HURCO COMPANIES INC
Form 10-K
January 11, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended October 31, 2012 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<br>(State or other jurisdiction of incorporation or organization) | 35-1150732<br>(I.R.S. Employer Identification Number) |
| One Technology Way<br>Indianapolis, Indiana<br>(Address of principal executive offices) | 46268<br>(Zip code) |

| | |
|---|---|
| Registrant's telephone number, including area code | (317) 293-5309 |
| Securities registered pursuant to Section 12(b) of the Act: | None |
| Securities registered pursuant to Section 12(g) of the Act: | Common Stock, No Par Value<br>(Title of Class) |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d). Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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 at least the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller Reporting Company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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 x No ¨

The aggregate market value of the registrant’s voting stock held by non-affiliates as of April 30, 2012 (the last day of our most recently completed second quarter) was $169,755,000.

The number of shares of the registrant’s common stock outstanding as of December 28, 2012 was 6,447,210.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the registrant’s Proxy Statement for its 2013 Annual Meeting of Shareholders (Part III).

**Disclosure Concerning Forward-looking Statements**

Certain statements made in this annual report on Form 10-K may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These risks, uncertainties and other factors include the risks identified in Item 1A.

## PART I

## Item 1. BUSINESS

### General

Hurco Companies, Inc. is an industrial technology company. We design, manufacture and sell computerized machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal working industry through a worldwide sales, service and distribution network. Although our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. As used in this report, the words “we”, “us”, “our”, “Hurco” and the “Company” refer to Hurco Companies, Inc. and its consolidated subsidiaries.

Since our founding in 1968, we have been a leader in the introduction of interactive computer control systems that automate manufacturing processes and improve productivity in the metal parts manufacturing industry. We pioneered the application of microprocessor technology and conversational programming software for use in machine tools. Our computer control systems can be operated by both skilled and unskilled machine tool operators and yet are capable of instructing a machine to perform complex tasks. The combination of microprocessor technology and patented interactive, conversational programming software in our computer control systems enables operators on the production floor to quickly and easily create a program for machining a particular part from a blueprint or computer aided design file and immediately begin machining that part.

Our executive offices and principal design and engineering operations are headquartered in Indianapolis, Indiana, USA. Sales, application engineering and service subsidiaries are located in China, France, Germany, India, Italy, Poland, Singapore, South Africa, the United Kingdom, and the United States. We have manufacturing operations in

Taiwan and China, and distribution facilities in the USA, the Netherlands, and Taiwan.

Our strategy is to design, manufacture and sell a comprehensive line of computerized machine tools that incorporate our proprietary, interactive, computer control technology for the global metalworking market. Our technology is designed to enhance the machine tool user's productivity through ease of operation and higher levels of machine performance (speed, accuracy and surface finish quality). We use an open system software architecture that permits our computer control systems and software to be produced and employed using standard PC hardware. We have emphasized a "user-friendly" design that employs both interactive conversational and graphical programming software. We routinely expand our product offering to meet customer needs, which has led us to design and manufacture more complex machining centers with advanced capabilities. We bring a disciplined approach to strategically enter new geographic markets, as appropriate. Combined with a strong worldwide demand for machine tools, our introduction of new, technologically advanced products and expansion into new markets resulted in significant growth prior to the recent recession and in the recovery that took place in fiscal 2011 and 2012.

**Industry**

Machine tool products are considered capital goods, which makes them part of an industry that has historically been highly cyclical.

Although, industry association data for the U.S. machine tool market is available, that market only accounts for approximately 8% of worldwide consumption. Reports available for the U.S. machine tool market include:

- United States Machine Tool Consumption – generated by the Association for Manufacturing Technology, this report includes metal cutting machines of all types and sizes, including segments in which we do not compete
- Purchasing Manager's Index - developed by the Institute for Supply Management and reports activity levels in U.S. manufacturing plants that purchase machine tools
- Capacity Utilization of Manufacturing Companies – issued by the Federal Reserve Board

A limited amount of information for foreign markets is available, and different reporting methodologies are used by various countries. Machine tool consumption data published by Gardner Publications, Inc., calculates machine tool consumption annually by country. It is important to note that data for foreign countries are based on government reports that may lag 6 to 12 months and therefore are unreliable for forecasting purposes.

Demand for capital equipment can fluctuate significantly during periods of changing economic conditions such as the global recession we experienced during 2009 and 2010. Manufacturers and suppliers of capital goods, such as our company, are often the first to experience these changes in demand. Additionally, since our typical order backlog is approximately 30 to 45 days, it is difficult to estimate demand with any reasonable certainty. Therefore, we do not have the benefit of relying on the common leading indicators other industries use for market analysis and forecasting purposes.

**Products**

Our core products consist of general purpose computerized machine tools for the metal cutting industry. These are, principally, vertical machining centers (mills) and turning centers (lathes), with which our proprietary software and computer control systems are fully integrated. We also produce computer control systems and related software for press brake applications that are sold as retrofit units for installation on existing or new press brake machines. Additionally, we produce and distribute software options, control upgrades, hardware accessories, and replacement

parts for our machine tool product lines, and we provide operator training and support services to our customers.

The following table sets forth the contribution of each of our product groups and services to our total revenues during each of the past three fiscal years:

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

(Dollars in thousands)

| | Year ended October 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | 2010 | |
| Computerized Machine Tools | $179,337 | 88.3% | $156,736 | 86.9% | $88,184 | 83.3% |
| Computer Control Systems and Software * | 2,947 | 1.5 % | 3,322 | 1.8 % | 2,347 | 2.2 % |
| Service Parts | 15,299 | 7.5 % | 14,836 | 8.2 % | 10,798 | 10.2% |
| Service Fees | 5,534 | 2.7 % | 5,506 | 3.1 % | 4,564 | 4.3 % |
| Total | $203,117 | 100 % | $180,400 | 100 % | $105,893 | 100 % |

* Amounts shown do not include computer control systems sold as integrated components of computerized machine tools.

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***Computerized Machine Tools – Machining and Turning Centers***

We design, manufacture and sell computerized machine tools equipped with a fully integrated interactive computer control system that features our proprietary WinMax® software. Our computer control system enables a machine tool operator to create complex two-dimensional or three-dimensional machining programs directly from an engineering drawing or computer aided design geometry file. An operator with little or no machine tool programming experience can successfully create a program with minimal training and begin machining the part in a short period of time. The control features an operator console with a liquid crystal display (LCD), and incorporates an upgradeable personal computer (PC) platform using a high speed processor with solid rendering graphical programming. In addition, WinMax® has a Windows®* based operating system to enable users to improve shop floor flexibility and software productivity.

Companies using computer controlled machine tools are better able to:

- maximize the efficiency of their human resources
- make more advanced and complex parts from a wide range of materials using multiple processes
- incorporate fast moving changes in technology into their operations to keep their competitive edge
- integrate into the global supply chain of their customers by supporting small to medium lot sizes for "just in time" initiatives

Our Windows®* based control facilitates our ability to meet these customer needs. The familiar Windows®* operating system coupled with our intuitive conversational style of program creation allows our customers' operators to create and edit part-making programs without incurring the incremental overhead of specialized computer aided design and computer aided manufacturing programmers. With the ability to transfer most computer aided design data directly into a Hurco program, programming time becomes minutes instead of hours.

Machine tool products today are being designed to meet the demand for machining complex parts with greater part accuracies. Our proprietary controls with WinMax® software and high speed processors efficiently handle the large amounts of data these complex part-making programs require, which enables our customers to create parts with higher accuracy at faster speeds. We continue to add technology to our control design as it becomes available.

Our offering of machining centers, currently equipped with either a twin touch-screen console or a single touch-screen console, consists of the following six product lines:

***VM Product Line***

The VM product line consists of moderately priced vertical machining centers for the entry-level market. Their design premise of a machining center with a large work cube and a small footprint optimizes the use of available floor space. The VM line consists of four models in three sizes with X-axis (horizontal) travels of 26, 40, and 50 inches. The base list prices of the VM machines range from $55,000 to $170,000.

***VMX Product Line***

The VMX product line consists of higher performing vertical machining centers aimed at manufacturers that require greater part accuracy. It is our flagship series of machining centers. The VMX line consists of nineteen models in seven sizes with X-axis travels of 24, 30, 42, 50, 60, 64, and 84 inches. The base list prices of VMX machines range from $70,000 to $ 330,000.

*Windows® is a registered trademark of Microsoft Corporation in the United States and other countries.

***Five-Axis Product Line***

The five-axis product line is targeted at manufacturers seeking to produce complex multi-sided parts in a single setup. Machines in this product line can yield significant productivity gains for manufacturers that previously had to process each side of a part separately. In total, we have seven models in five sizes to offer customers. The base list prices of the five-axis machines range from $120,000 to $350,000.

***TM/TMM Product Line***

Since its introduction in fiscal 2005, we have continued to expand the TM turning center (horizontal slant-bed lathe) product line. The TM series is designed for entry-level job shops and contract manufacturers seeking efficient processing of small to medium lot sizes. There is one TM model in six sizes: the TM6, TM8, TM10, TM12, TM18, and TM18L. We added motorized tooling on the lathe turret to further enhance the capability of the TM turning centers and designated it as the TMM product line. These turning centers with live tooling allow our customers to complete a number of secondary milling, drilling and tapping operations while the part is still held in the chuck after the turning operations are complete, which provides significant productivity gains. We offer one TMM model in two sizes: the TMM8 and TMM10. The base list prices of the TM/TMM machines range from $50,000 to $350,000.

***TMX Product Line***

The TMX product line consists of high performance turning centers. There are three models in two sizes. One of the models is equipped with an additional axis and motorized live tooling, and another one of the models has an additional spindle. The base list prices of TMX turning centers range from $100,000 to $250,000.

***Specialty Product Lines***

This category includes two product series: the dual column DCX Series and the zone VTXZ Series. The zone VTXZ machining center is designed for production flexibility. The VTXZ can work as a dual work zone machine to support continuous production or a single zone to produce long, structural parts. Both the DCX Series which includes three models in two sizes and the VTXZ Series which is just one model and size are designed to facilitate production of large parts and molds often required by the aerospace and energy industries. The base list prices of these machines range from $300,000 to $ 450,000.

***New Products and Rebranding Initiative***

At the September 2012 International Manufacturing Technology Show (IMTS), we introduced a new design and several new products. The new design that we featured at IMTS resulted from a two-year rebranding initiative we completed in 2012. The new machine aesthetics reflect the technological advantages our products provide customers throughout the world. The new products we introduced at IMTS included the HS (High Speed) product line, an advanced VMXSRTi 5-axis machining center, the VM5i machining center, and the HMX horizontal machining center product line. The base list prices of these machines range from $50,000 to $600,000.

***Computer Control Systems and Software***

The following machine tool computer control systems and software products are sold directly to end-users and/or to original equipment manufacturers.

***Autobend®***

Autobend® computer control systems are applied to metal bending press brake machines that form parts from sheet metal and steel plate.  They consist of a microprocessor-based computer control and back gauge (an automated gauging system that determines where the bend will be made).  We have manufactured and sold the Autobend® product line since 1968.  We currently market two models of our Autobend® computer control systems for press brake machines, in combination with six different back gauges as retrofit units for installation on existing or new press brake machines.

***Software Products***

In addition to our standard computer control features, we offer software option products for two-dimensional programming.  These products are sold to users of our computerized machine tools equipped with our twin touch-screen or single touch-screen consoles featuring WinMax® control software.  The options include: Swept Surface, SelectSurface Finish Quality (SFQ), DXF Transfer, UltiMonitorTM, UltiMotionTM, UltiPocketTM, Conversational Part and Tool Probing, Advanced Verification Graphics, the Tool and Material Library, NC/Conversational Merge, and Simultaneous Five-Axis Contouring.

Our Swept Surface software option simplifies programming of 3D contours and significantly reduces programming time.

SelectSurface Finish Quality (SFQ) lets the customer control surface finish quality and run time in one easy step.

The DXF Transfer software option increases operator productivity because it eliminates manual data entry of part features by transferring AutoCAD™ drawing files directly into our computer control or into our desktop programming software, WinMax® Desktop.

UltiMonitor is a web-based productivity, management and service tool, enabling customers to monitor, inspect and receive notifications about their Hurco machines from any location where they can access the internet. Customers can transfer part designs, receive event notifications via email or text, access diagnostic data, monitor the machine via webcam and communicate with the machine operator.

UltiMotion uses software-based motion control, which is more efficient than conventional hardware-based motion control. This software-based motion control system provides significant cycle time reductions, minimizes machine jerk, and increases the quality of the part’s surface finish.

UltiPocket automatically calculates the tool path around islands, eliminating the arduous task of plotting these shapes.  Islands can also be rotated, scaled and repeated.

Conversational Part and Tool Probing options permit the computerized dimensional measurement of machined parts and the associated cutting tools.  This “on-machine” technique improves the throughput of the measurement process

when compared to traditional “off-machine” approaches.

The Advanced Verification Graphics feature significantly reduces both scrap and programming time because it provides customers with a three-dimensional solid rendering of the part, including dynamic rotation. This feature allows a customer to view the rendered part from any angle without needing to redraw it.

The Tool and Material Library option stores the tool and material information with the machine instead of storing it with each individual part program. The user enters the tool data and geometry one time and chooses the particular tool from the list when it is needed. Additionally, the library reads the part program and automatically locates the tool or displays an alert if the tool does not exist. In addition to saving time, the Tool and Material Library eliminates the need to enter information repeatedly, and can prevent common tool crash conditions.

NC/Conversational Merge lets the user incorporate conversational features, such as tool probing, pattern operations, and scaling, into existing G-Code programs.

Simultaneous Five-Axis Contouring software enables a five-axis machine to command motion concurrently on all axes. This allows the user to create continuous tool-paths along complex geometries with only a single machine/part setup, providing increased productivity along with the performance benefits of using shorter cutting tools. The sale of simultaneous five-axis contouring software is subject to government export licensing requirements.

**Parts and Service**

Our service organization provides installation, warranty, operator training and customer support for our products on a worldwide basis. In the United States, our principal distributors have primary responsibility for machine installation and warranty service and support for product sales. Our service organization also sells software options, computer control upgrades, accessories and replacement parts for our products. Our after-sales parts and service business strengthens our customer relationships and provides continuous information concerning the evolving requirements of end-users.

**Manufacturing**

Our computerized metal cutting machine tools are manufactured to our specifications primarily by our wholly owned subsidiary in Taiwan, Hurco Manufacturing Limited (HML). HML conducts final assembly operations and is supported by a network of contract suppliers of components and sub-assemblies who manufacture components for our products. Our manufacturing facility in Ningbo, China, focuses on the machining of castings to support HML's production in Taiwan as well as producing VM machines specifically for the Chinese market.

We have a contract manufacturing agreement for computer control systems with Hurco Automation, Ltd., a Taiwanese company in which we have a 35% ownership interest. This company produces all of our computer control systems to our specifications, sources industry standard computer components and our proprietary parts, performs final assembly and conducts test operations.

We work closely with our subsidiaries, key component suppliers and our minority-owned affiliate to ensure that their production capacity will be sufficient to meet the projected demand for our machine tool products. Many of the key components used in our machines can be sourced from multiple suppliers. However, any prolonged interruption of operations or significant reduction in the capacity or performance capability at any of our manufacturing facilities, or at any of our key component suppliers, could have a material adverse effect on our operations.

**Marketing and Distribution**

We sell our products through more than 100 independent agents and distributors throughout North America, Europe and Asia. Although some distributors carry competitive products, we are the primary line for the majority of our distributors globally. We also have direct sales personnel in China, France, Germany, India, Italy, Poland, Singapore, South Africa, the United Kingdom and certain parts of the United States, which are among the world's principal

machine tool consuming markets.

Approximately 92% of the worldwide demand for computerized machine tools and computer control systems is outside the United States.  In fiscal 2012, approximately 70% of our revenues were from overseas customers.  No single end-user or distributor of our products accounted for more than 5% of our total sales and service fees.

The end-users of our products are precision tool, die and mold manufacturers, independent metal parts manufacturers, and specialized production application or prototype departments within large manufacturing companies.  Industries served include aerospace, defense, medical equipment, energy, automotive/transportation, electronics and computer equipment.

We also sell our Autobend® computer control systems to original equipment manufacturers of new metal fabrication machine tools who integrate them with their own products prior to the sale of those products to their own customers, to retrofitters of used metal fabrication machine tools who integrate them with those machines as part of the retrofitting operation, and to end-users who have an installed base of metal fabrication machine tools, either with or without related computer control systems.

**Demand**

We believe demand for our products is driven by advances in industrial technology and the related demand for automated process improvements.

Other factors affecting demand include:

- the need to continuously improve productivity and shorten cycle time
- an aging machine tool installed base that will require replacement with more advanced technology
- the industrial development of emerging markets in Asia and Eastern Europe
- the declining supply of skilled machinists

Demand for our products is also highly dependent upon economic conditions and the general level of business confidence, as well as such factors as production capacity utilization and changes in governmental policies regarding tariffs, corporate taxation, fluctuations in foreign currencies, and other investment incentives.

**Competition**

We compete with many other machine tool producers in the United States and foreign countries. Most of our competitors are larger and have greater financial resources than our company. Major worldwide competitors include Deckel Maho Gildemeister Group (DMG), Mori Seiki Co., Ltd., Mazak, Haas Automation, Inc., Hardinge Inc., Doosan, and Okuma Machinery Works Ltd.

We strive to compete effectively by developing patentable software and other proprietary features that offer enhanced productivity, technological capabilities and ease of use. We offer our products in a range of prices and capabilities to target a broad potential market. We also believe that our competitiveness is aided by our reputation for reliability and quality, our strong international sales and distribution organization, and our extensive customer service organization.

**Intellectual Property**

We consider our products to be proprietary. Various features of our control systems and machine tools employ technologies covered by patents and trademarks that are material to our business. We also own additional patents covering new technologies that we have acquired or developed, and that we are planning to incorporate into our control systems in the future.

**Research and Development**

In the fiscal years set forth below, non-capitalized research and development expenditures for new products, significant product improvements and expenditures related to software development projects that were capitalized were as follows (in thousands):

| Fiscal Year | Non-capitalized research and development | Capitalized software development |
|---|---|---|
| 2012 | $ 2,600 | $ 1,000 |
| 2011 | 2,500 | 1,100 |
| 2010 | 2,200 | 1,200 |

**Employees**

We had approximately 560 full-time employees at the end of fiscal 2012, none of whom are covered by a collective-bargaining agreement or represented by a union. We have experienced no employee-generated work stoppages or disruptions and we consider our employee relations to be satisfactory.

**Geographic Areas**

Financial information about geographic areas in which we sell our products is set forth in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 14 of Notes to Consolidated Financial Statements.

Some of the risks of doing business on a global basis are described in Item 1A. Risk Factors below.

**Backlog**

For information on orders and backlog, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Availability of Reports and Other Information**

Our website can be found at www.hurco.com. We make available on this website, free of charge, access to our annual, quarterly and current reports and other documents filed by us with the Securities and Exchange Commission (SEC) as soon as reasonably practical after the filing date. These reports can also be obtained at the SEC's Public Reference Room at 100 F Street, NE Washington, DC 20549.

## Item 1A. RISK FACTORS

In this section we describe what we believe to be the material risks related to our business. The risks and uncertainties described below or elsewhere in this report are not the only ones to which we are exposed. Additional risks and uncertainties not presently known and/or risks we currently deem immaterial may also adversely affect our business and operations. If any of the developments included in the following risks were to occur, our business, financial condition, results of operations, cash flows or prospects could be materially adversely affected.

***The cyclical nature of our business causes fluctuations in our operating results.***

The machine tool industry is highly cyclical and changes in demand can occur abruptly in the geographic markets we serve. As a result of this cyclicality, we have experienced significant fluctuations in our sales, which, in periods of reduced demand, have adversely affected our results of operations and financial condition.

***Uncertain economic conditions, particularly in Europe, may adversely affect overall demand.***

Although we experienced strong growth in sales and profitability in fiscal 2012, there can be no assurance that the global recovery will be sustained or that our performance will return to pre-recession levels in Europe where we sell most of our higher-performance VMX series machines. The ongoing economic uncertainty in the European market could adversely affect our results of operations and financial condition.

***Our international operations pose additional risks that may adversely impact sales and earnings.***

During fiscal 2012, approximately 70% of our revenues were derived from sales to customers located outside the United States. In addition, our manufacturing facilities are located outside of the United States. Our international operations are subject to a number of risks, including:

- trade barriers
- regional economic uncertainty
- differing labor regulation
- governmental expropriation

- domestic and foreign customs and tariffs
- current and changing regulatory environments affecting the importation and exportation of products and raw materials
- difficulty in obtaining distribution support
- difficulty in staffing and managing widespread operations
- differences in the availability and terms of financing
- political instability and unrest
- changes in tax regulations and rates in foreign countries

Quotas, tariffs, taxes or other trade barriers could require us to change manufacturing sources, reduce prices, increase spending on marketing or product development, withdraw from or not enter certain markets or otherwise take actions that could be adverse to us. Also, in some foreign jurisdictions, we may be subject to laws limiting the right and ability of entities organized or operating therein to pay dividends or remit earnings to affiliated companies unless specified conditions are met. These factors may adversely affect our future operating results. The vast majority of our products are shipped from our manufacturing facility in Taiwan from the Port of Taichung to two ports of destination: Los Angeles, California, and Venlo, the Netherlands. Changes in customs requirements, as a result of national security or other constraints put upon these ports, may also have an adverse impact on our results of operations.

***We depend on limited sources for our products.***

Our wholly owned subsidiaries in Taiwan and China, Hurco Manufacturing Ltd. (HML) and Ningbo Hurco Manufacturing Limited (NHML), produce all of our machine tools. An unplanned interruption in manufacturing would have a material adverse effect on our results of operations and financial condition. Such an interruption could result from a change in the political environment or a natural disaster, such as an earthquake, typhoon, or tsunami. Any interruption in service by one of our key component suppliers, if prolonged, also could have a material adverse effect on our results of operations and financial condition.

***Fluctuations in the exchange rates between the U.S. Dollar and any of several foreign currencies can increase our costs and decrease our revenues.***

Our foreign sales, which generate approximately 70% of our revenues, are invoiced and received in several foreign currencies, primarily the Euro, Pound Sterling and Chinese Yuan. Therefore, our results of operations and financial condition are affected by fluctuations in exchange rates between these currencies and the U.S. Dollar, both for purposes of actual conversion and for financial reporting purposes. In addition, we are exposed to exchange risk associated with our purchases of materials and components for our Taiwan manufacturing operations, which are primarily made in the New Taiwan Dollar. We hedge our foreign currency exposure with the purchase of forward exchange contracts. These hedge contracts only mitigate the impact of changes in foreign currency rates that occur during the term of the related contract period and carry risks of counter-party failure. There can be no assurance that our hedges will have their intended effects.

***Our competitive position and prospects for growth may be diminished if we are unable to develop and introduce new and enhanced products on a timely basis that are accepted in the market.***

The machine tool industry is subject to technological change, evolving industry standards, changing customer requirements, and improvements in and expansion of product offerings. Our ability to anticipate changes in technology, industry standards, customers' requirements and competitors' product offerings and to develop and introduce new and enhanced products on a timely basis that are accepted in the market, are significant factors in maintaining and improving our competitive position and growth prospects. If the technologies or standards used in our products become obsolete or fail to gain widespread commercial acceptance, our business would be materially adversely affected. Although we believe that we have the technological capabilities to remain competitive, developments by others may render our products or technologies obsolete or noncompetitive.

***We compete with larger companies that have greater financial resources, and our business could be harmed by competitors' actions.***

The markets in which our products are sold are extremely competitive and highly fragmented. In marketing our products, we compete with other manufacturers in terms of quality, reliability, price, value, delivery time, service and technological characteristics. We compete with a number of U.S., European and Asian competitors, most of which are larger, have substantially greater financial resources and have been supported by governmental or financial institution subsidies and, therefore, may have competitive advantages over us. While we believe our product lines compete effectively, our financial resources are limited compared to those of most of our competitors, making it challenging to remain competitive.

***Fluctuations in the price of raw materials, especially steel and iron, could adversely affect our sales, costs and profitability.***

We manufacture products with a high iron and steel content. The availability and price for these and other raw materials are subject to volatility due to worldwide supply and demand forces, speculative actions, inventory levels, exchange rates, production costs and anticipated or perceived shortages. In some cases, those cost increases can be passed on to customers in the form of price increases; in other cases they cannot. If the prices of raw materials increase and we are not able to charge our customers higher prices to compensate, our results of operations would be adversely affected.

***Due to future changes in technology, changes in market demand, or changes in market expectations, portions of our inventory may become obsolete or excess.***

The technology within our products changes and, generally, we bring new versions of our machines to market in three-year to five-year cycles. The phasing out of an old product involves estimating the amount of inventory to hold to satisfy the final demand for those machines and to satisfy future repair part needs. Based on changing customer demand and expectations of delivery times for repair parts, we may find that we have either obsolete or excess inventory on hand. Because of unforeseen future changes in technology, market demand or competition, we might have to write off unusable inventory, which would adversely affect our results of operations.

***We may make acquisitions that could disrupt our operations and harm our operating results.***

We may seek to expand our product offerings or the markets we serve by acquiring other companies, product lines, technologies and personnel. Acquisitions involve numerous risks, including the following:

- difficulties integrating the operations, technologies, products, and personnel of the acquired companies
- diversion of management's attention from normal daily operations of the business
- potential difficulties completing projects associated with in-process research and development
- difficulties entering markets in which we have no or limited prior experience, especially when competitors in such markets have stronger market positions
- initial dependence on unfamiliar supply chains or relatively small supply partners
- insufficient revenues to offset increased expenses associated with acquisitions
- the potential loss of key employees of the acquired companies

Acquisitions may also cause us to:

- issue common stock that would dilute our current shareholders' percentage ownership
- assume liabilities
- record goodwill and non-amortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges
- incur amortization expenses related to certain intangible assets
- incur large and immediate write-offs, and restructuring and other related expenses
- become subject to litigation

Mergers and acquisitions are inherently risky. No assurance can be given that our acquisitions will be successful. Further, no assurance can be given that acquisitions will not adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could harm our business and operating results in a material way. Even when an acquired company has already developed and marketed products, there can be no assurance that product enhancements will be made in a timely manner or that pre-acquisition due diligence will identify all possible issues that might arise with respect to such products.

Risks related to new product development also apply to acquisitions. For additional information, please see the risk factor above entitled, “Due to future changes in technology, changes in market demand, or changes in market expectations, portions of our inventory may become obsolete or excess.”

***Assets may become impaired, requiring us to record a significant charge to earnings.***

We review our assets for indications of impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We could be required to record a significant charge to earnings in our financial statements for the period in which any impairment of these assets is determined, which would adversely affect our results of operations for that period.

***We may experience negative or unforeseen tax consequences.***

We may experience negative or unforeseen tax consequences. We review the probability of the realization of our net deferred tax assets each period based on forecasts of taxable income in both the U.S. and foreign jurisdictions. This review uses historical results, projected future operating results based upon approved business plans, eligible carryforward periods, tax-planning opportunities and other relevant considerations. Adverse changes in the profitability and financial outlook in the U.S. or foreign jurisdictions may require the creation of a valuation allowance to reduce our net deferred tax assets. Such changes could result in material non-cash expenses in the period in which the changes are made and could have a material adverse impact on our results of operations and financial condition.

***Our continued success depends on our ability to protect our intellectual property.***

Our future success depends in part upon our ability to protect our intellectual property. We rely principally on nondisclosure agreements, other contractual arrangements, trade secret law, trademark registration and patents to protect our intellectual property. However, these measures may be inadequate to protect our intellectual property from infringement by others or prevent misappropriation of our proprietary rights. In addition, the laws of some foreign

countries do not protect proprietary rights to the same extent as do U.S. laws. Our inability to protect our proprietary information and enforce our intellectual property rights through infringement proceedings could have a material adverse effect on our business, financial condition and results of operations.

***The unanticipated loss of current members of our senior management team and other key personnel may adversely affect our operating results.***

The unexpected loss of members of our senior management team or other key personnel could impair our ability to carry out our business plan. We believe that our future success will depend in part on our ability to attract and retain highly skilled and qualified personnel. The loss of senior management or other key personnel may adversely affect our operating results as we incur costs to replace the departed personnel and potentially lose opportunities in the transition of important job functions.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. PROPERTIES**

The following table sets forth the principal use, location, and size of each of our facilities:

| Principal Uses | Locations | Square Footage |
|---|---|---|
| Corporate headquarters, design and engineering, product testing, sales and marketing, application engineering and customer service. | Indianapolis, Indiana, USA [(1)] | 165,000 |
| Manufacturing | Taichung, Taiwan | 330,600 |
| | Ningbo, China | 112,400 |
| Sales, design engineering, product testing and customer service. | Dexter, Michigan, USA | 3,000 |
| Sales, application engineering and customer service. | High Wycombe, England | 12,000 |
| | Benoni, South Africa | 2,500 |
| | Paris and Toulouse, France | 11,100 |
| | Munich and Hagen, Germany | 26,200 |
| | Milan, Italy | 10,800 |
| | Netherlands | 4,000 |
| | South Korea | 700 |
| | Singapore | 6,300 |
| | Shanghai, Dongguan, Shenyang Ningbo, Chongqing, and Beijing, China | 18,800 |
| | Chennai, Haryana, and Pune India | 10,800 |
| | Liegnitz, Poland | 2,900 |
| | Grand Rapids, Michigan, USA | 5,000 |
| | Ball Ground, Georgia, USA | 5,200 |

| | | |
|---|---|---|
| Warehouse, distribution, sales, application engineering and customer service. | Los Angeles, California, USA | 13,100 |

(1) Approximately 50,000 square feet is leased to a third-party under a lease that expires March 31, 2013. We are currently pursuing other tenants as the current tenant has notified us that they will be vacating the property at the end of the lease.

We own the Indianapolis facility and lease all other facilities. The leases have terms expiring at various dates ranging from November 2012 to July 2017. We believe that all of our facilities are well maintained and are adequate for our needs now and in the foreseeable future. We do not believe that we would experience any difficulty in replacing any of the present facilities if any of our leases were not renewed at expiration.

**Item 3. LEGAL PROCEEDINGS**

From time to time we are involved in various claims and lawsuits arising in the normal course of business. We do not expect any of these claims, individually or in the aggregate, to have a material adverse effect on our financial position or results of operations.

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

None.

**Executive Officers of the Registrant**

Executive officers are elected each year by the Board of Directors at the first board meeting following the Annual Meeting of Shareholders to serve during the ensuing year and until their respective successors are elected and qualified. There are no family relationships between any of our executive officers or between any of them and any of the members of the Board of Directors.

The following information sets forth as of October 31, 2012, the name of each executive officer and his or her age, tenure as an officer, principal occupation and business experience for the last five years:

| Name | Age | Position(s) with the Company |
|---|---|---|
| Michael Doar | 57 | Chairman of the Board, Chief Executive Officer and President |
| John G. Oblazney | 44 | Vice President, Secretary, Treasurer and Chief Financial Officer |
| John P. Donlon | 55 | Executive Vice President, International Sales/Service |
| Sonja K. McClelland | 41 | Corporate Controller, Assistant Secretary |
| Gregory S. Volovic | 48 | Executive Vice President, Technology & Operations and North American Sales/Service |

Michael Doar was elected Chairman of the Board and Chief Executive Officer on November 14, 2001, and President effective October 31, 2009. Mr. Doar had held various management positions with Ingersoll Milling Machine Company from 1989 until 2001. Mr. Doar has been a director of Hurco since 2000.

John G. Oblazney was elected Vice President, Secretary, Treasurer and Chief Financial Officer in September 2006. Prior to joining us, Mr. Oblazney served as the Chief Financial Officer of Carrier Corporation's Light Commercial Business, a division of United Technologies Corporation, since December 2005. Prior to that, Mr. Oblazney served in various other financial positions with Carrier Corporation from 2000 to 2005. Prior to joining Carrier Corporation, Mr. Oblazney was employed for six years with Cooper Industries and employed for three years by an international public accounting firm.

John P. Donlon has been employed by us since April 2010 as Executive Vice President, International Sales/Service. Prior to joining us, Mr. Donlon served as the Vice President of Sales for Yaskawa America Robotics since 2008. From 2004 to 2008, Mr. Donlon served as the Vice President of Sales and Marketing for Ansaldo STS, a worldwide supplier of automation technologies to the rail industry. Earlier in his career, Mr. Donlon held executive sales and management positions with other multi-national companies including Honeywell and ABB, and he has significant international experience in the emerging markets of China, Russia and Brazil.

Sonja K. McClelland has been employed by us since September 1996 and was elected as our Corporate Controller and Assistant Secretary in November 2004. Ms. McClelland served as Corporate Accounting Manager from September 1996 to 1999, then as Division Controller for Hurco USA from September 1999 to November 2004. Prior to joining us, Ms. McClelland was employed for three years by an international public accounting firm.

Gregory S. Volovic has been employed by us since March 2005 and is Executive Vice President, Technology & Operations and North American Sales/Service. Mr. Volovic previously held the position of Executive Vice President, Software & Engineering until October 2009. Prior to joining us, Mr. Volovic held various positions with Thomson, Inc. including Director of E-Business, Engineering, and Information Technology. Prior to that, Mr. Volovic was employed by Unisys Corporation.

## PART II

## Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Global Select Market under the symbol "HURC". The following table sets forth the high and low sale prices of the shares of our common stock for the periods indicated, as reported by the Nasdaq Global Select Market.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| Fiscal Quarter Ended: | High | Low | High | Low |
| January 31 | $28.00 | $20.16 | $26.84 | $18.01 |
| April 30 | 28.80 | 22.51 | 32.82 | 23.25 |
| July 31 | 26.58 | 19.15 | 35.07 | 27.69 |
| October 31 | 24.89 | 19.58 | 30.47 | 17.45 |

On December 28, 2012, the closing price of our common stock on the Nasdaq Global Select Market was $22.84.

We do not currently pay dividends on our common stock and intend to continue to retain earnings for working capital and capital expenditures.

There were 166 holders of record of our common stock as of December 28, 2012.

During the period covered by this report, we did not sell any equity securities that were not registered under the Securities Act of 1933, as amended.

The disclosure under the caption "Equity Compensation Plan Information" is included in Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

**Item 6. SELECTED FINANCIAL DATA**

The Selected Financial Data presented below has been derived from our consolidated financial statements for the years indicated and should be read in conjunction with the consolidated financial statements and related notes set forth elsewhere herein and Management's Discussion and Analysis of Financial Condition and Results of Operations.

| | Year Ended October 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| | (Dollars in thousands, except per share amounts) | | | | |
| Statement of Operations Data: | | | | | |
| Sales and service fees | $203,117 | $180,400 | $105,893 | $91,016 | $223,994 |
| Gross profit | 63,181 | 55,874 | 21,796 | 25,828 | 82,617 |
| Selling, general and administrative expenses | 41,160 | 38,493 | 29,837 | 30,874 | 46,811 |
| Operating income (loss) | 22,021 | 17,381 | (8,041) | (5,046) | 35,806 |
| Other income (expense) | (157) | (1,762) | (818) | 1,234 | (1,640) |
| Net income (loss) | 15,638 | 11,124 | (5,744) | (2,321) | 22,520 |
| Earnings (loss) per common share- diluted | 2.40 | 1.71 | (0.89) | (0.36) | 3.49 |
| Weighted average common shares outstanding-diluted | 6,470 | 6,472 | 6,441 | 6,429 | 6,444 |

| | As of October 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| | (Dollars in thousands) | | | | |
| Balance Sheet Data: | | | | | |
| Current assets | $173,381 | $164,074 | $136,208 | $118,264 | $151,312 |
| Current liabilities | 49,372 | 57,228 | 42,240 | 20,807 | 51,129 |
| Working capital | 124,009 | 106,846 | 93,968 | 97,457 | 100,183 |
| Current ratio | 3.5 | 2.9 | 3.2 | 5.7 | 3.0 |
| Total assets | 195,312 | 186,545 | 160,346 | 144,743 | 177,444 |
| Non-current liabilities | 2,147 | 3,105 | 3,366 | 3,560 | 2,838 |
| Total debt | 3,206 | 865 | — | — | — |
| Shareholders' equity | 143,793 | 126,212 | 114,740 | 120,376 | 123,477 |

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## **Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

EXECUTIVE OVERVIEW

Hurco Companies, Inc. is an industrial technology company operating in a single segment. We design and produce computerized machine tools, featuring our proprietary computer control systems and software, for sale through our own distribution network to the worldwide metal cutting market. We also provide software options, control upgrades, accessories and replacement parts for our products, as well as customer service and training support.

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

The market for machine tools is international in scope. We have both significant foreign sales and significant foreign manufacturing operations. During fiscal 2012, 59% of our revenues were attributable to customers in Europe, where we typically sell more of our higher-performance, higher-priced VMX series machines. Additionally, 11% of our revenues were attributable to customers in Asia, where we sell more of our entry-level, lower-priced machines, but where we also encounter greater price pressures. 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 China, France, Germany, India, Italy, Poland, Singapore, South Africa, the United Kingdom and certain parts of the United States. The vast majority of our machine tools are manufactured to our specifications primarily by our wholly owned subsidiary in Taiwan, Hurco Manufacturing Limited (HML). Machine castings and components to support HML’s production are manufactured at our facility in Ningbo, China. We also manufacture machine tools for the Chinese market at the Ningbo plant.

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

rates had on those results.

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

During fiscal 2012, we continued to focus on our core competencies and strategic priorities, which we believe have a positive impact on our financial performance and our ability to remain competitive in a very diverse global market for machine tools. We continued to invest in China, the largest machine tool market in the world. Unit sales of our products in China in fiscal 2012 increased by more than 50% on a year-over-year basis. In addition, we expanded our product line of five-axis and high speed machines, as well as multi-axis lathes and other specialty equipment that simplifies complex operations with an intuitive, user-friendly interface allowing our customers to increase productivity and profitability. Our overall results reflected a strong improvement in sales of approximately 13% over fiscal 2011 and a 27% improvement in operating income resulting from more effective management of our operating costs.

**Results of Operations**

The following table presents, for the fiscal years indicated, selected items from the Consolidated Statements of Operations expressed as a percentage of our worldwide sales and service fees and the year-to-year percentage changes in the dollar amounts of those items.

| | Percentage of Revenues | | | Year-to-Year % Change Increase (Decrease) | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | ’12 vs. ’11 | ’11 vs. ’10 |
| Sales and service fees | 100.0% | 100.0% | 100.0% | 12.6% | 70.4 % |
| Gross profit | 31.1 % | 31.0 % | 20.6 % | 13.1% | 156.3 % |
| Selling, general and administrative expenses | 20.3 % | 21.3 % | 28.2 % | 6.9 % | 29.0 % |
| Operating income (loss) | 10.8 % | 9.6 % | (7.6 )% | 26.7% | 316.2 % |
| Other income (expense) | (0.1 )% | (1.0 )% | (0.8 )% | 91.1% | (115.4)% |
| Net income (loss) | 7.7 % | 6.2 % | (5.4 )% | 40.6% | 293.7 % |

Fiscal 2012 Compared to Fiscal 2011

*Sales and Service Fees.* Annual sales and service fees for fiscal 2012 were $203.1 million, an increase of $22.7 million, or 12.6%, from fiscal 2011. A stronger U.S. Dollar when translating foreign sales to U.S. Dollars had an unfavorable impact of approximately 4%, or $7.6 million, on the year-to-year comparison.

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

The following table sets forth net sales and service fees by geographic region for the fiscal years ended October 31, 2012 and 2011 (in thousands):

| | October 31, | | | | Increase (Decrease) | |
|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | Amount | % |
| North America | $60,527 | 29.8 % | $49,637 | 27.5 % | $10,890 | 21.9% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Europe | 119,359 | 58.8 % | 111,080 | 61.6 % | 8,279 | 7.5 % |
| Asia Pacific | 23,231 | 11.4 % | 19,683 | 10.9 % | 3,548 | 18.0% |
| Total | $203,117 | 100.0% | $180,400 | 100.0% | $22,717 | 12.6% |

The increase in sales during fiscal 2012 was primarily the result of higher customer demand in all regions. The 7.5% increase in Europe was actually 13.3% when adjusted to exclude the adverse impact of foreign currency translation due to a weaker Euro relative to the U.S. Dollar. In fiscal 2012, unit shipments increased 14% in North America, 4% in Europe and 16% in Asia compared to fiscal 2011.

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

The following table sets forth net sales and service fees by product category for the years ended October 31, 2012 and 2011 (in thousands):

| | October 31, 2012 | | 2011 | | Increase Amount | % |
|---|---|---|---|---|---|---|
| Computerized Machine Tools | $179,337 | 88.3 % | $156,736 | 86.9 % | $22,601 | 14.4% |
| Service Fees, Parts and Other | 23,780 | 11.7 % | 23,664 | 13.1 % | 116 | 0.5 % |
| Total | $203,117 | 100.0% | $180,400 | 100.0% | $22,717 | 12.6% |

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*Orders and Backlog*. New order bookings in fiscal 2012 were $198.1 million, an increase of $1.2 million, or 0.6%, over the prior year. Orders in fiscal 2012 increased over fiscal 2011 in North America by $11.6 million (or 23%), but decreased in Europe by $6.1 million (or 5%), and $4.4 million (or 17%) in the Asia Pacific region. The effect of a stronger U.S. Dollar in 2012 when translating foreign orders to U.S. Dollars had an unfavorable impact of $7.0 million, or 4%, on the year-to-year comparison. Unit orders increased 22% in North America, but decreased in Europe by 9% and in the Asia Pacific region by 22%. Backlog was $25.8 million at October 31, 2012, compared to $31.9 million at October 31, 2011. We do not believe backlog is a useful measure of past performance or indicative of future performance. Backlog orders as of October 31, 2012 are expected to be fulfilled in fiscal 2013.

*Gross Profit*. Gross profit for fiscal 2012 was $63.2 million, or 31.1% of sales, compared to $55.9 million, or 31.0% of sales for fiscal 2011. The year-over-year improvement in gross profit was primarily related to an increase in volume of sales year-over-year.

*Operating Expenses.* Selling, general and administrative expenses were $41.2 million for fiscal 2012, an increase of $2.7 million, or 6.9%, from fiscal 2011. The increase consisted primarily of higher sales and marketing expense, and higher commissions as a result of the increase in sales. Despite the dollar increase, selling, general and administrative expenses as a percentage of sales and service fees declined to 20.3% as compared to 21.3% for fiscal 2011 due to the increased sales in 2012.

*Operating Income (Loss).* Operating income for fiscal 2012 was $22.0 million, or 10.8% of sales, compared to an operating income of $17.4 million, or 9.6% of sales, in fiscal 2011. The improvement in operating income year-over-year was primarily due to the increase in sales.

*Other (Income) Expense.* Other expense for fiscal 2012 decreased by $1.6 million from fiscal 2011 due to lower foreign currency losses experienced in fiscal 2012.

*Provision (Benefit) for Income Taxes*. Our effective tax rate for fiscal 2012 was 28.5%, which reflected minimal change compared to the effective tax rate for fiscal 2011 of 28.8%.

*Net Income (Loss).* Net income for fiscal 2012 was $15.6 million, or $2.40 per diluted share, which is an increase of $4.5 million from fiscal 2011 net income of $11.1 million, or $1.71 per diluted share.

Fiscal 2011 Compared to Fiscal 2010

*Sales and Service Fees.* Annual sales and service fees for fiscal 2011 were $180.4 million, an increase of $74.5 million, or 70.4%, from fiscal 2010. A weaker U.S. Dollar when translating foreign sales to U.S. Dollars had a favorable impact of approximately 4%, or $4.3 million, on the year-to-year comparison.

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

The following table sets forth net sales and service fees by geographic region for the fiscal years ended October 31, 2011 and 2010 (in thousands):

| | October 31, | | | | Increase (Decrease) | |
|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | Amount | % |
| North America | $49,637 | 27.5 % | $27,818 | 26.3 % | $21,819 | 78.4% |
| Europe | 111,080 | 61.6 % | 65,678 | 62.0 % | 45,402 | 69.1% |
| Asia Pacific | 19,683 | 10.9 % | 12,397 | 11.7 % | 7,286 | 58.8% |
| Total | $180,400 | 100.0% | $105,893 | 100.0% | $74,507 | 70.4% |

The significant percentage increase in sales during fiscal 2011 was primarily the result of higher customer demand as a result of a rebound in industrial manufacturing activity and our ability to increase production to meet demand. In fiscal 2011, unit shipments increased 72% in North America, 51% in Europe and 46% in Asia compared to fiscal 2010.

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

The following table sets forth net sales and service fees by product category for the years ended October 31, 2011 and 2010 (in thousands):

| | October 31, 2011 | | 2010 | | Increase Amount | % |
|---|---|---|---|---|---|---|
| Computerized Machine Tools | $156,736 | 86.9 % | $88,184 | 83.3 % | $68,552 | 77.7% |
| Service Fees, Partsand Other | 23,664 | 13.1 % | 17,709 | 16.7 % | 5,955 | 33.6% |
| Total | $180,400 | 100.0% | $105,893 | 100.0% | $74,507 | 70.4% |

*Orders and Backlog*. New order bookings in fiscal 2011 were $197.0 million, an increase of $81.7 million, or 70.8%, over the prior year. Orders in fiscal 2011 increased over fiscal 2010 by $17.9 million (or 56%) in North America, by $53.0 million (or 77%) in Europe, and $10.8 million (or 73%) in the Asia Pacific region. The effect of a weaker U.S. Dollar in 2011 when translating foreign orders to U.S. Dollars had a favorable impact of $3.7 million, or 3.2%, on the year-to-year comparison. Unit orders increased 41% in North America, 57% in Europe and 66% in the Asia Pacific region. Backlog was $31.9 million at October 31, 2011, compared to $15.6 million at October 31, 2010. We do not believe backlog is a useful measure of past performance or indicative of future performance. Backlog orders as of October 31, 2011 were fulfilled in fiscal 2012.

*Gross Profit*. Gross profit for fiscal 2011 was $55.9 million, or 31.0% of sales, compared to $21.8 million, or 20.6% of sales for fiscal 2010. The year-over-year improvement in gross profit was primarily related a general increase in volume of sales year-over-year, particularly in Europe, the primary market for our higher-performance VMX series machines, and the increased cost efficiencies realized from higher production levels during fiscal 2011. However, gross profit for fiscal 2011 was adversely impacted by higher raw material costs, primarily for metals, as well as the appreciation of the New Taiwanese Dollar relative to the U.S. Dollar. We increased selling prices across all product offerings at the end of the second quarter of fiscal 2011 to offset these higher costs.

*Operating Expenses*. Selling, general and administrative expenses were $38.5 million for fiscal 2011, an increase of $8.7 million, or 29.0%, from fiscal 2010. The increase consisted primarily of higher sales commissions due to increased sales volume, higher global sales and marketing expense, and increased wages and compensation paid to employees who had experienced wage reductions when cost containment measures were implemented during fiscal 2009 and 2010. Despite the dollar increase, selling, general and administrative expenses as a percentage of the sales and service fees declined to 21.8% in fiscal 2012 as compared to 28.2% for fiscal 2010 due to increased sales in 2011.

*Operating Income (Loss).* Operating income for fiscal 2011 was $17.4 million, or 9.6% of sales, compared to an operating loss of $8.0 million, or 7.6% of sales, in fiscal 2010. The substantial improvement in operating income year-over-year was primarily due to the significant increase in sales in fiscal 2011.

*Other (Income) Expense.* Other income for fiscal 2011 decreased by $1.1 million in comparison to fiscal 2010 due primarily to net realized and unrealized losses from foreign currency fluctuations on payables and receivables, net of foreign currency forward exchange contracts.

*Provision (Benefit) for Income Taxes*. Our effective tax rate for fiscal 2011 was an expense of 28.8%, compared to a benefit of 35.2% for fiscal 2010. The reduction in the effective tax rate for the year was primarily due to changes in the geographic mix of income or loss between tax jurisdictions with statutory tax rates ranging from 17% to 37%.

*Net Income (Loss).* Net income for fiscal 2011 was $11.1 million, or $1.71 per diluted share, which is an increase of $16.8 million from fiscal 2010 net loss of $5.7 million, or $0.89 per diluted share.

**Liquidity and Capital Resources**

At October 31, 2012, we had cash and cash equivalents of $35.8 million compared to $45.0 million at October 31, 2011.

Approximately 72.1% of our $35.8 million of cash and cash equivalents is held in the U.S. The remaining balances are denominated in various foreign currencies and held by our foreign subsidiaries. These balances are associated with our permanent reinvestment strategy and are subject to fluctuations in currency exchange rates. We do not believe that the indefinite reinvestment of these funds offshore impairs our ability to meet our domestic working capital needs.

Working capital, excluding cash, was $88.2 million at October 31, 2012, compared to $61.9 million at October 31, 2011. The increase in working capital, excluding cash, was primarily due to increased inventory resulting from higher production levels and increased accounts receivable due to higher sales volumes.

Inventories were $91.3 million at October 31, 2012, compared to $81.1 million at October 31, 2011. The $10.2 million increase was due to increased finished goods inventory to support the 13% increase in sales. Inventory turns remained relatively stable from 1.6 turns as of October 31, 2011 to 1.5 turns as of October 31, 2012.

Capital expenditures were $3.7 million in fiscal 2012 and $2.8 million in fiscal 2011. Capital expenditures for 2012 were primarily for purchase of factory equipment for production facilities in Taiwan, software development costs, and implementation of operating systems. We funded these expenditures with cash flow from operations.

On December 7, 2012, we entered into a new credit agreement to replace our prior credit agreement. Under the prior credit agreement, we had a $15.0 million unsecured revolving credit facility, a letter of credit facility with a maximum amount for outstanding letters of credit of $3.0 million and a backup letter of credit facility in the amount of 100 million New Taiwan Dollars or approximately $3.5 million.  Pursuant to the new credit agreement, the lenders will provide us with a $12.5 million unsecured revolving credit and letter of credit facility, with a $3.0 million maximum amount for outstanding letters of credit. The scheduled maturity date of the new credit agreement is December 7, 2014.  Given our current cash position, we determined that a $12.5 million revolving credit facility was sufficient to meet our needs during the term of the new credit agreement; moreover, the reduction in the size of the line from the prior credit agreement facilitated more favorable pricing and covenants.

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

The new credit agreement permits us to make investments in subsidiaries of up to $5.0 million, an increase from the amount permitted in the prior credit agreement. Further, the new credit agreement replaces the financial covenants that were in the prior credit agreement with a minimum working capital requirement of $90.0 million and a minimum tangible net worth requirement of $120.0 million. The new credit agreement will permit us to pay cash dividends in an amount not to exceed $1.0 million per calendar year so long as we are not in default before and after giving effect to such dividends.  The remaining covenants in the new credit agreement are substantially the same as those that were in the prior credit agreement.

We also have credit facilities in the United Kingdom, Germany, Taiwan and China. At October 31, 2012, our only outstanding borrowings were in China, where we had $3.2 million outstanding. At October 31, 2012, we were in compliance with those covenants contained in all of our credit facilities and had $25.2 million of available borrowing capacity under those facilities.

We believe our cash position and borrowing capacity under our credit facilities provide adequate liquidity to fund our operations over the next twelve months and keep us committed to our strategic plan for product innovation and targeted penetration of developing markets.

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 may be available for purchase.

Contractual Obligations and Commitments

The following is a table of contractual obligations and commitments as of October 31, 2012 (all amounts in thousands):

Payments Due by Period

| | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|---|---|---|---|---|---|
| Short-term debt | $3,206 | $ 3,206 | $— | $ — | $— |
| Operating Leases | 6,978 | 3,037 | 3,788 | 153 | — |
| Other | 1,244 | — | — | — | 1,244 |
| Total | $11,428 | $ 6,243 | $3,788 | $ 153 | $1,244 |

In addition to the contractual obligations and commitments disclosed above, we also have a variety of other obligations for the procurement of materials and services, none of which subject us to any material non-cancelable commitments. While some of these obligations arise under long-term supply agreements, we are not committed under these agreements to accept or pay for requirements that are not needed to meet our production needs. We have no material minimum purchase commitments or “take-or-pay” type agreements or arrangements. Unrecognized tax benefits in the amount of approximately $118,000, excluding any interest and penalties, have been excluded from the table above because we are unable to determine a reasonably reliable estimate of the timing of future payment.

We expect capital spending in fiscal 2013 to be approximately $4.6 million, which includes investments for capitalized software, capital equipment and costs to continue implementation of our integrated computer system. We expect to fund these commitments with cash on hand and cash generated from operations.

**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. As of October 31, 2012, we had 19 outstanding third party payment guarantees totaling approximately $1.1 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer has the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue 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.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. Generally Accepted Accounting Principles. The preparation of financial statements in conformity with those accounting principles require us to make judgments and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. Those judgments and estimates have a significant effect on the financial statements because they result primarily from the need to make estimates about the effects of matters that are inherently uncertain. Actual results could differ from those estimates. Our accounting policies, including those described below, are frequently evaluated as our judgment and estimates are based upon historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

*Revenue Recognition* - We recognize revenue from sales of our machine tool systems upon delivery of the product to the customer, which is normally at the time of shipment, because persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed and determinable and collectability is reasonably assured. In certain foreign locations, we retain title after shipment under a “retention of title” clause solely to protect collectability. The retention of title is similar to Uniform Commercial Code (“UCC”) filings in the United States and provides the creditor with additional rights to the machine if the customer fails to pay. Revenue recognition at the time of shipment is appropriate in this instance as long as all risks of ownership have passed to the buyer. Our computerized machine tools are general-purpose computer controlled machine tools that are typically used in stand-alone operations. Transfer of ownership and risk of loss are not contingent upon contractual customer acceptance. Prior to shipment, we test each machine to ensure the machine’s compliance with standard operating specifications as listed in our sales literature.

Depending upon geographic location, after shipment, a machine may be installed at the customer’s facilities by a distributor, independent contractor or by one of our service technicians. In most instances where a machine is sold through a distributor, we have no installation involvement. If sales are direct or through sales agents, we will typically complete the machine installation, which consists of the reassembly of certain parts that were removed for shipping and the re-testing of the machine to ensure that it is performing within the standard specifications. We consider the machine installation process to be inconsequential and perfunctory.

Service fees from maintenance contracts are deferred and recognized in earnings on a pro rata basis over the term of the contract. Sales related to software products are recognized when shipped in conformity with U.S. Generally Accepted Accounting Principles as promulgated by Financial Accounting Standards Board or its predecessor (FASB guidance) related to software revenue recognition that requires at the time of shipment, persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed and determinable and collectability is reasonably assured. The software does not require production, modification or customization.

*Inventories* – We determine at each balance sheet date how much, if any, of our inventory may ultimately prove to be unsalable or unsalable at its carrying cost. Reserves are established to effectively adjust the carrying value of such inventory to net realizable value. To determine the appropriate level of valuation reserves, we evaluate current stock levels in relation to historical and expected patterns of demand for all of our products. We evaluate the need for changes to valuation reserves based on market conditions, competitive offerings and other factors on a regular basis.

*Income Taxes* – We account for income taxes in accordance with FASB guidance. Deferred tax assets and liabilities are measured using enacted income tax rates in each jurisdiction in effect for the year in which the temporary differences are expected to be recovered or settled. These deferred tax assets are reduced by a valuation allowance, which is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Our judgment regarding the realization of deferred tax assets may change due to future profitability and market conditions, changes in U.S. or foreign tax laws and other factors. These changes, if any, may require material adjustments to these deferred tax assets and an accompanying reduction or increase in net income in the period when such determinations are made.

The determination of our provision for income taxes requires judgment, the use of estimates and the interpretation and application of complex tax laws. Our provision for income taxes reflects a combination of income earned and taxed at the federal and state level in the U.S., as well as in various foreign jurisdictions. We have not provided for any U.S. income taxes on the undistributed earnings of our foreign subsidiaries based upon our determination that such earnings will be indefinitely reinvested abroad.

In addition to the risks to the effective tax rate described above, the future effective tax rate reflected in forward-looking statements is based on currently effective tax laws. Significant changes in those laws could materially affect these estimates.

We recognize uncertain tax positions when it is more likely than not that the tax position will be sustained upon examination by relevant taxing authorities, based on the technical merits of the position. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

*Capitalized Software Development Costs* – Costs incurred to develop computer software products and significant enhancements to software features of existing products are capitalized as required by FASB guidance relating to accounting for the costs of computer software to be sold, leased, or otherwise marketed, and amortized over the estimated product life of the related software. The determination as to when in the product development cycle technological feasibility has been established, and the expected product life, require judgments and estimates by management and can be affected by technological developments, innovations by competitors and changes in market conditions affecting demand. We periodically review the carrying values of these assets and make judgments as to ultimate realization considering the above-mentioned risk factors.

*Derivative Financial Instruments* – Critical aspects of our accounting policy for derivative financial instruments that we designate as hedging instruments include conditions that require that critical terms of a hedging instrument are essentially the same as a hedged forecasted transaction. Another important element of our policy demands that formal documentation be maintained as required by FASB guidance relating to accounting for derivative instruments and

hedging activities. Failure to comply with these conditions would result in a requirement to recognize changes in market value of hedge instruments in earnings. We routinely monitor significant estimates, assumptions, and judgments associated with derivative instruments, and compliance with formal documentation requirements.

*Stock Compensation* – We account for share-based compensation according to FASB guidance relating to share based payments, which requires the measurement and recognition of compensation expense for all share-based awards made to employees and directors based on estimated fair values on the grant date. This guidance requires that we estimate the fair value of share-based awards on the date of grant and recognize as expense the value of the portion of the award that is ultimately expected to vest over the requisite service period.

## Item 7a. Quantitative and Qualitative Disclosures About Market Risks

### Interest Rate Risk

Interest on borrowings under our bank credit agreements are tied to prevailing domestic and foreign interest rates. At October 31, 2012, we had $3.2 million of borrowings outstanding under our credit facility in China, but had no outstanding borrowings under any of our other bank credit facilities.

### Foreign Currency Exchange Risk

In fiscal 2012, we derived approximately 70% of our revenues from foreign markets. All of our computerized machine tools and computer control systems assembled in Taiwan, 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 in Taiwan. Our purchases are predominantly in foreign currencies and in some cases our arrangements with these suppliers include foreign currency risk sharing agreements, which reduce (but do not eliminate) the effects of currency fluctuations on product costs. The predominant portion of the exchange rate risk associated with our product purchases relates to the New Taiwan Dollar.

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 October 31, 2012, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities were as follows:

Contract Amount at

| Forward Contracts | Notional Amount in Foreign Currency | Weighted Avg. Forward Rate | | Forward Rates in U.S. Dollars Contract Date | October 31, 2012 | Maturity Dates |
|---|---|---|---|---|---|---|
| Sale Contracts: | | | | | | |
| Euro | 27,850,000 | 1.2987 | | $36,169,655 | $36,158,378 | Nov 2012-Oct 2013 |
| Sterling | 6,070,000 | 1.5871 | | $9,633,399 | $9,785,006 | Nov 2012-Oct 2013 |
| Purchase Contracts: | | | | | | |
| New Taiwan Dollar | 763,000,000 | 29.25 | * | $26,085,655 | $26,272,742 | Nov 2012-Oct 2013 |

*NT Dollars per U.S. Dollar

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Forward contracts for the sale or purchase of foreign currencies as of October 31, 2012, 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:

| | | | | Contract Amount at Forward Rates in U.S. Dollars | | |
|---|---|---|---|---|---|---|
| Forward Contracts | Notional Amount in Foreign Currency | Weighted Avg. Forward Rate | | Contract Date | October 31, 2012 | Maturity Dates |
| Sale Contracts: | | | | | | |
| Euro | 12,884,438 | 1.2945 | | $16,678,875 | $16,717,779 | Nov 2012 – Apr 2013 |
| Pound Sterling | 1,315,940 | 1.6082 | | $2,116,306 | $2,122,312 | Nov 2012 |
| Canadian Dollar | 996,217 | 0.9973 | | $993,534 | $991,774 | Apr 2013 |
| South African Rand | 6,129,420 | 0.1126 | | $690,282 | $690,497 | Apr 2013 |
| Purchase Contracts: | | | | | | |
| New Taiwan Dollar | 315,083,180 | 29.10 | * | $10,827,649 | $10,799,598 | Nov 2012 – Dec 2012 |

* NT Dollars per U.S. Dollar

We are exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we entered into a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro denominated assets. We selected the forward method under the FASB guidance related to the accounting for derivatives instruments and hedging activities. The forward method requires all changes in the fair value of the contract to be reported as a cumulative translation adjustment in Accumulated Other Comprehensive Loss, net of tax, in the same manner as the underlying hedged net assets. This forward contract matured in November 2012 and we entered into a new forward contract for the same notional amount that is set to mature in November 2013. As of October 31, 2012, we had a realized gain of $227,000 and an unrealized gain of $106,000, net of tax, recorded as cumulative translation adjustments in Accumulated Other Comprehensive Loss, related to these forward contracts.

Forward contracts for the sale or purchase of foreign currencies as of October 31, 2012, which are designated as net investment hedges under this guidance were as follows:

| | Notional Amount | Weighted Avg. | Contract Amount at Forward Rates in U.S. Dollars | | |
|---|---|---|---|---|---|
| Forward Contracts | in Foreign Currency | Forward Rate | Contract Date | October 31, 2012 | Maturity Date |

| | | | | | |
|---|---|---|---|---|---|
| Sale Contracts: | | | | | |
| Euro | 3,000,000 | 1.3520 | $ 4,056,000 | $ 3,889,680 | Nov 2012 |

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**Management's Annual Report on Internal Control Over Financial Reporting**

To the Shareholders and

Board of Directors

of Hurco Companies, Inc.:

Management of Hurco Companies, Inc. (the "Company"), has assessed the effectiveness of internal controls over financial reporting as of October 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting.

Because of its inherent limitations, the Company's internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In management's opinion, the Company's internal controls over financial reporting as of October 31, 2012, are effective based on the criteria specified above.

Our independent registered accounting firm, Ernst & Young LLP, who also audited our consolidated financial statements, audited the effectiveness of our internal control over financial reporting as of October 31, 2012. Ernst & Young has issued their attestation report, which is included in Part II, Item 8 of this Annual Report on Form 10-K.

/s/ Michael Doar
Michael Doar,
Chairman of the Board, Chief Executive Officer and President

/s/ John G. Oblazney
John G. Oblazney,
Vice President & Chief Financial Officer

/s/ Sonja K. McClelland
Sonja K. McClelland

Corporate Controller, Assistant Secretary
(Principal Accounting Officer)

Indianapolis, Indiana
January 11, 2013

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## **Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Report of Independent Registered Public Accounting Firm

To the Shareholders and

Board of Directors

of Hurco Companies, Inc.

We have audited the accompanying consolidated balance sheets of Hurco Companies, Inc. as of October 31, 2012 and 2011 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended October 31, 2012. Our audits also included the financial statement schedule listed at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hurco Companies, Inc. at October 31, 2012 and 2011 and the consolidated results of its operations and its cash flows for each of the three years in the period ended October 31, 2012 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Hurco Companies, Inc.'s internal control over financial reporting as of October 31, 2012, based on criteria established in Internal Control – Integrated Framework issued by the Commission of Sponsoring Organizations of the Treadway Commission and our report dated January 11, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Indianapolis, Indiana

January 11, 2013

**Report of Independent Registered Public Accounting Firm**

To the Shareholders and

Board of Directors

of Hurco Companies, Inc.

We have audited Hurco Companies, Inc.'s internal control over financial reporting as of October 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Hurco Companies, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or, disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may

deteriorate.

In our opinion, Hurco Companies, Inc. maintained, in all material respects, effective internal control over financial reporting as of October 31, 2012, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Hurco Companies, Inc. as of October 31, 2012 and 2011 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended October 31, 2012 of Hurco Companies, Inc. and our report dated January 11, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Indianapolis, Indiana

January 11, 2013

HURCO COMPANIES, INC.

**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Year Ended October 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except per share amounts) | | |
| Sales and service fees | $ 203,117 | $ 180,400 | $ 105,893 |
| Cost of sales and service | 139,936 | 124,526 | 84,097 |
| Gross profit | 63,181 | 55,874 | 21,796 |
| Selling, general and administrative expenses | 41,160 | 38,493 | 29,837 |
| Operating income (loss) | 22,021 | 17,381 | (8,041) |
| Interest expense | 168 | 143 | 49 |
| Interest income | 69 | 132 | 86 |
| Investment income | 7 | 13 | 14 |
| Earnings (losses) from equity investments | 276 | 53 | (149) |
| Other (income) expense, net | 341 | 1,817 | 720 |
| Income (loss) before income taxes | 21,864 | 15,619 | (8,859) |
| Provision (benefit) for income taxes | 6,226 | 4,495 | (3,115) |
| Net income (loss) | $ 15,638 | $ 11,124 | $ (5,744) |
| Earnings (loss) per common share – basic | $ 2.41 | $ 1.72 | $ (0.89) |
| Weighted average common shares outstanding – basic | 6,445 | 6,441 | 6,441 |
| Earnings (loss) per common share – diluted | $ 2.40 | $ 1.71 | $ (0.89) |
| Weighted average common shares outstanding – diluted | 6,470 | 6,472 | 6,441 |

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

**HURCO COMPANIES, INC.**

**CONSOLIDATED BALANCE SHEETS**

**ASSETS**

| | As of October 31, | |
|---|---|---|
| | 2012 | 2011 |
| | ( In thousands, except share and per share data) | |
| Current assets: | | |
| Cash and cash equivalents | $ 35,770 | $ 44,961 |
| Accounts receivable, less allowance for doubtful accounts of $384 in 2012 and $608 in 2011 | 35,297 | 27,057 |
| Refundable taxes | 1,459 | 1,442 |
| Inventories, net | 91,320 | 81,127 |
| Deferred income taxes, net | 1,182 | 2,692 |
| Derivative assets | 708 | 1,197 |
| Other | 7,645 | 5,598 |
| Total current assets | 173,381 | 164,074 |
| | | |
| Property and equipment: | | |
| Land | 782 | 782 |
| Building | 7,352 | 7,116 |
| Machinery and equipment | 17,411 | 16,336 |
| Leasehold improvements | 3,467 | 2,508 |
| | 29,012 | 26,742 |
| Less accumulated depreciation and amortization | (16,933 ) | (15,198 ) |
| | 12,079 | 11,544 |
| Software development costs, less accumulated amortization | 3,969 | 4,928 |
| Investments and other assets, net | 5,883 | 5,999 |
| | $ 195,312 | $ 186,545 |
| | | |
| LIABILITIES AND SHAREHOLDERS’ EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 28,621 | $ 36,335 |
| Accounts payable-related parties | 1,167 | 2,711 |
| Accrued expenses and other | 14,186 | 13,983 |
| Accrued warranty expenses | 1,623 | 1,725 |
| Derivative liabilities | 569 | 1,609 |
| Short-term debt | 3,206 | 865 |
| Total current liabilities | 49,372 | 57,228 |
| | | |
| Non-current liabilities: | | |

| | | |
|---|---|---|
| Deferred income taxes, net | 903 | 1,982 |
| Deferred credits and other | 1,244 | 1,123 |
| | 2,147 | 3,105 |
| Commitments and contingencies | | |
| Shareholders’ equity: | | |
| Preferred stock: no par value per share, 1,000,000 shares authorized, no shares issued | — | — |
| Common stock: no par value, $.10 stated value per share, 12,500,000 shares authorized, 6,502,928 and 6,471,710 shares issued; and 6,447,210 and 6,440,851 shares outstanding, as of October 31, 2012 and October 31, 2011, respectively | 645 | 644 |
| Additional paid-in capital | 53,415 | 52,614 |
| Retained earnings | 90,586 | 74,948 |
| Accumulated other comprehensive loss | (853) | (1,994) |
| Total shareholders’ equity | 143,793 | 126,212 |
| | $ 195,312 | $ 186,545 |

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

**HURCO COMPANIES, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year Ended October 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands) | | |
| Cash flows from operating activities: | | | |
| Net income (loss) | $15,638 | $11,124 | $(5,744) |
| Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities: | | | |
| Provision for doubtful accounts | (224) | 111 | (312) |
| Deferred income taxes | 1,846 | 1,372 | (216) |
| Equity in (income) loss of affiliates | (276) | (53) | 149 |
| Foreign currency (gain) loss | 3,003 | 311 | 1,927 |
| Unrealized (gain) loss on derivatives | 522 | (720) | (624) |
| Depreciation and amortization | 4,126 | 4,300 | 3,804 |
| Stock-based compensation | 870 | 470 | 141 |
| Change in assets and liabilities: | | | |
| (Increase) decrease in accounts receivable and refundable taxes | (8,662) | (3,395) | (4,047) |
| (Increase) decrease in inventories | (10,152) | (25,702) | 4,154 |
| Increase (decrease) in accounts payable | (9,594) | 8,085 | 21,114 |
| Increase (decrease) in accrued expenses | 343 | 5,922 | (398) |
| Net change in derivative assets and liabilities | 68 | (330) | (174) |
| Other | (4,495) | (2,690) | 1,978 |
| Net cash provided by (used for) operating activities | (6,987) | (1,195) | 21,752 |
| | | | |
| Cash flows from investing activities: | | | |
| Proceeds from sale of property and equipment | 1 | — | 40 |
| Purchase of property and equipment | (2,755) | (1,745) | (632) |
| Software development costs | (977) | (1,097) | (1,216) |
| Other proceeds (investments) | (42) | (34) | 50 |
| Net cash used for investing activities | (3,773) | (2,876) | (1,758) |
| | | | |
| Cash flows from financing activities: | | | |
| Proceeds from exercise of common stock options | 1 | — | — |
| Borrowings on short-term debt | 2,293 | 844 | — |
| Net cash provided by financing activities | 2,294 | 844 | — |
| | | | |
| Effect of exchange rate changes on cash | (725) | (67) | (521) |
| Net increase (decrease) in cash | (9,191) | (3,294) | 19,473 |
| | | | |
| Cash and cash equivalents at beginning of year | 44,961 | 48,255 | 28,782 |
| | | | |
| Cash and cash equivalents at end of year | $35,770 | $44,961 | $48,255 |

| | | | |
|---|---|---|---|
| Supplemental disclosures: | | | |
| Cash paid for (refunds of): | | | |
| Interest | $127 | $23 | $18 |
| Income taxes, net | $10,679 | $1,381 | $(6,211 ) |

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

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**HURCO COMPANIES, INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

| | Common Stock | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Shares Outstanding | Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
| Balances, October 31, 2009 | 6,440,851 | $ 644 | $ 52,003 | $ 69,568 | $ (1,839) | $ 120,376 |
| Net loss | — | — | — | (5,744) | — | (5,744) |
| Translation of foreign currency financial statements | — | — | — | — | (50) | (50) |
| Realized loss on derivative instruments reclassified into operations, net of tax of $11 | — | — | — | — | 19 | 19 |
| Unrealized loss of derivative instruments, | — | — | — | — | (2) | (2) |
| Comprehensive loss | | | | | | (5,777) |
| Stock-based compensation expense | — | — | 141 | — | — | 141 |
| Balances, October 31, 2010 | 6,440,851 | $ 644 | $ 52,144 | $ 63,824 | $ (1,872) | $ 114,740 |
| Net income | — | — | — | 11,124 | — | 11,124 |
| Translation of foreign currency financial statements | — | — | — | — | 363 | 363 |
| Realized loss on derivative instruments reclassified into operations, net of tax of $3 | — | — | — | — | 7 | 7 |
| Unrealized loss of derivative instruments, net of tax of $(283) | — | — | — | — | (492) | (492) |
| Comprehensive income | | | | | | 11,002 |
| Stock-based compensation expense | — | — | 470 | — | — | 470 |
| Balances, October 31, 2011 | 6,440,851 | $ 644 | $ 52,614 | $ 74,948 | $ (1,994) | $ 126,212 |
| Net income | — | — | — | 15,638 | — | 15,638 |
| Translation of foreign currency financial statements | — | — | — | — | (838) | (838) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Realized loss on derivative instruments reclassified into operations, net of tax of $63 | — | — | — | — | 109 | 109 |
| Unrealized gain of derivative instruments, net of tax of $1,076 | — | — | — | — | 1,870 | 1,870 |
| Comprehensive income | | | | | | 16,779 |
| Exercise of common stock options | 500 | — | 1 | — | — | 1 |
| Restricted shares vested | 5,859 | 1 | (1) | — | — | — |
| Tax benefit from exercise of stock options | — | — | (69) | — | — | (69) |
| Stock-based compensation expense | — | — | 870 | — | — | 870 |
| Balances, October 31, 2012 | 6,447,210 | $ 645 | $53,415 | $90,586 | $ (853) | $143,793 |

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

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**HURCO COMPANIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Consolidation*. The consolidated financial statements include the accounts of Hurco Companies, Inc. (an Indiana corporation) and its wholly-owned subsidiaries. We have a 35% ownership interest in a Taiwan affiliate that is accounted for using the equity method. Our investment in that affiliate was approximately $2.4 million and $2.1 million as of October 31, 2012 and 2011, respectively. That investment is included in Investments and Other Assets, Net on the accompanying Consolidated Balance Sheets. Intercompany accounts and transactions have been eliminated.

*Statements of Cash Flows*. We consider all highly liquid investments with a stated maturity at the date of purchase of three months or less to be cash equivalents. Cash flows from hedges are classified consistent with the items being hedged.

*Translation of Foreign Currencies*. All balance sheet accounts of non-U.S. subsidiaries are translated at the exchange rate as of the end of the year and translation adjustments of foreign currency balance sheets are recorded as a component of Accumulated Other Comprehensive Loss in shareholders' equity. Income and expenses are translated at the average exchange rates during the year. Cumulative foreign currency translation adjustments as of October 31, 2012 were a net loss of $2.2 million and are included in Accumulated Other Comprehensive Loss. Foreign currency transaction gains and losses are recorded as income or expense as incurred and are recorded in other (income) expense.

*Hedging.* We account for derivative instruments as either assets or liabilities and carry them at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. For derivative instruments designated as a fair value hedge, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributed to the risk being hedged. For a derivative instrument designated as a cash flow hedge, the effective portion of the derivative’s gain or loss is initially reported as a component of Accumulated Other Comprehensive Loss in shareholders’ equity and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately. For derivative instruments that are not designated as accounting hedges under the Derivatives and Hedging Topic of the Financial Accounting Standards Board (FASB guidance), changes in fair value are recognized in earnings in the period of change. The Company does not hold or issue derivative financial instruments for speculative trading purposes. We only enter into derivatives with one counterparty which is among one of the largest U.S. banks ranked by assets, in order to minimize its credit risk and to date, no such counterparty has failed to meet its financial obligations under such contracts. We are exposed to certain market risks relating to our

ongoing business operations, including foreign currency risk, interest rate risk and credit risk. We manage our exposure to these and other market risks through regular operating and financing activities. Currently, the only risk that we manage through the use of derivative instruments is foreign currency risk.

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

**HURCO COMPANIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

We account for derivative instruments designated as hedging instruments in accordance with FASB guidance related to accounting for derivative instruments and report all derivative instruments as assets or liabilities at fair value on our consolidated balance sheet.

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 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 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 October 31, 2012, in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from November 2012 through October 2013. The contract amount at forward rates in U.S. Dollars at October 31, 2012 for Euros and Pounds Sterling was $36.2 million and $9.8 million, respectively. The contract amount at forward rates in U.S. Dollars for New Taiwan Dollars was $26.3 million at October 31, 2012. At October 31, 2012, we had approximately $1.1 million of gains, net of tax, related to cash flow hedges deferred in Accumulated Other Comprehensive Loss. Of this amount, $30,000 represents unrealized gains, net of tax, related to cash flow hedge instruments that remain subject to currency fluctuation risk. The majority of these deferred gains will be recorded as an adjustment to Cost of Sales and Service in periods through October 2013, in which the corresponding inventory that is the subject of the related hedge contract is sold, as described above.

We are exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we entered into a forward contract with a notional amount of €3.0 million. We designated this

forward contract as a hedge of our net investment in Euro denominated assets. We selected the forward method under the FASB guidance related to the accounting for derivatives instruments and hedging activities. The forward method requires all changes in the fair value of the contract to be reported as a cumulative translation adjustment in Accumulated Other Comprehensive Loss, net of tax, in the same manner as the underlying hedged net assets This forward contract matured in November 2012 and we entered into a new forward contract for the same notional amount that is set to mature in November 2013. As of October 31, 2012, we had a realized gain of $227,000 and an unrealized gain of $106,000, net of tax, recorded as cumulative translation adjustments in Accumulated Other Comprehensive Loss, related to these forward contracts.

**HURCO COMPANIES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued**

Derivatives Not Designated as Hedging Instruments

We enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. These derivative instruments are not designated as hedges under FASB guidance and, as a result, changes in their fair value are reported currently as Other (Income) Expense, Net in the 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 October 31, 2012, in Euros, Pounds Sterling, Canadian Dollars, South African Rand, and New Taiwan Dollars with set maturity dates ranging from November 2012 through April 2013. The contract amounts at forward rates in U.S. Dollars at October 31, 2012 for Euros, Pounds Sterling, Canadian Dollars, South African Rand and Singapore Dollars totaled $20.5 million. The contract amount at forward rates in U.S. Dollars for New Taiwan Dollars was $10.8 million at October 31, 2012.

Fair Value of Derivative Instruments

We recognize the fair value of derivative instruments as assets and liabilities on a gross basis on our Consolidated Balance Sheets. As of October 31, 2012 and October 31, 2011, all derivative instruments were recorded at fair value on the balance sheets as follows (in thousands):

| | 2012 | | 2011 | |
|---|---|---|---|---|
| Derivatives | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| **Designated as Hedging Instruments:** | | | | |
| Foreign exchange forward contracts | Derivative assets | $ 705 | Derivative assets | $ 634 |
| Foreign exchange forward contracts | Derivative liabilities | $ 492 | Derivative liabilities | $ 1,492 |
| **Not Designated as Hedging Instruments:** | | | | |
| Foreign exchange forward contracts | Derivative assets | $ 3 | Derivative assets | $ 563 |
| Foreign exchange forward contracts | Derivative liabilities | $ 77 | Derivative liabilities | $ 117 |

Effect of Derivative Instruments on the Consolidated Balance Sheets, Statements of Changes in Shareholders’ Equity and Statements of Operations

Derivative instruments had the following effects on our Consolidated Balance Sheets, Statements of Changes in Shareholders’ Equity and Statements of Operations, net of tax during the year ended October31, 2012 and 2011 (in thousands):

| Derivatives | Amount of Gain (Loss) Recognized in Other Comprehensive Income | | Location of Gain (Loss) Reclassified from Other Comprehensive Income | Amount of Gain (Loss) Reclassified from Other Comprehensive Income | |
|---|---|---|---|---|---|
| | 2012 | 2011 | | 2012 | 2011 |
| Designated as Hedging Instruments: (Effective Portion) | | | | | |
| Foreign exchange forward contracts – Intercompany sales/purchases | $ 2,946 | $ (775 ) | Cost of sales and service | $ (172 ) | $ (10 ) |
| Foreign exchange forward contract – Net Investment | $ 292 | $ (32 ) | | | |

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