

HURCO COMPANIES INC  
Form 10-Q  
June 08, 2007

**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 April 30, 2007 or  
 Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 0-9143

**HURCO COMPANIES, INC.**

(Exact name of registrant as specified in its charter)

**Indiana**

(State or other jurisdiction of  
incorporation or organization)

**35-1150732**

(I.R.S. Employer Identification Number)

**One Technology Way  
Indianapolis, Indiana**

(Address of principal executive offices)

**46268**

(Zip code)

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

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

Yes  No

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

Large accelerated filer [  ] Accelerated filer [  ] Non-accelerated filer [  ]

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 June 7, 2007 was 6,389,720.

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**HURCO COMPANIES, INC.**  
April 2007 Form 10-Q Quarterly Report

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**PART I - FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS**

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

	Three Months Ended April 30,		Six Months Ended April 30,	
	2007 (unaudited)	2006	2007 (unaudited)	2006
Sales and service fees	\$ 42,494	\$ 36,861	\$ 89,372	\$ 68,755
Cost of sales and service	26,145	23,682	55,700	44,649
<b>Gross profit</b>	16,349	13,179	33,672	24,106
Selling, general and administrative expenses	9,405	7,140	18,655	13,436
<b>Operating income</b>	6,944	6,039	15,017	10,670
Interest (income) expense, net	(5)	80	39	164
Other expense, net	495	220	858	325
Income before taxes	7,444	6,179	15,836	10,831
Provision for income taxes	2,764	2,250	5,761	3,869
<b>Net income</b>	\$ 4,680	\$ 3,929	\$ 10,075	\$ 6,962
<b>Earnings per common share:</b>				
Basic	\$ .73	\$ .62	\$ 1.58	\$ 1.11
Diluted	\$ .73	\$ .62	\$ 1.57	\$ 1.09
<b>Weighted-average common shares outstanding:</b>				
Basic	6,373	6,291	6,373	6,291
Diluted	6,431	6,377	6,427	6,377

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

**HURCO COMPANIES, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEET**  
(Dollars in thousands)

	<b>April 30</b>		<b>October 31</b>
	<b>2007</b>		<b>2006</b>
	<b>(unaudited)</b>		<b>(audited)</b>
<b>ASSETS</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$ 34,457	\$	29,846
Accounts receivable	24,122		22,248
Inventories	45,149		43,343
Deferred tax assets	2,987		2,768
Other	3,796		2,677
Total current assets	110,511		100,882
<b>Property and equipment:</b>			
Land	761		761
Building	7,234		7,234
Machinery and equipment	13,633		12,952
Leasehold improvements	1,241		1,147
	22,869		22,094
Less accumulated depreciation and amortization	(13,580)		(12,944)
	9,289		9,150
<b>Non-current assets:</b>			
Deferred tax assets	1,021		1,121
Software development costs, less accumulated amortization	6,341		5,580
Investments and other assets	8,235		7,381
	\$ 135,397	\$	124,114
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities:</b>			
Accounts payable	\$ 27,883	\$	26,605
Accrued expenses	20,690		17,599
Current portion of long-term debt	-		136
Total current liabilities	48,573		44,340
<b>Non-current liabilities:</b>			
Long-term debt	-		3,874
Deferred credits and other	625		525
Total liabilities	49,198		48,739
<b>Shareholders' equity:</b>			
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, and 6,389,720 and 6,346,520 shares issued and outstanding, respectively	639		635
Additional paid-in capital	50,760		50,011
Retained earnings	38,555		28,480

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Accumulated other comprehensive income	(3,755)	(3,751)
Total shareholders' equity	86,199	75,375
	\$ 135,397	\$ 124,114

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



**HURCO COMPANIES, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**  
(Dollars in thousands)

	Three Months Ended April 30,		Six Months Ended April 30,	
	2007	2006	2007	2006
	(unaudited)		(unaudited)	
<b>Cash flows from operating activities:</b>				
Net income	\$ 4,680	\$ 3,929	\$ 10,075	\$ 6,962
Adjustments to reconcile net income to Net cash provided by (used for) operating activities:				
Provision for doubtful accounts	281	67	243	83
Equity in income of affiliates	(416)	(205)	(620)	(301)
Depreciation and amortization	396	367	787	732
Stock-based compensation	58		366	8
Change in operating assets and liabilities:				
(Increase) decrease in accounts receivable	1,370	(5,400)	(1,217)	(4,178)
(Increase) decrease in inventories	(4,219)	(4,189)	(524)	(5,168)
Increase (decrease) in accounts payable	3,770	7,984	1,136	9,951
Increase (decrease) in accrued expenses	2,292	1,558	497	(1,001)
Increase (decrease) in deferred asset	(573)	457	(496)	867
Other	(1,590)	(1,290)	(1,285)	(1,213)
<b>Net cash provided by operating activities</b>	<b>6,049</b>	<b>3,278</b>	<b>8,962</b>	<b>6,742</b>
<b>Cash flows from investing activities:</b>				
Purchase of property and equipment	(441)	(236)	(592)	(297)
Software development costs capitalized	(543)	(468)	(1,050)	(900)
Other investments	139	(182)	(160)	(341)
<b>Net cash used for investing activities</b>	<b>(845)</b>	<b>(886)</b>	<b>(1,802)</b>	<b>(1,538)</b>
<b>Cash flows from financing activities:</b>				
Repayment on first mortgage	(3,976)	(32)	(4,010)	(62)
Tax benefit from exercise of stock options	153	--	268	499
Proceeds from exercise of common stock options	22	--	119	530
<b>Net cash provided by (used for) financing activities</b>	<b>(3,801)</b>	<b>(32)</b>	<b>(3,623)</b>	<b>967</b>
<b>Effect of exchange rate changes on cash</b>	<b>728</b>	<b>288</b>	<b>1,074</b>	<b>480</b>

<b>Net increase in cash and cash equivalents</b>	2,131	2,648	4,611	6,651
<b>Cash and cash equivalents at beginning of period</b>	32,326	21,562	29,846	17,559
<b>Cash and cash equivalents at end of period</b>	\$ 34,457	\$ 24,210	\$ 34,457	\$ 24,210

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

**HURCO COMPANIES, INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**For the six months ended April 30, 2007 and 2006**  
**(Dollars in thousands except Shares Issued and Outstanding)**

	Common Stock		Additional	Retained	Accumulated		
	Shares Issued	Amount	Paid-In	Earnings	Other	Income	Total
	&		Capital	(Deficit)	Comprehensive	(Loss)	
	Outstanding		(Dollars in thousands)				
<b>Balances, October 31, 2005</b>	<b>6,220,220</b>	<b>\$ 622</b>	<b>\$ 48,701</b>	<b>\$ 13,001</b>	<b>\$ (3,380)</b>	<b>\$</b>	<b>\$ 58,944</b>
Net income	--	--	--	6,962	--	--	6,962
Translation of foreign currency financial statements	--	--	--	--	1,306	--	1,306
Unrealized gain on derivative instruments	--	--	--	--	(625)	--	(625)
Comprehensive income	--	--	--	--	--	--	7,643
Exercise of common stock options	120,800	12	518	--	--	--	530
Tax benefit from exercise of stock options	--	--	499	--	--	--	499
Stock-based compensation expense	--	--	8	--	--	--	8
<b>Balances, April 30, 2006</b>	<b>6,341,020</b>	<b>\$ 634</b>	<b>\$ 49,726</b>	<b>\$ 19,963</b>	<b>\$ (2,699)</b>	<b>\$</b>	<b>\$ 67,624</b>
<b>Balances, October 31, 2006</b>	<b>6,346,520</b>	<b>\$ 635</b>	<b>\$ 50,011</b>	<b>\$ 28,480</b>	<b>\$ (3,751)</b>	<b>\$</b>	<b>\$ 75,375</b>
Net income	--	--	--	10,075	--	--	10,075
Translation of foreign currency financial statements	--	--	--	--	1,365	--	1,365
Unrealized loss on derivative instruments	--	--	--	--	(1,369)	--	(1,369)

Comprehensive income	--	--	--	--	--	10,071
Exercise of common stock options	43,200	4	115	--	--	119
Tax benefit from exercise of stock options	--	--	268	--	--	268
Stock-based compensation expense	--	--	366	--	--	366
<b>Balances, April 30, 2007</b>	<b>6,389,720</b>	<b>\$ 639</b>	<b>\$ 50,760</b>	<b>\$ 38,555</b>	<b>\$ (3,755)</b>	<b>\$ 86,199</b>

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

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

1. GENERAL

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

The condensed financial information as of April 30, 2007 and for the three and six months ended April 30, 2007 and April 30, 2006 is unaudited; however, in our opinion, the interim data include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of our results for, and our financial position 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, 2006.

2. HEDGING

We enter into foreign currency forward exchange contracts periodically to hedge certain forecast inter-company sales and forecast inter-company and third party 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 Other Current Assets and Accrued Expenses. Gains and losses resulting from changes in the fair value of these hedge contracts are deferred in Accumulated Other Comprehensive Income and recognized as an adjustment to Cost of Sales in the period that the sale 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.

At April 30, 2007, we had \$1,817,000 of losses related to cash flow hedges deferred in Accumulated Other Comprehensive Income, net of tax. Of this amount, \$1,442,000 represented unrealized losses related to future cash flow hedge instruments that remain subject to currency fluctuation risk. These deferred losses will be recorded as an adjustment to Cost of Sales in the periods through December 2007, in which the sale that is the subject of the related hedge contract is recognized, as described above. Net losses on cash flow hedge contracts, which we reclassified from Other Comprehensive Income to Cost of Sales in the quarter ended April 30, 2007, were \$273,000 compared to net gains of \$346,000 for the same period in the prior year.

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 Statement of Financial Accounting Standards No. 133, “Accounting Standards for Derivative Instruments and Hedging Activities” (SFAS 133), and, as a result, changes in their fair value are reported currently as Other Expense (Income), Net in the Consolidated Statement of Operations consistent with the transaction gain or loss on the related foreign denominated receivable or payable. Such net transaction losses were \$27,000 and \$71,000 for the quarters ended April 30, 2007 and 2006, respectively.

### 3. STOCK OPTIONS

We have a stock option plan that allows us to grant awards of options to purchase shares of our common stock, stock appreciation rights, restricted shares and performance shares. Options granted under the plan are exercisable for a period up to ten years after the date of grant and vest in equal annual installments as specified by the Compensation Committee of our Board of Directors at the time of grant. The exercise price of options intended to qualify as incentive stock options may not be less than 100% of the fair market value of a share of common stock on the date of grant. During the first six months of fiscal 2007, options to purchase 43,200 shares were exercised, resulting in cash proceeds of approximately \$119,000 and an additional tax benefit of approximately \$268,000, compared to 120,800 shares exercised in the prior year period resulting in cash proceeds of \$530,000 and an additional tax benefit of approximately \$499,000.

Effective November 1, 2005, we adopted SFAS No. 123(R), "Share Based Payment," using the modified prospective method, and began applying its provisions to all options granted as well as to the nonvested portion of previously granted options outstanding at that date. Compensation expense is determined at the date of grant using the Black-Scholes valuation model.

On November 16, 2006, the Compensation Committee of the Board of Directors granted 40,000 shares under the 1997 Plan to certain employees and directors. The fair value of options awarded was estimated on the date of grant using a Black-Scholes valuation model with assumptions for expected volatility based on the historical volatility of the Company's stock, contractual term of the options of ten years and a risk-free interest rate based upon a three-year U.S. Treasury yield as of the date of grant. The options granted to employees vest in three equal annual installments and the directors' options were granted with immediate vesting as of the date of grant.

The weighted-average fair value of options granted during the six months ended April 30, 2007 was \$22.84 and \$24.97 for employees and directors, respectively. During the six months ended April 30, 2007 approximately \$366,000 of stock-based compensation expense had been recorded related to options granted under the 1997 Plan compared to \$8,000 for the same period in the prior year. As of April 30, 2007 there was approximately \$571,000 of total unrecognized stock-based compensation cost that is expected to be recognized over the next three years.

A summary of stock option activity for the six-month period ended April 30, 2007, is as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding at October 31, 2006	88,700	\$ 2.46
Options granted	40,000	\$ 26.69
Options exercised	(43,200)	\$ 2.78
Options cancelled	-	-
Outstanding at April 30, 2007	85,500	\$ 13.63

The total intrinsic value of stock options exercised during the six-month periods ended April 30, 2007 and 2006 was approximately \$1.8 million and \$3.2 million, respectively. The intrinsic value is calculated as the difference between the stock price as of April 30, 2007 and the exercise price of the stock option multiplied by the number of shares exercised.



Summarized information about outstanding stock options as of April 30, 2007, that is already vested and those that we expect to vest, as well as stock options that are currently exercisable, is as follows:

	Outstanding Stock Options Already Vested and Expected to Vest	Options that are outstanding and Exercisable
Number of outstanding options	85,500	55,500
Weighted average remaining contractual life	7.9	4.7
Weighted average exercise price per share	\$ 13.63	\$ 6.57
Intrinsic value	\$ 2,606,000	\$ 2,083,000

#### 4. EARNINGS PER SHARE

Basic and diluted earnings per common share are based on the weighted average number of our shares of common stock outstanding. Diluted earnings per common share give effect to outstanding stock options using the treasury method. The dilutive number of shares for the three months ended April 30, 2007 and 2006 was 58,000 and 86,000, respectively.

#### 5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowance for doubtful accounts of \$904,000 as of April 30, 2007 and \$635,000 as of October 31, 2006.

#### 6. INVENTORIES

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

	April 30, 2007	October 31, 2006
Purchased parts and sub-assemblies	\$ 10,231	\$ 7,645
Work-in-process	8,166	7,608
Finished goods	26,752	28,090
	\$ 45,149	\$ 43,343

#### 7. SEGMENT INFORMATION

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

#### 8. GUARANTEES



From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of certain machines to customers that use financing. At April 30, 2007 we had 54 outstanding third party guarantees totaling approximately \$1.6 million. The terms of our subsidiaries' guarantees are consistent with the underlying customer financing terms. Upon shipment, the customer has the risk of ownership, but does not obtain title until the machine is paid in full. A retention of title clause allows us to recover the machine if the customer defaults on the lease. We believe that the proceeds obtained from liquidation of the machine would cover any payments required by the guarantee.

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):

	Six months ended	
	4/30/07	4/30/06
Balance, beginning of period	\$ 1,926	\$ 1,618
Provision for warranties during the period	1,202	782
Charges to the accrual	(1,049)	(542)
Impact of foreign currency translation	65	72
Balance, end of period	\$ 2,144	\$ 1,930

#### 9. COMPREHENSIVE INCOME

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

	Three months ended	
	4/30/07	4/30/06
Net income	\$ 4,680	\$ 3,929
Translation of foreign currency financial statements	727	750
Unrealized gain (loss) on derivative instruments	(1,134)	(1,209)
Comprehensive income	\$ 4,273	\$ 3,470

#### 10. DEBT AGREEMENT

Effective February 27, 2007, we amended our domestic bank credit agreement to allow us to pay dividends and redeem or purchase our capital stock at any time unless we are then or would become in default. All other terms and conditions under this bank credit agreement remain unchanged.

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

**EXECUTIVE OVERVIEW**

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design and produce computerized machine tools, featuring our proprietary computer control systems and software, for sale through our distribution network to the worldwide metal cutting market. We also provide software options, control upgrades, accessories and replacement parts for our products, as well as customer service and training support. The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto appearing elsewhere in this report.

Our computerized metal cutting machine tools are manufactured in Taiwan to our specifications by our wholly owned subsidiary, Hurco Manufacturing Limited (HML), and a minority owned affiliate. We sell our products through more than 150 independent agents and distributors in countries throughout North America, Europe and Asia. We also have direct sales and service organizations in England, France, Germany, Italy, Singapore and China.

As part of our ongoing product development strategy, during the second quarter of fiscal 2007 we introduced two new products: WinMax Control Software and the VMX 84. The WinMax Control Software has a Windows(R) based interface and is designed to reduce setup time and improve surface finish. The new WinMax Control Software has 25 key new features and more than 200 enhancements. The VMX 84 with X/Y/Z Axis travels of 84/34/30 inches is our largest machining center and broadens our product line to meet the needs of customers who produce large parts, molds, and dies.

Approximately 88% of worldwide demand for machine tools comes from outside the United States. During fiscal 2005 and 2006, over two-thirds of our sales and service fees were attributable to customers located abroad. Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies—primarily the Euro and Pound Sterling—in the countries in which those customers are located. Our product costs are incurred and paid primarily in the New Taiwan Dollar and the U.S. Dollar. Changes in currency exchange rates may have a material effect on our consolidated statement of operations and balance sheet as reported under U.S. generally accepted accounting principles. For example, when a foreign currency increases in value relative to the U.S. Dollar, 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 that currency has a lower value relative to the U.S. Dollar. In the comparisons of our period-to-period results, we discuss not only the increases or decreases in those results as reported in our financial statements (which reflect translation to U.S. Dollars at prevailing exchange rates), but 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 hedging instruments - principally foreign currency forward exchange contracts.

The volatility of demand for machine tools can significantly impact our working capital requirements and, therefore, our cash flow from operations and our operating profits. Because our products are manufactured in Taiwan, manufacturing and ocean transportation lead times require that we schedule machine tool production based on forecasts of customer orders for a future period of four or five months. We continually monitor order activity levels and adjust future production schedules to reflect changes in demand, but a significant unexpected decline in customer orders from forecasted levels can temporarily increase our finished goods inventories and our use of working capital.

Our financial results for the second quarter of fiscal 2007 reflect increased revenues and operating income compared to the corresponding period of the prior year as a result of significant improvement in foreign markets, primarily in

Europe, as well as increased shipments of our larger and higher-priced machines in those markets. The second quarter results also reflect the benefit of a weaker U.S. Dollar when translating foreign sales for financial reporting purposes.

**RESULTS OF OPERATIONS****Three Months Ended April 30, 2007 Compared to Three Months Ended April 30, 2006**

*Sales and Service Fees.* Sales and service fees for the second quarter of fiscal 2007 were \$42.5 million, an increase of \$5.6 million, or 15%, from the amount reported for the prior year period. The growth of second quarter revenues was the result of significant improvement in demand, primarily in European markets, as well as increased shipments of our larger and higher-priced machines in those markets. As noted below, approximately 68% of our sales during the second quarter of fiscal 2007 were derived from European markets. Due to the effects of a weaker U.S. Dollar when translating foreign sales for financial reporting purposes, sales and service fees for the second quarter of fiscal 2007 were approximately \$2.8 million, or 8%, more than would have been the case if the foreign sales had been translated at the same rate of exchange that was utilized for the second quarter of fiscal 2006.

The following tables set forth net sales (in thousands) by geographic region and product category for the second quarter of 2007 and 2006:

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

	2007		April 30, 2006		Increase			
					Amount	%		
North America	\$	11,581	27.3%	\$	12,550	34.1%	\$ (969)	(7.7%)
Europe		28,694	67.5%		22,134	60.0%	6,560	29.6%
Asia Pacific		2,219	5.2%		2,177	5.9%	42	1.9%
Total	\$	42,494	100.0%	\$	36,861	100.0%	\$ 5,633	15.3%

Sales and service fees in Europe increased by 30% during the 2007 second quarter primarily due to continued market demand and increased penetration into new and existing markets, which resulted in a 22% increase in total unit shipments. The increased sales and service fees also reflect a favorable mix of higher-priced VMX product line shipments compared to the same period in the prior year. Sales and service fees in Europe for the second quarter of fiscal 2007 were favorably impacted by \$2.6 million, or 12%, when compared to the same period in the prior year, due to the effect of a weaker U.S. Dollar.

Sales and service fees in Asia increased 2% compared to the prior year period primarily due to a favorable shift in unit shipments from the TM and VM product lines to the higher-priced VMX product line.

Sales and service fees in North America decreased 8% compared to the prior year period primarily due to softening in the market, which resulted in decreased unit shipments of 7%.

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

	2007		April 30, 2006		Increase			
					Amount	%		
Computerized Machine Tools	\$	37,246	87.7%	\$	31,903	86.5%	\$ 5,343	16.7%
Service Fees, Parts and Other		5,248	12.3%		4,958	13.5%	290	5.8%
Total	\$	42,494	100.0%	\$	36,861	100.0%	\$ 5,633	15.3%

Sales of computerized machine tools during the second quarter of fiscal 2007 increased 17% over the corresponding period in fiscal 2006. The increase was driven by a 6% increase in overall unit shipments combined with the impact of a favorable product mix, particularly higher-priced VMX products, and the impact of a weaker U.S. Dollar when

translating foreign sales for financial reporting purposes.

*Orders.* New orders booked during the second quarter of fiscal 2007 totaled \$48.5 million, an increase of \$11.5 million, or 31%, over the amount recorded in the second quarter of fiscal 2006. Orders increased in Europe and Asia by 50% and 23%, respectively, compared to the second quarter of 2006 as a result of continued market demand and increased market penetration. North American orders decreased by 1% due to softening market conditions. Orders for the second quarter of fiscal 2007 were favorably impacted by \$3.2 million, or 9%, when compared to the same period in the prior year due to the effect of a weaker U.S. Dollar.

*Gross Margin.* Gross margin for the second quarter of fiscal 2007 was 39% compared to 36% for the prior year period, as a result of higher volume and a more favorable product mix.

*Operating Expenses.* Selling, general and administrative expenses were \$9.4 million, an increase of 32%, from the \$7.1 million reported for the prior year period. The increase was due to the effects of translation of foreign operating expenses for financial reporting purposes, as well as incremental variable expenses related to market expansion, commissions and compensation.

*Operating Income.* Operating income was \$6.9 million, or 16%, of sales and service fees, compared to \$6.0 million, or 16%, of sales and service fees for the prior year period.

*Other Expense (Income).* The increase in other income is the result of improved earnings of our affiliates accounted for using the equity method and increased interest income earned on short-term cash investments.

*Income Taxes.* Our provision for income taxes during the second quarter of fiscal 2007 was approximately \$514,000 higher than in the same period in fiscal 2006 as a result of increased operating income. Our effective tax rate for the second quarter of fiscal 2007 was 37% compared to 36% for the second quarter of 2006.

#### Six Months Ended April 30, 2007 Compared to Six Months Ended April 30, 2006

*Sales and Service Fees.* Sales and service fees for the first half of fiscal 2007 were \$89.4 million, an increase of \$20.6 million, or 30%, from the amount reported for the prior year period. The growth in revenues was primarily the result of significant improvement in demand, primarily in the European market, as well as increased shipments of our larger and higher-priced machines in that market. As noted below, approximately 67% of our sales during the first half of fiscal 2007 were derived from Europe. Due to the effects of a weaker U.S. Dollar when translating foreign sales for financial reporting purposes, sales and service fees for the first half of fiscal 2007 were approximately \$5.7 million, or 8%, more than would have been the case if foreign sales had been translated at the same rate of exchange that was utilized for the first half of fiscal 2006.

The following tables set forth net sales (in thousands) by geographic region and product category for the first half of 2007 and 2006:

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

	2007		April 30, 2006		Increase	
	\$	%	\$	%	Amount	%
North America	\$ 24,804	27.8%	\$ 24,880	36.2%	\$ (76)	(.3%)
Europe	60,188	67.3%	40,178	58.4%	20,010	49.8%
Asia Pacific	4,380	4.9%	3,697	5.4%	683	18.5%
Total	\$ 89,372	100.0%	\$ 68,755	100.0%	\$ 20,617	30.0%

Sales and service fees in Europe increased by 50% during the first half of fiscal 2007, primarily due to favorable market conditions and increased market penetration, which resulted in a 37% increase in total unit shipments. The increased sales and service fees also reflect a favorable mix of higher-priced VMX product line shipments compared

to the same period in the prior year. Sales and service fees in Europe for the first half of fiscal 2007 were favorably impacted by \$5.4 million, or 14% when compared to the same period in the prior year due to the effect of a weaker U.S. Dollar when translating foreign sales for financial reporting purposes.



Sales and service fees in Asia increased 19% compared to the prior year period primarily due to a favorable shift in unit shipments from the TM and VM product lines to the higher-priced VMX product line.

Unit shipments in North America were unchanged year over year, reflecting softening in the market.

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

	April 30,		2006		Increase	
	2007				Amount	%
Computerized Machine Tools	\$ 78,993	88.4%	\$ 59,267	86.2%	\$ 19,726	33.3%
Service Fees, Parts and Other	10,379	11.6%	9,488	13.8%	891	9.4%
Total	\$ 89,372	100.0%	\$ 68,755	100.0%	\$ 20,617	30.0%

Sales of computerized machine tools during the first half of fiscal 2007 increased 33% over the corresponding period in fiscal 2006. The increase was driven by a 17% increase in overall unit shipments combined with the impact of a more favorable mix, particularly higher-priced VMX products, and the impact of a weaker U.S. Dollar when translating foreign sales for financial reporting purposes.

*Orders.* New orders booked during the first half of fiscal 2007 totaled \$95.6 million, an increase of \$20.8 million, or 28%, over the amount recorded in the first half of fiscal 2006. Orders increased in Europe by 51.3% compared to the first half of 2006. Orders decreased in North America and Asia by 5% and 2%, respectively, due to softening in the U.S. machine tool market and timing of order activity in Asia. Orders for the first half of fiscal 2007 were favorably impacted by \$6.2 million, or 8%, when compared to the same period in the prior year due to the effect of a weaker U.S. Dollar when translating foreign orders for financial reporting purposes.

*Gross Margin.* Gross margin for the first half of fiscal 2007 was 38% compared to 35% for the prior year period, as a result of higher volume and more favorable mix.

*Operating Expenses.* Selling, general and administrative expenses were \$18.7 million, an increase of 40%, from the \$13.4 million reported for the prior year period. The increase was due to the effects of translation of foreign operating expenses for financial reporting purposes, as well as incremental variable expenses related to market expansion, commissions and compensation.

*Operating Income.* Operating income was \$15.0 million, or 17%, of sales and service fees, compared to \$10.7 million, or 16% of sales and service fees for the prior year period.

*Other Expense (Income).* The increase in other income is the result of improved earnings of our affiliates accounted for using the equity method and increased interest income earned on short-term cash investments.

*Income Taxes.* Our provision for income taxes during the first half of fiscal 2007 was approximately \$1.9 million higher than in the same period in fiscal 2006 as a result of increased operating income. Our effective tax rate for the first half of fiscal 2007 was unchanged at 36% compared to the first half of 2006.

#### LIQUIDITY AND CAPITAL RESOURCES

At April 30, 2007, we had cash and cash equivalents of \$34.5 million, compared to \$29.8 million at October 31, 2006. Approximately 45% of the \$34.5 million of cash and cash equivalents is denominated in U.S. Dollars. The remaining balances are held outside the U.S. in the local currencies of our various foreign entities and are subject to fluctuations

in currency exchange rates. Cash generated from operations totaled \$9.0 million for the first half of fiscal 2007, compared to \$6.7 million in the prior year period, and was driven by increased net income.

Working capital, excluding short-term debt, was \$61.9 million at April 30, 2007, compared to \$56.7 million at October 31, 2006.

Capital investments during the first half of fiscal 2007 included normal expenditures for software development projects and purchases of equipment. We funded these expenditures with cash flow from operations.

We eliminated our debt balance by repaying the \$4.0 million mortgage for the Indianapolis facility on April 30, 2007. We have an \$11.4 million credit facility, which had no outstanding borrowings as of April 30, 2007.

Effective February 27, 2007, we amended our domestic bank credit agreement to allow us to pay dividends and redeem or purchase our capital stock at any time unless we are then or would become in default. All other terms and conditions under this bank credit agreement remain unchanged.

Although we have not made any significant acquisitions in the recent past, we may acquire other businesses and assets, including intellectual property assets, in the future. Should attractive opportunities arise, we believe that our earnings, cash flow from operations and balance sheet will allow us to obtain any necessary additional capital.

### **NEW ACCOUNTING PRONOUNCEMENTS**

In July 2006, the FASB released Interpretation No. 48 “Accounting for Uncertainty in Income Taxes,” an interpretation of FASB Statement No. 109 which clarifies the accounting and reporting for uncertainties in income taxes. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expect to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We will be required to adopt and report the impact of FIN No. 48 in the first quarter of fiscal year 2008. We have not begun implementation of FIN No. 48 and therefore cannot report the potential impact of implementation.

During 2006, the FASB released Statement No. 157, “Fair Value Measurements”, a new standard which provides further guidance on using fair value to measure assets and liabilities, the information used to measure fair value and the effect of fair value measurements on earnings. Statement No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, but does not expand the use of fair value in any new circumstances. We will be required to adopt and report the impact of Statement No. 157 in the first quarter of fiscal year 2008. We have not begun implementation of Statement No. 157 and therefore cannot report the potential impact of the implementation.

In February 2007, the FASB released Statement No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities”, a new standard that permits an entity to choose to measure many financial instruments and certain other items at fair value. The objective of this statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Statement No. 159 is effective in the first quarter of fiscal 2008. We have not begun implementation of Statement No. 159 and therefore cannot report the potential impact of the implementation.

In September 2006, the U.S. Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (SAB 108). SAB 108 was issued in order to eliminate the diversity in practice surrounding how public companies quantify financial statement misstatements. SAB 108 requires that registrants quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 must be implemented by the end of fiscal 2007. We have not begun implementation of SAB 108 and therefore cannot report the potential impact of the implementation.



## **CRITICAL ACCOUNTING POLICIES**

Our accounting policies, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2006, require our 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 half of 2007.

## **CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

There have been no material changes from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2006.

## **OFF BALANCE SHEET ARRANGEMENTS**

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of certain machines to customers that use financing. At April 30, 2007 we had 54 outstanding third party guarantees totaling approximately \$1.6 million. The terms of our subsidiaries' guarantees are consistent with the underlying customer financing terms. Upon shipment, the customer has the risk of ownership, but does not obtain title until the machine is paid in full. A retention of title clause allows us to recover the machine if the customer defaults on the lease. We believe that the proceeds obtained from liquidation of the machine would cover any payments required by the guarantee.

## 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;
  - The risks of our international operations;
- The limited number of our manufacturing sources;
- The effects of changes in currency exchange rates;
  - Our dependence on new product development;
  - The need to make technological advances;
- Competition with larger companies that have greater financial resources;
- Changes in the prices of raw materials, especially steel and iron products;
  - Possible obsolescence of our technology;
  - Impairment of our goodwill or other assets;
- The need to protect our intellectual property assets; and
  - The effect of the loss of key personnel.

We discuss these and other important risks and uncertainties that may affect our future operation in Part I, Item 1A - Risk Factors in our most recent Annual Report on Form 10-K and may update that discussion in Part II, Item 1A - Risk Factors in this or another 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 RISKInterest Rate Risk

Interest on borrowings on our bank credit facilities are tied to prevailing U.S. and European interest rates. At April 30, 2007, there were no outstanding borrowings under our bank credit facilities.

Foreign Currency Exchange Risk

In fiscal 2007, over two-thirds of our sales and service fees, including export sales, were derived from foreign markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

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

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

Forward contracts for the sale or purchase of foreign currencies as of April 30, 2007 which are designated as cash flow hedges under SFAS No. 133 were as follows:

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Dates
			Contract Date	April 30, 2007	
<b>Sale Contracts:</b>					
Euro	32,275,000	1.3234	42,712,735	44,273,048	May 2007 - April 2008
Pound Sterling	4,585,000	1.9287	8,843,090	9,150,531	May 2007 - April 2008
<b>Purchase Contracts:</b>					
New Taiwan Dollar	825,000,000	32.48*	25,401,498	24,885,122	May 2007 - January 2008

\*NT Dollars per U.S. Dollar



Forward contracts for the sale or purchases of foreign currencies as of April 30, 2007, which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables and are not designated as hedges under SFAS 133, "Accounting Standards for Derivative Instruments and Hedging Activities" 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		Maturity Dates
			Contract Date	April 30, 2007	
<b>Sale Contracts:</b>					
Euro	12,713,322	1.3467	17,121,030	17,380,961	May 2007 - June 2007
Singapore Dollar	6,305,636	0.6607	4,166,261	4,170,241	May 2007 - July 2007
Pound Sterling	1,329,254	1.9863	2,640,297	2,657,156	May 2007 - June 2007
<b>Purchase Contracts:</b>					
New Taiwan Dollar	354,100,000	33.06*	10,712,265	10,627,628	May 2007 - July 2007

\* NT Dollars per U.S. Dollar

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 April 30, 2007 pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the evaluation date.

There were no changes in our internal controls over financial reporting during the quarter ended April 30, 2007 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

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

**Item 1A. RISK FACTORS**

There have been no material changes from the risk factors disclosed in Part I, Item 1A - Risk Factors in our Annual Report on Form 10-K for the year ended October 31, 2006.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Our annual meeting of the shareholders was held on March 14, 2007. The election of seven directors to the Board of Directors was the only matter submitted to a vote.

The following table sets forth the results of voting on this matter.

<b>Election of Directors Name</b>	<b>Number of Votes FOR</b>	<b>Number of Votes AGAINST or WITHHELD</b>	<b>Abstentions or Broker Non-Votes</b>
Stephen H. Cooper	5,576,883	321,321	482,316
Robert W. Cruickshank	5,244,271	653,933	482,316
Michael Doar	5,594,770	303,434	482,316
Michael P. Mazza	5,600,726	297,478	482,316
Richard T. Niner	5,595,193	303,011	482,316
O. Curtis Noel	5,587,693	310,511	482,316
Charlie Rentschler	5,590,493	307,711	482,316

In addition, as previously reported, on April 5, 2007 the board of directors elected Philip James as an eighth director. All of our directors serve annual terms of office.

**Item 5. OTHER INFORMATION**

During the period covered by this report, the Audit Committee of our Board of Directors did not engage our independent registered public accounting firm to perform any non-audit 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 Second Amendment to Third Amended and Restated Credit Agreement between the Registrant and JPMorgan Chase Bank, N.A. dated as of February 27, 2007.
- 11 Computation of per share earnings.
- 31.1 Certification by the Chief Executive Officer, pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended.
- 31.2 Certification by the Chief Financial Officer, pursuant to Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended.
- 32.1 Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

HURCO COMPANIES, INC.

By: /s/ John G. Oblazney  
John G. Oblazney  
Vice President and  
Chief Financial Officer

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

June 8, 2007