

HURCO COMPANIES INC
Form 10-Q
June 03, 2011

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 April 30, 2011 or

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

Commission File No. 0-9143

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

Indiana
(State or other jurisdiction of
incorporation or organization)

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

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

46268
(Zip code)

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

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

Yes ☒ No ☐

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

Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

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

Smaller reporting company ☐

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 1, 2011 was 6,440,851.

HURCO COMPANIES, INC.
April 2011 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 April 30		Six Months Ended April 30	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
Sales and service fees	\$41,576	\$24,088	\$81,256	\$44,704
Cost of sales and service	28,925	19,411	56,914	36,047
Gross profit	12,651	4,677	24,342	8,657
Selling, general and administrative expenses	9,254	7,230	18,084	13,763
Operating income (loss)	3,397	(2,553)	6,258	(5,106)
Interest expense	9	8	14	22
Interest income	32	5	72	25
Investment income	2	3	7	8
Other (income) expense, net	23	116	479	393
Income (loss) before taxes	3,399	(2,669)	5,844	(5,488)
Provision (benefit) for income taxes	1,050	(1,096)	1,949	(2,079)
Net income (loss)	\$2,349	\$(1,573)	\$3,895	\$(3,409)
Income (losses) per common share				
Basic	\$.36	\$(0.24)	\$.60	\$(0.53)
Diluted	\$.36	\$(0.24)	\$.60	\$(0.53)
Weighted average common shares outstanding				
Basic	6,441	6,441	6,441	6,441
Diluted	6,489	6,441	6,476	6,441

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)

	April 30 2011 (Unaudited)	October 31 2010 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$48,678	\$48,255
Accounts receivable, net	24,175	20,114
Refundable taxes	4,387	5,093
Inventories, net	69,610	55,866
Deferred income taxes	2,965	2,467
Derivative assets	1,530	905
Other	5,458	3,508
Total current assets	156,803	136,208
Non-current assets:		
Property and equipment:		
Land	782	782
Building	7,116	7,116
Machinery and equipment	15,901	15,095
Leasehold improvements	2,334	2,183
	26,133	25,176
Less accumulated depreciation and amortization	(14,804)	(13,424)
	11,329	11,752
Software development costs, less accumulated amortization	5,588	6,042
Investments and other assets, net	6,268	6,344
	\$179,988	\$160,346
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$38,745	\$30,394
Accrued expenses and other	10,482	8,132
Accrued warranty expenses	1,778	1,591
Derivative liabilities	4,230	2,123
Short-term debt	647	—
Total current liabilities	55,882	42,240
Non-current liabilities:		
Deferred income taxes	2,440	2,335
Deferred credits and other	1,152	1,031
Total liabilities	59,474	45,606
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, 6,471,710 and 6,440,851 shares issued; and 6,440,851 and 6,440,851 shares outstanding,	644	644

as of April 30, 2011 and October 31, 2010, respectively

Additional paid-in capital	52,338	52,144
Retained earnings	67,719	63,824
Accumulated other comprehensive loss	(187)	(1,872)
Total shareholders' equity	120,514	114,740
	\$ 179,988	\$ 160,346

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 April 30		Six Months Ended April 30	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
Cash flows from operating activities:				
Net income (loss)	\$2,349	\$(1,573)	\$3,895	\$(3,409)
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:				
Provision for doubtful accounts	(256)	(74)	(202)	(189)
Deferred income taxes	110	(243)	230	(783)
Equity in (income) loss of affiliates	(22)	69	(17)	181
Depreciation and amortization	1,079	1,000	2,146	1,833
Foreign currency (gain) loss	(3,306)	1,365	(3,320)	3,584
Unrealized (gain) loss on derivatives	(422)	(173)	(288)	(835)
Stock-based compensation	123	31	194	49
Change in assets and liabilities:				
(Increase) decrease in accounts receivable and refundable taxes	(4,364)	(1,609)	(2,084)	(403)
(Increase) decrease in inventories	(7,863)	2,135	(10,831)	7,413
Increase (decrease) in accounts payable	8,376	4,876	6,622	4,649
Increase (decrease) in accrued expenses	(152)	(336)	1,765	(1,067)
Net change in derivative assets and liabilities	1,044	(1)	587	(1,039)
Other	845	(1,042)	1,201	(848)
Net cash provided by (used for) operating activities	(2,459)	4,425	(102)	9,136
Cash flows from investing activities:				
Proceeds from sale of property and equipment	—	35	—	35
Purchase of property and equipment	(207)	(67)	(375)	(249)
Software development costs	(279)	(202)	(652)	(495)
Other investments	28	(8)	16	(17)
Net cash provided by (used for) investing activities	(458)	(242)	(1,011)	(726)
Cash flows from financing activities:				
Advances on short-term debt	637	—	637	—
Effect of exchange rate changes on cash	669	(546)	899	(1,174)
Net increase (decrease) in cash and cash equivalents	(1,611)	3,637	423	7,236
Cash and cash equivalents at beginning of period	50,289	32,381	48,255	28,782
Cash and cash equivalents at end of period	\$48,678	\$36,018	\$48,678	\$36,018

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 six months ended April 30, 2011 and 2010
(Unaudited)

(In thousands, except shares outstanding)	Common stock		Additional	Retained	Accumulated other comprehensive income (loss)	Total
	Shares outstanding	Amount	paid-in capital	earnings		
Balances, October 31, 2009	6,440,851	\$ 644	\$ 52,003	\$ 69,568	\$ (1,839)	\$ 120,376
Net loss	—	—	—	(3,409)	—	(3,409)
Translation of foreign currency financial statements	—	—	—	—	(1,617)	(1,617)
Realized loss on derivative instruments reclassified into operations, net of tax of \$46	—	—	—	—	75	75
Unrealized gain on derivative instruments, net of tax of \$533	—	—	—	—	865	865
Comprehensive loss	—	—	—	—	—	(4,086)
Stock-based compensation expense	—	—	49	—	—	49
Balances, April 30, 2010 (Unaudited)	6,440,851	\$ 644	\$ 52,052	\$ 66,159	\$ (2,516)	\$ 116,339
Balances, October 31, 2010	6,440,851	\$ 644	\$ 52,144	\$ 63,824	\$ (1,872)	\$ 114,740
Net income	—	—	—	3,895	—	3,895
Translation of foreign currency financial statements	—	—	—	—	2,888	2,888
Realized gain on derivative instruments reclassified into operations, net of tax of \$(184)	—	—	—	—	(313)	(313)
Unrealized loss on derivative instruments, net of tax of \$(523)	—	—	—	—	(890)	(890)
Comprehensive income	—	—	—	—	—	5,580

Stock-based compensation expense	—	—	194	—	—	194
Balances, April 30, 2011 (Unaudited)	6,440,851	\$644	\$52,338	\$67,719	\$ (187)	\$120,514

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, 2011 and for the three and six months ended April 30, 2011 and April 30, 2010 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, 2010.

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.

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 subsidiary's 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 April 30, 2011, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from May 2011 through April 2012. The contract amounts, expressed at forward rates in U.S. Dollars at April 30, 2011, were \$38.4 million for Euros, \$10.5 million for Pounds Sterling and \$33.5 million for New Taiwanese Dollars. At April 30, 2011, we had approximately \$1.6 million of losses, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive loss. Of this amount, \$1.4 million 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 April 2012, 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 matures in November 2011. At April 30, 2011, we had \$216,000 of realized gains and \$226,000 of unrealized losses, 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 guidance of the Financial Accounting Standards Board, or FASB, 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 April 30, 2011, in Euros, Pounds Sterling, Canadian Dollars, South African Rand, Singapore Dollars and New Taiwan Dollars with set maturity dates ranging from May 2011 through September 2011. The amounts of these contracts at forward rates in U.S. Dollars at April 30, 2011 for Euros, Pounds Sterling, Canadian Dollars, South African Rand, New Taiwan Dollars and Singapore Dollars totaled \$28.3 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 April 30, 2011 and October 31, 2010, all derivative instruments were recorded at fair value on the balance sheets as follows (in thousands):

Derivatives	2011 Balance sheet location	Fair value	2010 Balance sheet location	Fair value
Designated as hedging instruments:				
Foreign exchange forward contracts	Derivative assets	\$ 1,306	Derivative assets	\$ 872
Foreign exchange forward contracts	Derivative liabilities	\$ 3,963	Derivative liabilities	\$ 1,778
Not designated as hedging instruments:				
Foreign exchange forward contracts	Derivative assets	\$ 224	Derivative assets	\$ 33
Foreign exchange forward contracts	Derivative liabilities	\$ 267	Derivative liabilities	\$ 345

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 six months ended April 30, 2011 and 2010 (in thousands):

Derivatives	Amount of gain (loss) recognized in Other comprehensive loss		Location of gain (loss) reclassified from Other comprehensive loss	Amount of gain (loss) reclassified from Other comprehensive loss	
	Six months ended April 30, 2011	2010		Six months ended April 30, 2011	2010
Designated as hedging instruments: (Effective portion)					
Foreign exchange forward contracts			Cost of sales and service		
– Intercompany sales/purchases	\$ (1,413)	\$ 1,398		\$ 497	\$ (121)
Foreign exchange forward contract					
– Net investment	\$ (279)	\$ 401			

We recognized a loss of \$25,000 for the six months ended April 30, 2011, and a loss of \$65,000 for the six months ended April 30, 2010 as a result of contracts closed early that were deemed ineffective for financial reporting purposes.

Derivatives	Location of gain (loss) recognized in operations	Amount of gain (loss) recognized in operations	
		Six months ended April 30, 2011	2010

Not designated as hedging instruments:

Foreign exchange forward contracts	Other (income) expense, net	\$ (548)	\$ 1,334
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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 three months ended April 30, 2011 and 2010 (in thousands):

Derivatives	Amount of gain (loss) recognized in Other comprehensive loss		Location of gain (loss) reclassified from Other comprehensive loss	Amount of gain (loss) reclassified from Other comprehensive loss	
	Three months ended April 30, 2011	2010		Three months ended April 30, 2011	2010

Designated as hedging instruments:
(Effective portion)Foreign exchange forward
contracts

– Intercompany sales/purchases	\$ (2,983)	\$ 568	Cost of sales and service	\$148	\$ (149)
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Foreign exchange forward contract

– Net investment	\$ (335)	\$ 156
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We recognized a loss of \$18,000 for the three months ended April 30, 2011, and a loss of \$65,000 for the three months ended April 30, 2010 as a result of contracts closed early that were deemed ineffective for financial reporting purposes.

Derivatives	Location of gain (loss) recognized in operations	Amount of gain (loss) recognized in operations	
		Three months ended April 30, 2011	2010

Not designated as hedging instruments:

Foreign exchange forward contracts	Other (income) expense, net	\$ (1,040)	\$ 454
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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 (the “1997 Plan”) which expired in March 2007. The Compensation Committee of the Board of Directors has authority to determine the officers, directors and key employees who will be granted awards; designate the number of shares subject to each award; determine the terms and conditions upon which awards will be granted; and prescribe the form and terms of award agreements. We have granted stock options under both plans which are currently outstanding and restricted shares under the 2008 Plan. 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 six-month period ended April 30, 2011, is as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding at October 31, 2010	115,369	\$ 20.66
Options granted	—	—
Options exercised	—	—
Options cancelled	—	—
Outstanding at April 30, 2011	115,369	\$ 20.66

Summarized information about outstanding stock options as of April 30, 2011, that are already vested and those that are expected to vest, as well as stock options that are currently exercisable, are as follows:

	Options already vested and expected to vest	Options currently exercisable
Number of outstanding options	115,369	68,369
Weighted average remaining contractual life (years)	7.51	5.30
Weighted average exercise price per share	\$ 20.66	\$ 23.69
Intrinsic value of outstanding options	\$ 1,400,000	\$ 635,000

The intrinsic value of an outstanding stock option is calculated as the difference between the stock price as of April 30, 2011 and the exercise price of the option.

On December 22, 2010, the Compensation Committee granted a total of 25,000 shares of restricted stock to our executive officers. The restricted stock vests in full three years from the date of grant provided the recipient remains

employed by us through that date. The grant date fair value of the restricted stock is based on the closing sales price of our common stock on the grant date which was \$23.10 per share.

On March 17, 2011, the Compensation Committee granted a total of 5,859 shares of restricted stock to our board of directors. The restricted stock vests one year from the date of grant provided the recipient remains on the board of directors through that date. The grant date fair value of the restricted stock is based on the closing sales price of our common stock on the grant date which was \$29.86 per share.

A reconciliation of the Company's restricted stock activity and related information is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested at October 31, 2010	—	\$ —
Shares granted	30,859	24.38
Shares vested	—	—
Shares cancelled	—	—
Unvested at April 30, 2011	30,859	\$ 24.38

During the first six months of fiscal 2011 and 2010, we recorded \$194,000 and \$49,000, respectively, of stock-based compensation expense related to grants of stock options and shares of restricted stock under the plans. As of April 30, 2011, there was \$1.0 million of total unrecognized stock-based compensation cost that we expect to recognize by the end of fiscal 2014.

4. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares actually outstanding during the period. Diluted earnings (loss) per share assumes the issuance of additional shares of common stock upon exercise of all outstanding stock options and contingently issuable securities if the effect is dilutive, in accordance with the treasury stock method discussed in FASB issued guidance on "Earnings Per Share". The impact of stock options and restricted stock on weighted average shares for the three and six months ended April 30, 2011 and 2010 did not change the income (loss) per share. The following table presents a reconciliation of our basic and diluted earnings (loss) per share computation:

(in thousands,
except per share
amount)

	Three months ended April 30,				Six months ended April 30,			
	2011		2010		2011		2010	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
Net income (loss)	\$ 2,349	\$ 2,349	\$ (1,573)	\$ (1,573)	\$ 3,895	\$ 3,895	\$ (3,409)	\$ (3,409)
Weighted average shares outstanding	6,441	6,441	6,441	6,441	6,441	6,441	6,441	6,441
Assumed issuances under equity incentive plans	—	48	—	—	—	35	—	—
	6,441	6,489	6,441	6,441	6,441	6,476	6,441	6,441
Income (loss) per share	\$ 0.36	\$ 0.36	\$ (0.24)	\$ (0.24)	\$ 0.60	\$ 0.60	\$ (0.53)	\$ (0.53)

5. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$295,000 as of April 30, 2011 and \$497,000 as of October 31, 2010.

6. INVENTORIES

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

	April 30, 2011	October 31, 2010
Purchased parts and sub-assemblies	\$ 19,032	\$ 16,137
Work-in-process	13,256	13,157
Finished goods	37,322	26,572
	\$ 69,610	\$ 55,866

7. SEGMENT INFORMATION

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

8. GUARANTEES AND WARRANTIES

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. We follow FASB guidance for accounting for contingencies with respect to these guarantees. As of April 30, 2011, we had 29 outstanding third party payment guarantees totaling approximately \$1.6 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue for potential liabilities under these guarantees when we believe a loss is probable and can be estimated.

We provide warranties on our products with respect to defects in material and workmanship. The terms of these warranties are generally one year for machines and shorter periods for service parts. We recognize a reserve with respect to this obligation at the time of product sale, with subsequent warranty claims recorded against the reserve. The amount of the warranty reserve is determined based on historical trend experience and any known warranty issues that could cause future warranty costs to differ from historical experience. The increased provision in the six months ended April 30, 2011 reflects the increased production and sales occurring in the period as compared to the six months ended April 30, 2010. A reconciliation of the changes in our warranty reserve is as follows (in thousands):

	Six months ended	
	April 30, 2011	April 30, 2010
Balance, beginning of period	\$ 1,591	\$ 1,286
Provision for warranties during the period	1,250	835
Charges to the reserve	(1,101)	(854)
Impact of foreign currency translation	38	(45)
Balance, end of period	\$ 1,778	\$ 1,222

9. COMPREHENSIVE INCOME (LOSS)

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

	Three months ended	
	April 30, 2011	April 30, 2010
Net income (loss)	\$ 2,349	\$ (1,573)
Translation of foreign currency financial statements	2,206	(586)
Realized (gain) loss on derivative instruments reclassified into operations, net of tax	(93)	92
Unrealized gain (loss) on derivative instruments, net of tax	(1,879)	352
Comprehensive income (loss)	\$ 2,583	\$ (1,715)

10. DEBT AGREEMENTS

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

On March 7, 2011 we entered into an uncommitted credit facility in China in the amount of 20.0 million Chinese Yuan (approximately \$3.0 million) and amended our unsecured domestic credit agreement to accommodate the new facility. This facility expires on February 24, 2012.

Borrowings under the domestic facility may be used for general corporate purposes and bear interest at a floating rate, based either on LIBOR or the prime rate, plus an applicable margin. Prior to the second quarter of fiscal 2011, the domestic credit agreement restricted our ability to declare and pay dividends, incur additional indebtedness other than under this facility and make acquisitions because we had reported a cumulative net loss for four consecutive quarters. When we report cumulative net losses for four consecutive quarters the domestic credit agreement contains a financial covenant that requires no less than a 1:00 to 1:00 ratio of excess cash (defined as cash minus debt) to an annualized net loss (defined as a net loss for the two most recent consecutive quarters multiplied by two). These restrictions are no longer in effect as we moved to a cumulative net income for four consecutive quarters. After reporting cumulative income for four consecutive quarters, we are required to maintain a ratio of 0.5 to 1.0 of total indebtedness to the sum of total indebtedness and net worth. At April 30, 2011, we were in compliance with the covenants contained in our credit facilities.

At April 30, 2011, we had \$647,000 of borrowings outstanding under our credit facility in China, but had no other debt or borrowings under any of our other bank credit facilities. As of April 30, 2011, we had unutilized credit facilities of \$24.5 million.

11. INCOME TAXES

Our effective tax rate for the first six months of fiscal 2011 was 33% in comparison to 38% for the same period in fiscal 2010. The decrease in the effective tax rate period-over-period was primarily due to changes in the geographic mix of income or loss between tax jurisdictions, reduction in certain statutory tax rates of foreign jurisdictions, and increases in allowable research and development credits. We recorded an income tax provision during the first six months of fiscal 2011 of approximately \$1.9 million compared to an income tax benefit of \$2.1 million for the same

period in fiscal 2010, as a result of the increase in operating income period-over-period.

Our unrecognized tax benefits were \$217,000 as of April 30, 2011 and \$196,000 as of October 31, 2010, and in each case included accrued interest.

We recognize accrued interest and penalties related to unrecognized tax benefits as components of our income tax provision. We believe our unrecognized tax positions meet the minimum statutory threshold to avoid payment of penalties and, therefore, no tax penalties have been estimated. As of April 30, 2011, the gross amount of interest accrued, reported in Accrued expenses and other, was approximately \$23,000, 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 2012 and August 2014.

12. FINANCIAL INSTRUMENTS

The carrying amounts for our trade receivables and payables approximate their fair values. We also have financial instruments in the form of foreign currency forward exchange contracts as described in Note 2. The U.S. Dollar equivalent notional amount of these contracts was \$109.5 million and \$89.1 million at April 30, 2011 and October 31, 2010, respectively. The fair value of Derivative assets recorded on our Condensed Consolidated Balance Sheets at April 30, 2011 and October 31, 2010 was \$1.5 million and \$905,000, respectively. The fair value of Derivative liabilities recorded on our Condensed Consolidated Balance Sheets at April 30, 2011 and October 31, 2010 was \$4.2 million and \$2.1 million, respectively.

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

FASB fair value guidance established a three-tier fair value hierarchy, which categorizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs, such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exist, therefore requiring an entity to develop its own assumptions.

In accordance with this guidance, the following table represents the fair value hierarchy for our financial assets and liabilities measured at fair value as of April 30, 2011 and October 2010 (in thousands):

	Assets		Liabilities	
	April 30, 2011	October 31, 2010	April 30, 2011	October 31, 2010
Level 1				
Deferred Compensation	\$ 773	\$ 674	\$ -	\$ -
Level 2				
Derivatives	\$ 1,530	\$ 905	\$ 4,230	\$ 2,123

Included in Level 1 assets are mutual fund investments under a nonqualified deferred compensation plan. We estimate the fair value of these investments on a recurring basis using market prices which are readily available. Included as Level 2 fair value measurements are derivative assets and liabilities related to hedged and unhedged gains and losses on foreign currency forward exchange contracts entered into with a third party. We estimate the fair value of these derivatives on a recurring basis using foreign currency exchange rates obtained from active markets.

During fiscal 2011, we did not have any significant non-recurring measurements of nonfinancial assets and nonfinancial liabilities.

13. EMPLOYEE BENEFITS

We have defined contribution plans that include a majority of our employees, under which our matching contributions are primarily discretionary. The purpose of these plans is generally to provide additional financial security during retirement by providing employees with an incentive to save throughout their employment. Our matching contributions to the plans are based on employee contributions or compensation. From April 1, 2009 to December 31, 2010 we suspended our discretionary contributions to the U.S. plan as a cost reduction measure, however effective January 1, 2011 we reinstated our matching contributions to that plan in an amount equal to 25% of the first 6% of a participant's annual earnings contributed, up to the maximum permitted by law. Our contributions totaled approximately \$130,000 and \$76,000, for the six months ended April 30, 2011 and 2010, respectively.

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 reporting segment. We design and produce computerized machine tools, featuring our proprietary computer control systems and software, for sale through our own distribution network to the worldwide metal cutting market. We also provide software options, control upgrades, accessories and replacement parts for our products, as well as customer service and training support.

The following overview is intended to provide a brief explanation of the principal factors that have contributed to our recent financial performance. This overview is intended to be read in conjunction with the more detailed information included in our unaudited financial statements that appear elsewhere in this report.

The substantial decline in global demand for machine tools we experienced in fiscal 2009 and 2010 during the recent global recession adversely affected our operational performance in the past two years. We are now experiencing substantial improvements in sales and net income reflecting the recovery in industrial manufacturing activity which is still ongoing. During the recession, we significantly reduced our production levels and took several cost containment measures. Our financial resources allowed us to continue to expand our product offering during the downturn. We began increasing our production levels at the end of fiscal 2010 and are continuing to do so. However, we have not yet generated the levels of sales and net income that we experienced prior to fiscal 2009 and there is no assurance in the existing economic climate that the demand for our machine tools will continue at the current pace.

The market for machine tools is international in scope. We have both significant foreign sales and foreign manufacturing operations. During the past three years, sales to foreign customers as a percentage of total sales between 72% and 78% of our revenues. During the first six months of fiscal 2010 and 2011, more than 60% of our revenues were attributable to customers located in Europe where we typically sell the majority of our higher performance VMX series machines. We sell our products through more than 100 independent agents and distributors in countries throughout North America, Europe and Asia. We also have our own direct sales and service organizations in Canada, China, France, Germany, India, Italy, Poland, Singapore, South Africa, South Korea, the United Kingdom and certain parts of the United States. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly owned subsidiary in Taiwan, Hurco Manufacturing Limited (HML). Machine castings and components to support HML's production are manufactured at our facility in Ningbo, China. We also manufacture machine tools for the Chinese market at the Ningbo plant.

Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies—primarily the Euro and Pound Sterling—in the countries in which those customers are located. Our product costs are incurred and paid primarily in the New Taiwan Dollar and the U.S. Dollar. Changes in currency exchange rates may have a material effect on our operating results and consolidated balance sheets as reported under U.S. Generally Accepted Accounting Principles. For example, when the U.S. Dollar strengthens 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 lower than would be the case when the U.S. Dollar is weaker. 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.

In the second quarter of fiscal 2011, our business continued to benefit from increased global demand for machine tools, as orders were 137% higher than in the second quarter of fiscal 2010 and 64% higher than in the first quarter of fiscal 2011. Sales for the second quarter of fiscal 2011 were 73% above those in the second quarter of fiscal 2010 and 5% above the first quarter 2011. Orders continued to outpace sales as our production and supply chain continued to ramp up to meet customer demand. A portion of the increased orders in the second quarter of fiscal 2011 came from customers placing orders in advance of an announced price increase that went into effect at the end of the quarter. The significant improvement in sales increased our gross profit for the second quarter of fiscal 2011 to 30%, compared to gross profit of 19% for the second quarter of fiscal 2010. The increase in gross profit was partially offset by an increase in the cost of raw materials, particularly metals, and the negative cost impact of a strengthened Taiwanese Dollar in relations to the U.S. Dollar. The Taiwanese Dollar appreciated 8% during the second quarter and first six months of fiscal 2011 compared to the corresponding periods in fiscal 2010. We expect that the cost impact from the appreciation of the Taiwanese Dollar and metals will continue and we will adjust sales prices accordingly.

RESULTS OF OPERATIONS

Three Months Ended April 30, 2011 Compared to Three Months Ended April 30, 2010

Sales and Service Fees. Sales and service fees for the second quarter of fiscal 2011 were \$41.6 million, an increase of \$17.5 million, or 73%, from the second quarter of fiscal 2010. The increase in second quarter revenues reflected the rebound in industrial manufacturing activity. A weaker U.S. Dollar when translating foreign sales to U.S. Dollars had a favorable impact of approximately 5%, or \$1.1 million, on the period-to-period comparison.

The following tables set forth net sales (in thousands) by geographic region and product category for the second quarter of fiscal 2011 and 2010, respectively:

Net Sales and Service Fees by Geographic Region

	Three months ended April 30,						Change	
	2011			2010			Amount	%
North America	\$ 9,137	22	%	\$ 5,804	24	%	\$ 3,333	57 %
Europe	27,297	66	%	15,342	64	%	11,955	78 %
Asia Pacific	5,142	12	%	2,942	12	%	2,200	75 %
Total	\$ 41,576	100	%	\$ 24,088	100	%	\$ 17,488	73 %

The increase in sales was primarily driven by higher customer demand in all sales regions. Unit shipments for the second quarter of fiscal 2011 increased in North America by 78%, in Europe by 65%, and in the Asia Pacific region by 67% compared to the same period in fiscal 2010.

Net Sales and Service Fees by Product Category

	Three months ended April 30,						Change	
	2011			2010			Amount	%
Computerized Machine Tools	\$35,834	86	%	\$19,883	83	%	\$15,951	80 %
Service Fees, Parts and Other	5,742	14	%	4,205	17	%	1,537	37 %
Total	\$41,576	100	%	\$24,088	100	%	\$17,488	73 %

Unit shipments of computerized machine tools during the second quarter of fiscal 2011 increased by 68% from the corresponding period in fiscal 2010.

Orders. Orders for the second quarter of fiscal 2011 totaled \$72.6 million, an increase of \$42.0 million, or 137%, from the corresponding period in fiscal 2010. Orders increased in North America by \$5.7 million, or 69%, in Europe by

\$32.2 million, or 175%, and in the Asia Pacific region by \$4.1 million, or 107%. The impact of currency translation on Orders was consistent with the impact on sales. Orders, measured in units, increased in North America by 66%, in Europe by 140%, and in the Asia Pacific region by 88%. Orders outpaced sales as our production and supply chain responded to the increased customer demand. A portion of the increased orders booked in the second quarter of fiscal 2011 came from customers placing orders in advance of an announced price increase that went into effect at the end of the quarter.

Gross Profit. Our gross profit for the second quarter of fiscal 2011 was 30%, compared to 19% for the same period in fiscal 2010. The increase in gross profit was due to the significant increase in sales volume, particularly of our higher margin, high performance vertical machining centers in Europe. The increase in gross profit was partially offset by an increase in the cost of raw materials, particularly metals, and the negative cost impact of a strengthened Taiwanese Dollar in relations to the U.S. Dollar. The Taiwanese Dollar appreciated 8% during the second quarter and first six months of fiscal 2011 compared to the corresponding periods in fiscal 2010.

Operating Expenses. Selling, general and administrative expenses were \$9.3 million for the second quarter of fiscal 2011, an increase of \$2.0 million, or 28%, from the second quarter of fiscal 2010. The increase consisted primarily of higher sales commission due to increased sales volume, increased sales and marketing expense, increased incentive compensation expense and the unfavorable impact of currency translation. Despite the dollar increase, the increased sales in fiscal 2011 resulted in selling, general and administrative expenses of 22% of sales and service fees during the second quarter of fiscal 2011 as compared to 30% for the second quarter of fiscal 2010.

Operating Income (Loss). Operating income for the second quarter of fiscal 2011 was \$3.4 million compared to an operating loss of \$2.6 million for the prior year period. The substantial improvement in operating income period-over-period was primarily due to the significant increase in sales.

Other (Income) Expense, Net. The decrease in other expense of \$118,000 for the second quarter of fiscal 2011 compared to the same period in fiscal 2010 was primarily due to a reduction in net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts.

Income Taxes. Our effective tax rate for the second quarter of fiscal 2011 was 31% in comparison to 41% for the same period in fiscal 2010. The decrease in the effective tax rate period-over-period is primarily due to changes in the geographic mix of income or loss between tax jurisdictions, reduction in certain foreign jurisdiction statutory tax rates, and increases in allowable research and development credits. We recorded an income tax provision during the second quarter of fiscal 2011 of approximately \$1.1 million compared to an income tax benefit of \$1.1 million for the same period in fiscal 2010, reflecting the increase in operating income period-over-period.

Six Months Ended April 30, 2011 Compared to Six Months Ended April 30, 2010

Sales and Service Fees. Sales and service fees for the first six months of fiscal 2011 were \$81.3 million, an increase of \$36.6 million, or 82%, from the first six months of fiscal 2010. The increase in first six months revenues reflected the rebound in industrial manufacturing activity. The impact of currency translation on the period-over-period sales comparison for the first six months of fiscal 2011 to the corresponding period in fiscal 2010 was not material.

The following tables set forth net sales (in thousands) by geographic region and product category for the first six months of fiscal 2011 and 2010, respectively:

Net Sales and Service Fees by Geographic Region

	Six months ended April 30,						Change	
	2011			2010			Amount	%
North America	\$ 22,599	28	%	\$ 11,905	27	%	\$ 10,694	90 %
Europe	48,576	60	%	27,358	61	%	21,218	78 %
Asia Pacific	10,081	12	%	5,441	12	%	4,640	85 %
Total	\$ 81,256	100	%	\$ 44,704	100	%	\$ 36,552	82 %

The increase in sales was primarily driven by higher customer demand in all sales regions. Unit shipments for the first six months of fiscal 2011 increased in North America by 110%, in Europe by 66%, and in the Asia Pacific region by 61% compared to the same period in fiscal 2010.

Net Sales and Service Fees by Product Category

	Six months ended April 30,						Change	
	2011			2010			Amount	%
C o m p u t e r i z e d								
Machine Tools	\$ 69,829	86	%	\$ 36,773	82	%	\$ 33,056	90 %
Service Fees, Parts and Other	11,427	14	%	7,931	18	%	3,496	44 %
Total	\$ 81,256	100	%	\$ 44,704	100	%	\$ 36,552	82 %

Unit shipments of computerized machine tools during the first six months of fiscal 2011 increased by 76% from the corresponding period in fiscal 2010.

Orders. Orders for the first six months of fiscal 2011 totaled \$116.9 million, an increase of \$65.7 million, or 128%, from the corresponding period in fiscal 2010. Orders increased in North America by \$13.5 million, or 96%, in Europe by \$45.9 million, or 152%, and in the Asia Pacific region by \$6.3 million, or 91%. The impact of currency translation on orders was consistent with the impact on sales. Orders, measured in units, increased in North America by 103%, in Europe by 128%, and in the Asia Pacific region by 68%. The increase is partially attributable to customers placing orders in advance of an announced price increase that went into effect at the end of the six month period.

Gross Profit. Our gross profit for the first six months of fiscal 2011 was 30%, compared to 19% for the same period in fiscal 2010. The increase in gross profit as a percentage of sales was due to the significant increase in sales volume and was partially offset by the negative impact of a strengthened Taiwanese Dollar in relation to the U.S. Dollar and an increase in the cost of raw materials, particularly metals.

Operating Expenses. Selling, general and administrative expenses were \$18.1 million for the first six months of fiscal 2011, an increase of \$4.3 million, or 31%, from the first six months of fiscal 2010. The increase consisted primarily of higher sales commission due to increased sales volume, increased sales and marketing expense, increased incentive compensation expense and an increase in wages paid to employees who had experienced wage reductions as cost containment measures. Despite the dollar increase, the increased sales in fiscal 2011 resulted in selling, general and administrative expenses being 22% of sales and service fees during the first six months of fiscal 2011 compared to 31% for the first six months of fiscal 2010.

Operating Income (Loss). Operating income for the first six months of fiscal 2011 was \$6.3 million compared to an operating loss of \$5.1 million for the prior year period. The substantial improvement in operating income period-over-period was primarily due to the significant increase in sales.

Other (Income) Expense, Net. Other expense for the first six months of fiscal 2011 was \$414,000 compared to \$382,000 for the first six months of fiscal 2010. The decrease in expense was due to reductions in net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts, offset by a reduction in our allocated share of loss incurred by a Taiwan contract manufacturer in which we have an equity investment.

Income Taxes. Our effective tax rate for the first six months of fiscal 2011 was 33% in comparison to 38% for the same period in fiscal 2010. The decrease in the effective tax rate period-over-period was primarily due to changes in the geographic mix of income or loss between tax jurisdictions, reduction in certain foreign jurisdiction statutory tax

rates, and increases in allowable research and development credits. We recorded an income tax provision during the first six months of fiscal 2011 of approximately \$1.9 million compared to an income tax benefit of \$2.1 million for the same period in fiscal 2010, reflecting the increase in operating income period-over-period.

LIQUIDITY AND CAPITAL RESOURCES

At April 30, 2011, we had cash of \$48.7 million, compared to \$48.3 million at October 31, 2010. Approximately 60% of the \$48.7 million of cash is denominated in U.S. Dollars. The balance is held outside the U.S. in the local currencies of our various foreign entities and is subject to fluctuations in currency exchange rates.

Working capital, excluding cash, was \$52.2 million at April 30, 2011, compared to \$45.7 million at October 31, 2010. The increase in working capital, excluding cash, was primarily due to an increase in finished goods inventory to meet the higher level of customer demand we are currently experiencing.

Capital expenditures during the first six months of fiscal 2011 were primarily for implementation of operating systems, purchase of factory equipment for production facilities in Taiwan and software development costs. We funded these expenditures with cash flow from operations.

Prior to the second quarter of fiscal 2011, we were subject to restrictions under our domestic credit agreement from making acquisitions, declaring and paying dividends, and incurring additional indebtedness. These restrictions were no longer in effect at the end of the second quarter of fiscal 2011, as we reported a cumulative net income for four consecutive quarters. At April 30, 2011, we had \$647,000 of borrowings outstanding under our credit facility in China, but had no other debt or borrowings under any of our other bank credit facilities. At April 30, 2011, we were in compliance with the covenants contained in our credit facilities.

Although we have not made any significant acquisitions in the recent past, we continue to receive and review information on businesses and assets, including intellectual property assets, which are available for purchase.

NEW ACCOUNTING PRONOUNCEMENTS

We have reviewed all recently issued, but not yet effective, accounting pronouncements and do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of its operations.

CRITICAL ACCOUNTING POLICIES

Our accounting policies, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2010, 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 six months of fiscal 2011.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

There have been no material changes related to contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2010.

OFF BALANCE SHEET ARRANGEMENTS

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. We follow FASB guidance for accounting for contingencies with respect to these guarantees. As of April 30, 2011, we had 29 outstanding third party payment guarantees totaling approximately \$1.6

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

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

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

- A recurrent global recession which could reduce overall demand and our customers’ ability to purchase our products and services;
- The cyclical nature of the machine tool industry;
- The risks of our international operations;
- The limited number of our manufacturing sources;
- The effects of changes in currency exchange rates;
- Our dependence on new product development;
- The need to make technological advances;
- Competition with larger companies that have greater financial resources;
- Changes in the prices of raw materials, especially steel and iron products;
- Possible obsolescence of our technology;
- Acquisitions that could disrupt our operations and affect operating results;
- Impairment of our assets;
- Negative or unforeseen tax consequences;
- The need to protect our intellectual property assets; and
- The effect of the loss of members of senior management and key personnel.

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

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

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Interest on borrowings on our bank credit agreements are tied to prevailing domestic and foreign interest rates. At April 30, 2011, we had \$647,000 of borrowings outstanding under our credit facility in China, but had no other debt or borrowings under any of our other bank credit facilities.

Foreign Currency Exchange Risk

In fiscal 2010, we derived more than 70% of our revenues from foreign markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

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

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

Forward contracts for the sale or purchase of foreign currencies as of April 30, 2011, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities were as follows:

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Date	Contract Amount at Forward Rates in U.S. Dollars April 30, 2011	Maturity Dates
Sale Contracts:					
Euro	25,970,000	1.3600	35,318,466	38,370,639	May 2011 – April 2012
Pound Sterling	6,295,000	1.5806	9,949,914	10,499,385	May 2011 – April 2012
Purchase Contracts:					
New Taiwan Dollar	942,000,000	29.25 *	32,200,706	33,503,030	May 2011 – April 2012

*NT Dollars per U.S. Dollar

Forward contracts for the sale or purchase of foreign currencies as of April 30, 2011, 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	April 30, 2011	Maturity Dates	
Sale Contracts:						
Euro	8,007,975	1.4618	11,705,852	11,862,449	May 2011 – September 2011	
Pound Sterling	554,085	1.6574	918,347	925,701	May 2011	
Canadian Dollar	575,360	1.0448	601,129	606,852	July 2011	
Singapore Dollar	859,340	.7903	679,105	702,781	July 2011	
South African Rand	5,034,612	.1481	745,725	757,625	July 2011	
Purchase Contracts:						
New Taiwan Dollar	384,505,573	28.98	*	13,269,038	13,493,336	May 2011 – June 2011

* 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 2011. At April 30, 2011, we had \$216,000 of realized gains and \$226,000 of unrealized losses, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive loss related to this forward contract. Forward contracts for the sale or purchase of foreign currencies as of April 30, 2011, which are designated as net investment hedges under this guidance were as follows:

Notional