indiana	46268
(Address of principal executive offices)	(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 x 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 x
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 x

The number of shares of the Registrant's common stock outstanding as of September 1, 2010 was 6,440,851.

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

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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 July 31		Nine Months Ended July 31	
	2010	2009	2010	2009
	(Unaudited)		(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.

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

	July 31 2010 (Unaudited)	October 31 2009 (Audited)
ASSETS		
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
LIABILITIES AND SHAREHOLDERS' EQUITY		
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

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 July 31		Nine Months Ended July 31	
	2010	2009	2010	2009
	(Unaudited)		(Unaudited)	
Cash flows from operating activities:				
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
Change in assets and liabilities:				
(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)
Cash flows from investing activities:				
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
Cash flows from financing activities:				
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 shares issued and outstanding)	Common stock		Additional		Accumulated other comprehensive	
	Shares issued & outstanding	Amount	paid-in capital	Retained earnings	income (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 financial statements	—	—	—	—	2,070	2,070
Realized gains on derivative instruments reclassified into operations, net of tax of $11	—	—	—	—	17	17
Unrealized loss on derivative instruments, net of tax of ($2,184)	—	—	—	—	(3,546)	(3,546)
Reversal of unrealized loss on investments, net of tax	—	—	—	—	202	202
Comprehensive loss	—	—	—	—	—	(2,415)
Exercise of common stock options	20,000	2	41	—	—	43
Stock-based compensation expense	—	—	186	—	—	186
Balances, July 31, 2009 (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 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.

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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 Fair value	Balance sheet location	2009 Fair value
Designated as hedging instruments:				
Foreign exchange forward contracts	Derivative assets	$ 1,256	Derivative assets	$ 74
Foreign exchange forward contracts	Derivative liabilities	$ 1,147	Derivative liabilities	$ 1,246
Not designated as hedging instruments:				
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 Three months ended July 31, 2010	2009	Location of gain (loss) reclassified from other comprehensive loss	Amount of gain (loss) reclassified from other comprehensive loss Three months ended July 31, 2010	2009
Designated as hedging instruments: (Effective portion)					
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)			

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) recognized in operations Three months ended July 31,	Amount of gain (loss) recognized in operations Three months ended July 31,	
		2010	2009
Not designated as hedging instruments:			
Foreign exchange forward contracts	Other (income) expense, net	$ (41)	$ (2,484)

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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) recognized in other comprehensive loss Nine months ended July 31, 2010	2009	Location of gain (loss) reclassified from other comprehensive loss	Amount of gain (loss) reclassified from other comprehensive loss Nine months ended July 31, 2010	2009
Designated as hedging instruments: (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) recognized in operations Nine months ended July 31,	Amount of gain (loss) recognized in operations Nine months ended July 31, 2010	2009
Not designated as hedging instruments:			