

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended July 31, 2022 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)

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, no par value	HURC	The Nasdaq Stock Market LLC

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No .

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

- Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the Registrant's common stock outstanding as of August 31, 2022 was 6,566,994.

HURCO COMPANIES, INC.
Form 10-Q Quarterly Report for Fiscal Quarter Ended July 31, 2022

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

(In thousands, except per share data)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2022	2021	2022	2021
Sales and service fees	\$ 57,640	\$ 54,178	\$ 187,352	\$ 166,213
Cost of sales and service	43,241	41,204	140,444	126,898
Gross profit	14,399	12,974	46,908	39,315
Selling, general and administrative expenses	12,647	10,331	36,859	32,172
Operating income (loss)	1,752	2,643	10,049	7,143
Interest expense	9	2	22	23
Interest income	16	17	69	33
Investment income (loss)	(11)	8	170	154
Other income (expense), net	(22)	11	(440)	(37)
Income (loss) before income taxes	1,726	2,677	9,826	7,270
Provision (benefit) for income taxes	488	1,109	3,024	2,602
Net income (loss)	<u>\$ 1,238</u>	<u>\$ 1,568</u>	<u>\$ 6,802</u>	<u>\$ 4,668</u>
Income (loss) per common share				
Basic	<u>\$ 0.19</u>	<u>\$ 0.23</u>	<u>\$ 1.02</u>	<u>\$ 0.70</u>
Diluted	<u>\$ 0.18</u>	<u>\$ 0.23</u>	<u>\$ 1.01</u>	<u>\$ 0.70</u>
Weighted average common shares outstanding				
Basic	<u>6,567</u>	<u>6,601</u>	<u>6,585</u>	<u>6,591</u>
Diluted	<u>6,629</u>	<u>6,618</u>	<u>6,637</u>	<u>6,605</u>
Dividends paid per share	<u>\$ 0.15</u>	<u>\$ 0.14</u>	<u>\$ 0.44</u>	<u>\$ 0.41</u>

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

HURCO COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>July 31,</u>	<u>2021</u>	<u>July 31,</u>	<u>2021</u>
	<u>2022</u>	<u>2021</u>	<u>2022</u>	<u>2021</u>
Net income (loss)	\$ 1,238	\$ 1,568	\$ 6,802	\$ 4,668
Other comprehensive income (loss):				
Translation gain (loss) of foreign currency financial statements	(3,079)	(732)	(12,622)	3,574
(Gain) / loss on derivative instruments reclassified into operations, net of tax of \$23, \$6, \$93 and \$(210), respectively	76	20	302	(699)
Gain / (loss) on derivative instruments, net of tax of \$30, \$(83), \$121 and \$(272), respectively	<u>95</u>	<u>(277)</u>	<u>389</u>	<u>(906)</u>
Total other comprehensive income (loss)	<u>(2,908)</u>	<u>(989)</u>	<u>(11,931)</u>	<u>1,969</u>
Comprehensive income (loss)	<u>\$ (1,670)</u>	<u>\$ 579</u>	<u>\$ (5,129)</u>	<u>\$ 6,637</u>

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

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

	July 31, 2022 (unaudited)	October 31, 2021
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 73,536	\$ 84,063
Accounts receivable, net	35,722	42,620
Inventories, net	159,818	148,216
Derivative assets	2,953	905
Prepaid assets	8,438	13,091
Other	204	975
Total current assets	<u>280,671</u>	<u>289,870</u>
Property and equipment:		
Land	868	868
Building	7,352	7,352
Machinery and equipment	27,703	29,533
Leasehold improvements	4,643	5,172
	<u>40,566</u>	<u>42,925</u>
Less accumulated depreciation and amortization	(31,483)	(32,318)
Total property and equipment, net	<u>9,083</u>	<u>10,607</u>
Non-current assets:		
Software development costs, less accumulated amortization	7,363	7,553
Intangible assets, net	1,322	1,565
Operating lease - right of use assets, net	8,804	10,624
Deferred income taxes	2,617	3,154
Investments and other assets, net	9,246	9,562
Total non-current assets	<u>29,352</u>	<u>32,458</u>
Total assets	<u>\$ 319,106</u>	<u>\$ 332,935</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 48,104	\$ 48,881
Customer deposits	6,187	8,593
Derivative liabilities	2,226	467
Operating lease liabilities	3,839	4,221
Accrued payroll and employee benefits	8,816	10,389
Accrued income taxes	1,873	1,192
Accrued expenses	5,914	5,911
Accrued warranty expenses	1,437	1,516
Total current liabilities	<u>78,396</u>	<u>81,170</u>
Non-current liabilities:		
Deferred income taxes	67	68
Accrued tax liability	1,314	1,749
Operating lease liabilities	5,306	6,794
Deferred credits and other	4,255	4,735
Total non-current liabilities	<u>10,942</u>	<u>13,346</u>
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; 6,645,352 and 6,691,052 shares issued and 6,566,994 and 6,617,717 shares outstanding, as of July 31, 2022 and October 31, 2021, respectively	657	662
Additional paid-in capital	63,334	63,924
Retained earnings	179,449	175,574
Accumulated other comprehensive loss	(13,672)	(1,741)
Total shareholders' equity	<u>229,768</u>	<u>238,419</u>
Total liabilities and shareholders' equity	<u>\$ 319,106</u>	<u>\$ 332,935</u>

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

HURCO COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2022	2021	2022	2021
Cash flows from operating activities:				
Net income (loss)	\$ 1,238	\$ 1,568	\$ 6,802	\$ 4,668
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:				
Provision for doubtful accounts	14	(1)	(179)	226
Deferred income taxes	(70)	192	(5)	703
Equity in loss (income) of affiliates	(72)	(33)	(462)	(69)
Foreign currency (gain) loss	836	229	2,018	(431)
Unrealized (gain) loss on derivatives	152	(163)	(176)	(306)
Depreciation and amortization	1,049	1,034	2,956	3,150
Stock-based compensation	791	699	2,386	2,079
Change in assets and liabilities, net of acquisitions:				
(Increase) decrease in accounts receivable	(2,154)	5,022	4,408	(3,851)
(Increase) decrease in inventories	(9,518)	(4,871)	(22,194)	2,483
(Increase) decrease in prepaid expenses	256	481	5,638	(680)
Increase (decrease) in accounts payable	(814)	4,200	2,937	13,542
Increase (decrease) in customer deposits	220	(107)	(1,924)	2,690
Increase (decrease) in accrued expenses	1,195	660	1,057	694
Increase (decrease) in accrued payroll and employee benefits	667	(548)	(1,573)	287
Increase (decrease) in accrued income tax	(67)	216	813	432
Net change in derivative assets and liabilities	104	7	75	170
Other	302	(71)	(136)	661
Net cash provided by (used for) operating activities	(5,871)	8,514	2,441	26,448
Cash flows from investing activities:				
Proceeds from sale of property and equipment	2	—	103	3
Purchase of property and equipment	(320)	(325)	(828)	(1,001)
Software development costs	(202)	(227)	(800)	(833)
Other investments	—	(28)	—	(210)
Net cash provided by (used for) investing activities	(520)	(580)	(1,525)	(2,041)
Cash flows from financing activities:				
Proceeds from exercise of common stock options	—	—	117	—
Dividends paid	(1,004)	(951)	(2,927)	(2,740)
Taxes paid related to net settlement of restricted shares	—	—	(208)	(197)
Stock repurchases	—	—	(2,890)	—
Net cash provided by (used for) financing activities	(1,004)	(951)	(5,908)	(2,937)
Effect of exchange rate changes on cash and cash equivalents	(1,111)	(400)	(5,535)	1,142
Net increase (decrease) in cash and cash equivalents	(8,506)	6,583	(10,527)	22,612
Cash and cash equivalents at beginning of period	82,042	73,888	84,063	57,859
Cash and cash equivalents at end of period	\$ 73,536	\$ 80,471	\$ 73,536	\$ 80,471

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

HURCO COMPANIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands, except shares outstanding)

	Three Months Ended July 31, 2022 and 2021					
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares Outstanding	Amount				
Balances, April 30, 2021	6,601,406	\$ 660	\$ 62,177	\$ 173,795	\$ (32)	\$ 236,600
Net income (loss)	—	—	—	1,568	—	1,568
Other comprehensive income (loss)	—	—	—	—	(989)	(989)
Stock-based compensation expense, net of taxes withheld for vested restricted shares	—	—	699	—	—	699
Dividends paid	—	—	—	(951)	—	(951)
Balances, July 31, 2021	6,601,406	\$ 660	\$ 62,876	\$ 174,412	\$ (1,021)	\$ 236,927
Balances, April 30, 2022	6,566,994	\$ 657	\$ 62,543	\$ 179,215	\$ (10,764)	\$ 231,651
Net income (loss)	—	—	—	1,238	—	1,238
Other comprehensive income (loss)	—	—	—	—	(2,908)	(2,908)
Stock-based compensation expense, net of taxes withheld for vested restricted shares	—	—	791	—	—	791
Dividends paid	—	—	—	(1,004)	—	(1,004)
Balances, July 31, 2022	6,566,994	\$ 657	\$ 63,334	\$ 179,449	\$ (13,672)	\$ 229,768

	Nine Months Ended July 31, 2022 and 2021					
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares Outstanding	Amount				
Balances, October 31, 2020	6,565,163	\$ 657	\$ 60,997	\$ 172,484	\$ (2,990)	\$ 231,148
Net income (loss)	—	—	—	4,668	—	4,668
Other comprehensive income (loss)	—	—	—	—	1,969	1,969
Stock-based compensation expense, net of taxes withheld for vested restricted shares	36,243	3	1,879	—	—	1,882
Dividends paid	—	—	—	(2,740)	—	(2,740)
Balances, July 31, 2021	6,601,406	\$ 660	\$ 62,876	\$ 174,412	\$ (1,021)	\$ 236,927
Balances, October 31, 2021	6,617,717	\$ 662	\$ 63,924	\$ 175,574	\$ (1,741)	\$ 238,419
Net income (loss)	—	—	—	6,802	—	6,802
Other comprehensive income (loss)	—	—	—	—	(11,931)	(11,931)
Stock-based compensation expense, net of taxes withheld for vested restricted shares	33,761	3	2,175	—	—	2,178
Exercise of common stock options	5,437	1	116	—	—	117
Stock repurchases	(89,921)	(9)	(2,881)	—	—	(2,890)
Dividends paid	—	—	—	(2,927)	—	(2,927)
Balances, July 31, 2022	6,566,994	\$ 657	\$ 63,334	\$ 179,449	\$ (13,672)	\$ 229,768

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. GENERAL

The unaudited Condensed Consolidated Financial Statements include the accounts of Hurco Companies, Inc. and its consolidated subsidiaries. As used in this report, the words “we”, “us”, “our”, “Hurco” and the “Company” refer to Hurco Companies, Inc. and its consolidated subsidiaries.

We design, manufacture, and sell computerized (i.e., Computer Numeric Control (“CNC”)) machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service, and distribution network. Although the majority of our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, automation integration equipment and solutions for job shops, software options, control upgrades, accessories and replacement parts for our products, as well as customer service, training, and applications support.

We operate in the industrial equipment industry and have a global footprint that subjects us to various business risks in many different countries. Our operating results during fiscal years 2020, 2021 and the nine months of fiscal 2022 were affected by the international business disruption due to the outbreak of COVID-19 and lockdowns in certain markets, vendor delays, transportation issues, unusually high inflation, volatility of foreign currencies, competitive labor markets, uncertainty surrounding the U.K. Brexit activities, and political friction in the U.S and many regions of the world. Because of the potential for extended vulnerability, we have closely evaluated the estimates we have made in preparing the financial statements as of July 31, 2022, with the understanding that these estimates could change in the near term. We will continue to evaluate and disclose any uncertainty associated with key assumptions underlying fair value estimates, trends, and uncertainties that have had, or are reasonably expected to have, a material effect on our consolidated financial position, results of operations, changes in shareholders' equity, and cash flows for and at the end of each interim period.

The condensed financial information as of July 31, 2022 and for the three and nine months ended July 31, 2022 and July 31, 2021 is unaudited. However, in our opinion, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our consolidated financial position, results of operations, changes in shareholders' equity and cash flows for and at the end of the interim periods. We suggest that you read these Condensed Consolidated Financial Statements in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended October 31, 2021.

2. REVENUE RECOGNITION

We design, manufacture and sell computerized machine tools. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, automation integration equipment and solutions for job shops, software options, control upgrades, accessories and replacement parts for our products, as well as customer service, training and applications support.

We recognize revenues from the sale of machine tools, components and accessories, and services and reflect the consideration to which we expect to be entitled. We record revenues based on a five-step model in accordance with Financial Accounting Standards Board (“FASB”) guidance codified in Accounting Standard Codification (“ASC”) 606, “Revenue from Contracts with Customers” (“ASC 606”). In accordance with ASC 606, we have defined contracts as agreements with our customers and distributors in the form of purchase orders, packing or shipping documents, invoices, and, periodically, verbal requests for components and accessories. For each contract, we identify our performance obligations, which are delivering goods or services, determine the transaction price, allocate the contract transaction price to each of the performance obligations (when applicable), and recognize the revenue when (or as) the performance obligation to the customer is fulfilled.

A good or service is transferred when the customer obtains control of that good or service. Our computerized machine tools are general purpose computer-controlled machine tools that are typically used in stand-alone operations. Prior to shipment, we test each machine to ensure the machine's compliance with standard operating specifications. We deem that the customer obtains control upon delivery of the product and that obtaining control is not contingent upon contractual customer acceptance. Therefore, we recognize revenue from sales of our machine tool systems upon delivery of the product to the customer or distributor, which is normally at the time of shipment.

Depending upon geographic location, after shipment, a machine may be installed at the customer's facility 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 operating specifications. We consider the machine installation process for our three-axis machines to be inconsequential and immaterial within the context of the contract. For our five-axis machines that we install, we estimate the fair value of the installation performance obligation and recognize that installation revenue on a prorata basis over the period of the installation process.

From time to time, and depending upon geographic location, we may provide training or freight services. We consider these services to be immaterial within the context of the contract, as the value of these services typically does not rise to a material level as a component of the total contract value. Service fees from maintenance contracts are deferred and recognized in earnings on a prorata basis over the term of the contract and are generally sold on a stand-alone basis. Customer discounts and estimated product returns are considered variable consideration and are recorded as a reduction of revenue in the same period that the related sales are recorded. We have reviewed the overall sales transactions for variable consideration and have determined that these amounts are not significant.

3. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to certain market risks relating to our ongoing business operations, including foreign currency risk, interest rate risk and credit risk. We manage our exposure to these and other market risks through regular operating and financing activities. Currently, the only risk that we manage through the use of derivative instruments is foreign currency risk, for which we enter into derivative instruments in the form of foreign currency forward exchange contracts with a major financial institution.

We enter into these forward exchange contracts to reduce the potential effects of foreign exchange rate movements on our net equity investment in one of our foreign subsidiaries, to reduce the impact on gross profit and net earnings from sales and purchases denominated in foreign currencies, and to reduce the impact on our net earnings of foreign currency fluctuations on receivables and payables denominated in foreign currencies that are different than the subsidiaries' functional currency. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in Euros, Pounds Sterling, Indian Rupee, Singapore Dollars, Chinese Yuan, Polish Zloty, and New Taiwan Dollars. We record all derivative instruments as assets or liabilities at fair value.

Derivatives Designated as Hedging Instruments

We enter into foreign currency forward exchange contracts periodically to hedge certain forecasted inter-company sales and purchases denominated in the following foreign currencies: the Pound Sterling, Euro and New Taiwan Dollar. The purpose of these instruments is to mitigate the risk that the U.S. Dollar net cash inflows and outflows resulting from sales and purchases denominated in foreign currencies will be adversely affected by changes in exchange rates. These forward contracts have been designated as cash flow hedge instruments and are recorded in the Condensed Consolidated Balance Sheets at fair value in Derivative assets and Derivative liabilities.

The effective portion of the gains and losses resulting from the changes in the fair value of these hedge contracts is deferred in Accumulated other comprehensive income (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 immediately reported in Other income (expense), net. 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.

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We had forward contracts outstanding as of July 31, 2022, denominated in Euros, Pounds Sterling and New Taiwan Dollars with set maturity dates ranging from August 2022 through July 2023. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2022, were \$27.6 million for Euros, \$7.0 million for Pounds Sterling and \$33.1 million for New Taiwan Dollars. At July 31, 2022, we had approximately \$0.4 million of gains, net of tax, related to cash flow hedges deferred in Accumulated other comprehensive income (loss). Included in this amount was \$15,000 of unrealized loss, 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 July 2023, when the corresponding inventory that is the subject of the related hedge contracts is sold, as described above.

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we entered into a forward contract with a notional amount of €3.0 million in November 2021. We designated this forward contract as a hedge of our net investment in Euro denominated assets. We selected the forward method under FASB guidance related to the accounting for derivative 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 income (loss), net of tax, in the same manner as the underlying hedged net assets. This forward contract matures in November 2022. As of July 31, 2022, we had a realized gain of \$0.9 million and an unrealized gain of \$0.3 million, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive income (loss) related to this forward contract.

Derivatives Not Designated as Hedging Instruments

We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on inter-company receivables, payables and loans 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 in Other income (expense), net in the Condensed Consolidated Statements of Operations consistent with the transaction gain or loss on the related receivables and payables denominated in foreign currencies.

We had forward contracts outstanding as of July 31, 2022, denominated in Euros, Pounds Sterling, and New Taiwan Dollars with set maturity dates ranging from August 2022 through October 2022. The contract amounts, expressed at forward rates in U.S. Dollars at July 31, 2022, totaled \$55.6 million.

Fair Value of Derivative Instruments

We recognize the fair value of derivative instruments as assets and liabilities on a gross basis on our Condensed Consolidated Balance Sheets. As of July 31, 2022 and October 31, 2021, all derivative instruments were recorded at fair value on our Condensed Consolidated Balance Sheets as follows (in thousands):

Derivatives	July 31, 2022		October 31, 2021	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<u>Designated as Hedging Instruments:</u>				
Foreign exchange forward contracts	Derivative assets	\$ 2,278	Derivative assets	\$ 646
Foreign exchange forward contracts	Derivative liabilities	\$ 1,915	Derivative liabilities	\$ 403
<u>Not Designated as Hedging Instruments:</u>				
Foreign exchange forward contracts	Derivative assets	\$ 675	Derivative assets	\$ 259
Foreign exchange forward contracts	Derivative liabilities	\$ 311	Derivative liabilities	\$ 64

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

Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Changes in Shareholders' Equity and Condensed Consolidated Statements of Operations, net of tax, during the three months ended July 31, 2022 and 2021 (in thousands):

Derivatives	Amount of Gain (Loss) Recognized in Other Comprehensive Income (Loss)		Location of Gain (Loss) Reclassified from Other Comprehensive Income (Loss)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income (Loss)	
	Three Months Ended July 31,			Three Months Ended July 31,	
	2022	2021		2022	2021
Designated as Hedging Instruments:					
(Effective portion)					
Foreign exchange forward contracts			Cost of sales and service		
– Intercompany sales/purchases	\$ 95	\$ (277)		\$ (76)	\$ (20)
Foreign exchange forward contract					
– Net investment	\$ 89	\$ 44			

We did not recognize any gains or losses as a result of hedges deemed ineffective for either of the three months ended July 31, 2022 or 2021. We recognized the following gains in our Condensed Consolidated Statements of Operations during the three months ended July 31, 2022 and 2021 on derivative instruments not designated as hedging instruments (in thousands):

Derivatives	Location of Gain (Loss) Recognized in Operations	Amount of Gain (Loss) Recognized in Operations	
		Three Months Ended July 31,	
		2022	2021
Not Designated as Hedging Instruments:			
Foreign exchange forward contracts	Other income (expense), net	\$ 1,059	\$ 602

The following table presents the changes in the components of Accumulated other comprehensive income (loss), net of tax, for the three months ended July 31, 2022 (in thousands):

	Foreign Currency Translation	Cash Flow Hedges	Total
Balance, April 30, 2022	\$ (11,211)	\$ 447	\$ (10,764)
Other comprehensive income (loss) before reclassifications	(3,079)	95	(2,984)
Reclassifications	—	76	76
Balance, July 31, 2022	\$ (14,290)	\$ 618	\$ (13,672)

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Derivative instruments had the following effects on our Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Changes in Shareholders' Equity and Condensed Consolidated Statements of Operations, net of tax, during the nine months ended July 31, 2022 and 2021 (in thousands):

Derivatives	Amount of Gain (Loss) Recognized in Other Comprehensive Income (Loss)		Location of Gain (Loss) Reclassified from Other Comprehensive Income (Loss)	Amount of Gain (Loss) Reclassified from Other Comprehensive Income (Loss)	
	Nine Months Ended July 31,			Nine Months Ended July 31,	
	2022	2021		2022	2021
Designated as Hedging Instruments:					
(Effective Portion)					
Foreign exchange forward contracts			Cost of sales and		
– Intercompany sales/purchases	\$ 389	\$ (906)	service	\$ (302)	\$ 699
Foreign exchange forward contract					
– Net investment	\$ 310	\$ (36)			

We did not recognize any gains or losses as a result of hedges deemed ineffective for either of the nine months ended July 31, 2022 or 2021. We recognized the following gains and losses in our Condensed Consolidated Statements of Operations during the nine months ended July 31, 2022 and 2021 on derivative instruments not designated as hedging instruments (in thousands):

Derivatives	Location of Gain (Loss) Recognized in Operations	Amount of Gain (Loss) Recognized in Operations	
		Nine Months Ended July 31,	
		2022	2021
Derivatives			
Not Designated as Hedging Instruments:			
Foreign exchange forward contracts	Other income (expense), net	\$ 1,838	\$ (801)

The following table presents the changes in the components of Accumulated other comprehensive income (loss), net of tax, for the nine months ended July 31, 2022 (in thousands):

	Foreign Currency Translation	Cash Flow Hedges	Total
Balance, October 31, 2021	\$ (1,668)	\$ (73)	\$ (1,741)
Other comprehensive income (loss) before reclassifications	(12,622)	389	(12,233)
Reclassifications	—	302	302
Balance, July 31, 2022	\$ (14,290)	\$ 618	\$ (13,672)

4. EQUITY INCENTIVE PLAN

In March 2016, we adopted the Hurco Companies, Inc. 2016 Equity Incentive Plan (as amended as described below, the “2016 Equity Plan”), which allows us to grant awards of stock options, stock appreciation rights, restricted stock, stock units and other stock-based awards. The 2016 Equity Plan replaced the Hurco Companies, Inc. 2008 Equity Incentive Plan (the “2008 Equity Plan”) and is the only active plan under which equity awards may be made by us to our employees and non-employee directors. No further awards will be made under our 2008 Equity Plan. The total number of shares of our common stock that may be issued pursuant to awards under the 2016 Equity Plan initially was 856,048, which included 386,048 shares remaining available for future grants under the 2008 Equity Plan as of March 10, 2016, the date our shareholders approved the 2016 Equity Plan. On March 10, 2022, our shareholders approved the Amended and Restated Hurco Companies, Inc. 2016 Equity Incentive Plan, which, among other items, increased the aggregate number of shares that may be issued under the 2016 Equity Plan by 850,000 shares.

The Compensation Committee of our Board of Directors has the authority to determine the officers, directors and key employees who will be granted awards under the 2016 Equity Plan; designate the number of shares subject to each award; determine the terms and conditions upon which awards will be granted; and prescribe the form and terms of award agreements. We have granted restricted shares and performance units under the 2016 Equity Plan that are currently outstanding, and we have granted stock options under the 2008 Equity Plan that are currently outstanding. No stock option may be exercised more than ten years after the date of grant or such shorter period as the Compensation Committee may determine at the date of grant. The market value of a share of our common stock, for purposes of the 2016 Equity Plan, is the closing sale price as reported by the Nasdaq Global Select Market on the date in question or, if not a trading day, on the last preceding trading date.

A summary of stock option activity for the nine-month period ended July 31, 2022, is as follows:

	Stock Options	Weighted Average Exercise Price
Outstanding at October 31, 2021	16,996	\$ 22.71
Options granted	—	—
Options exercised	(5,437)	21.45
Options cancelled	—	—
Outstanding at July 31, 2022	<u>11,559</u>	<u>\$ 23.30</u>

Summarized information about outstanding stock options as of July 31, 2022, that have already vested and are currently exercisable, are as follows:

	Options Already Vested and Currently Exercisable
Number of outstanding options	11,559
Weighted average remaining contractual life (years)	0.37
Weighted average exercise price per share	\$ 23.3
Intrinsic value of outstanding options	\$ 23,500

The intrinsic value of an outstanding stock option is calculated as the difference between the stock price as of July 31, 2022 and the exercise price of the option.

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On March 10, 2022, the Compensation Committee granted a total of 13,914 shares of time-based restricted stock to our non-employee directors. The restricted shares vest in full one year from the date of grant provided the recipient remains on the board of directors through that date. The grant date fair value of the restricted shares was based on the closing sales price of our common stock on the grant date, which was \$34.49 per share.

On January 4, 2022, the Compensation Committee approved a long-term incentive compensation arrangement for our executive officers in the form of time-based restricted shares and performance stock units (“PSUs”) under the 2016 Equity Plan, which will be payable in shares of our common stock if earned and vested. The awards were approximately 25% time-based vesting and approximately 75% performance-based vesting. The three-year performance period for the PSUs is fiscal 2022 through fiscal 2024.

On that date, the Compensation Committee granted a total of 23,442 shares of time-based restricted stock to our executive officers. The restricted shares vest in thirds over three years from the date of grant provided the recipient remains employed through that date. The grant date fair value of the restricted shares was based upon the closing sales price of our common stock on the date of grant, which was \$30.39 per share.

On January 4, 2022, the Compensation Committee also granted a total target number of 34,203 PSUs to our executive officers designated as “PSU – TSR”. These PSUs were weighted as approximately 40% of the overall 2022 executive long-term incentive compensation arrangement and will vest and be paid based upon the total shareholder return of our common stock over the three-year period of fiscal 2022-2024, relative to the total shareholder return of the companies in a specified peer group over that period. Participants will have the ability to earn between 50% of the target number of the PSUs – TSR for achieving threshold performance and 200% of the target number of the PSUs – TSR for achieving maximum performance. The grant date fair value of the PSUs – TSR was \$33.33 per PSU and was calculated using the Monte Carlo approach.

On January 4, 2022, the Compensation Committee also granted a total target number of 32,821 PSUs to our executive officers designated as “PSU – ROIC”. These PSUs were weighted as approximately 35% of the overall 2022 executive long-term incentive compensation arrangement and will vest and be paid based upon the achievement of pre-established goals related to our average return on invested capital over the three-year period of fiscal 2022-2024. Participants will have the ability to earn between 50% of the target number of the PSUs – ROIC for achieving threshold performance and 200% of the target number of the PSUs – ROIC for achieving maximum performance. The grant date fair value of the PSUs – ROIC was based on the closing sales price of our common stock on the grant date, which was \$30.39 per share.

On November 10, 2021, the Compensation Committee granted a total of 8,234 shares of time-based restricted stock to our non-executive employees. The restricted shares vest in thirds over three years from the date of grant provided the recipient remains employed through that date. The grant date fair value of the restricted shares was based upon the closing sales price of our common stock on the date of grant, which was \$33.99 per share.

A reconciliation of our restricted stock and PSU activity and related information for the nine-month period ended July 31, 2022 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested at October 31, 2021	262,556	\$ 34.84
Shares or units granted	112,614	32.05
Shares or units vested	(33,761)	34.90
Shares or units cancelled	(61,500)	38.41
Shares withheld	(6,806)	34.03
Unvested at July 31, 2022	<u>273,103</u>	<u>\$ 32.90</u>

During the nine months of fiscal 2022 and 2021, we recorded approximately \$2.4 million and \$2.1 million, respectively, of stock-based compensation expense related to grants under the 2016 Equity Plan. As of July 31, 2022, there was an estimated \$4.5 million of total unrecognized stock-based compensation cost that we expect to recognize by the end of the first quarter of fiscal 2025.

5. EARNINGS PER SHARE

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

	Three Months Ended July 31,				Nine Months Ended July 31,			
	2022		2021		2022		2021	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
Net income (loss)	\$ 1,238	\$ 1,238	\$ 1,568	\$ 1,568	\$ 6,802	\$ 6,802	\$ 4,668	\$ 4,668
Undistributed earnings (loss) allocated to participating shares	(15)	(15)	(17)	(17)	(80)	(80)	(51)	(51)
Net income (loss) applicable to common shareholders	\$ 1,223	\$ 1,223	\$ 1,551	\$ 1,551	\$ 6,722	\$ 6,722	\$ 4,617	\$ 4,617
Weighted average shares outstanding	6,567	6,567	6,601	6,601	6,585	6,585	6,591	6,591
Stock options and contingently issuable securities	—	62	—	17	—	52	—	14
	6,567	6,629	6,601	6,618	6,585	6,637	6,591	6,605
Income (loss) per share	\$ 0.19	\$ 0.18	\$ 0.23	\$ 0.23	\$ 1.02	\$ 1.01	\$ 0.70	\$ 0.70

6. ACCOUNTS RECEIVABLE

Accounts receivable are net of allowances for doubtful accounts of \$1.5 million as of July 31, 2022 and \$1.6 million as of October 31, 2021.

7. INVENTORIES

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

	July 31, 2022	October 31, 2021
Purchased parts and sub-assemblies	\$ 47,214	\$ 37,527
Work-in-process	19,906	17,559
Finished goods	92,698	93,130
	\$ 159,818	\$ 148,216

8. LEASES

We adopted Accounting Standards Update (“ASU”) No. 2016-02, “Leases” (“ASC 842”) on November 1, 2019. Our lease portfolio includes leased production and assembly facilities, warehouses and distribution centers, office space, vehicles, material handling equipment utilized in our production and assembly facilities, laptops and other information technology equipment, as well as other miscellaneous leased equipment. Most of the leased production and assembly facilities have lease terms ranging from two to five years, although the terms and conditions of our leases can vary significantly from lease to lease. We have assessed the specific terms and conditions of each lease to determine the amount of the lease payments and the length of the lease term, which includes the minimum period over which lease payments are required plus any renewal options that are both within our control to exercise and reasonably certain of being exercised upon lease commencement. In determining whether or not a renewal option is reasonably certain of being exercised, we assessed all relevant factors to determine if sufficient incentives exist as of lease commencement to conclude renewal is reasonably certain. There are no material residual value guarantees provided by us, nor any restrictions or covenants imposed by the leases to which we are a party. In determining the lease liability, we utilize our incremental borrowing rate to discount the future lease payments over the lease term to present value.

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In accordance with ASC 842, we record a right-of-use asset and lease liability on our Condensed Consolidated Balance Sheets for all leases that, at the commencement date, have a lease term of more than 12 months and are classified as operating leases.

We recorded total operating lease expense of \$3.8 million and \$3.9 million for the nine months ended July 31, 2022 and 2021, respectively, which is classified within Cost of sales and service and Selling, general and administrative expenses within the Condensed Consolidated Statements of Operations. Operating lease expense includes short-term leases and variable lease payments which are immaterial. There have been no lease costs capitalized on the Condensed Consolidated Balance Sheets as of July 31, 2022.

The following table summarizes supplemental cash flow information and non-cash activity related to operating leases for the nine months ended July 31, 2022 (in thousands):

	Nine Months Ended July 31, 2022	Nine Months Ended July 31, 2021
Operating cash flow information:		
Cash paid for amounts included in the measurement of lease liabilities	\$ 3,476	\$ 3,827
Non-cash information:		
Right-of-use assets obtained in exchange for new operating lease liabilities	\$ 2,593	\$ 3,003

The following table summarizes the maturities of undiscounted cash flows of lease commitments reconciled to the total lease liability as of July 31, 2022 (in thousands):

Remainder of 2022	\$ 1,143
2023	3,768
2024	1,998
2025	974
2026	574
2026 and thereafter	988
Total	9,445
Less: Imputed interest	(300)
Present value of operating lease liabilities	\$ 9,145

As of July 31, 2022, the weighted-average remaining term of our lease portfolio was approximately 3.3 years and the weighted-average discount rate was approximately 1.9%.

9. SEGMENT INFORMATION

We operate in a single segment: industrial automation equipment. We design, manufacture and sell computerized (i.e., CNC) machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service and distribution network. Although the majority of our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, automation integration equipment and solutions for job shops, software options, control upgrades, accessories and replacement parts for our products, as well as customer service, training and applications support.

10. GUARANTEES AND PRODUCT WARRANTIES

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. We follow FASB guidance for accounting for guarantees (codified in ASC 460 *Guarantees*). As of July 31, 2022, we had eight outstanding third party payment guarantees totaling approximately \$0.7 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer assumes the risk of ownership. The customer does not obtain title, however, until it has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue liabilities under these guarantees at fair value, which amounts are insignificant.

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

	Nine Months Ended	
	July 31,	
	2022	2021
Balance, beginning of period	\$ 1,516	\$ 1,200
Provision for warranties during the period	2,183	1,495
Charges to the reserve	(2,177)	(1,384)
Impact of foreign currency translation	(85)	21
Balance, end of period	<u>\$ 1,437</u>	<u>\$ 1,332</u>

The year-over-year increase in our warranty reserve was primarily due to an increase in the number of machines under warranty from increased sales volume.

11. DEBT AGREEMENTS

On December 31, 2018, we and our subsidiary Hurco B.V. entered into a credit agreement with Bank of America, N.A., as the lender, which was subsequently amended on each of March 13, 2020, December 23, 2020 and December 17, 2021 (as amended, the “2018 Credit Agreement”). The 2018 Credit Agreement provides for an unsecured revolving credit and letter of credit facility in a maximum aggregate amount of \$40.0 million. The 2018 Credit Agreement provides that the maximum amount of outstanding letters of credit at any one time may not exceed \$10.0 million, the maximum amount of outstanding loans made to our subsidiary Hurco B.V. at any one time may not exceed \$20.0 million, and the maximum amount of all outstanding loans denominated in alternative currencies at any one time may not exceed \$20.0 million. Under the 2018 Credit Agreement, we and Hurco B.V. are borrowers, and certain of our other subsidiaries are guarantors. The scheduled maturity date of the 2018 Credit Agreement is December 31, 2023.

Borrowings under the 2018 Credit Agreement bear interest at floating rates based on, at our option, either (i) a rate based upon the secured overnight financing rate (“SOFR”), the Sterling Overnight Index Average Reference Rate, the Euro Interbank Offering Rate, or another alternative currency-based rate approved by the lender, depending on the term of the loan and the currency in which such loan is denominated, plus 1.00% per annum, or (ii) a base rate (which is the highest of (a) the federal funds rate plus 0.50%, (b) the prime rate or (c) the one month SOFR-based rate plus 1.00%), plus 0.00% per annum. Outstanding letters of credit will carry an annual rate of 1.00%.

The 2018 Credit Agreement contains customary affirmative and negative covenants and events of default, including covenants (1) restricting us from making certain investments, loans, advances and acquisitions (but permitting us to make investments in subsidiaries of up to \$10.0 million); (2) restricting us from making certain payments, including (a) cash dividends, except that we may pay cash dividends as long as immediately before and after giving effect to such payment, the sum of the unused amount of the commitments under the 2018 Credit Agreement plus our cash on hand is not less than \$10.0 million, and as long as we are not in default before and after giving effect to such dividend payments and (b) payments made to repurchase shares of our common stock, except that we may repurchase shares of our common stock as long as we are not in default before and after giving effect to such repurchases and the aggregate amount of payments made by us for all such repurchases during any fiscal year does not exceed \$10.0 million; (3) requiring that we maintain a minimum working capital of \$125.0 million; and (4) requiring that we maintain a minimum tangible net worth of \$176.5 million. We may use the proceeds from advances under the 2018 Credit Agreement for general corporate purposes.

In March 2019, our wholly-owned subsidiaries in Taiwan (Hurco Manufacturing Limited (“HML”)), and China, (Ningbo Hurco Machine Tool, Ltd. (“NHML”)), closed on uncommitted revolving credit facilities with maximum aggregate amounts of 150 million New Taiwan Dollars and 32.5 million Chinese Yuan, respectively. As uncommitted facilities, both the Taiwan and China credit facilities are subject to review and termination by the respective underlying lending institution from time to time.

As a result, as of July 31, 2022, our existing credit facilities consisted of a €1.5 million revolving credit facility in Germany, the 150 million New Taiwan Dollars Taiwan credit facility, the 32.5 million Chinese Yuan China credit facility and the \$40.0 million revolving credit facility under the 2018 Credit Agreement.

As of July 31, 2022, there were no borrowings under any of our credit facilities and there was approximately \$51.4 million of available borrowing capacity thereunder.

12. INCOME TAXES

Our provision for income taxes and effective tax rate is affected by the geographical composition of pre-tax income which includes jurisdictions with differing tax rates, conditional reduced tax rates, and other events that are not consistent from period to period, such as changes in income tax laws.

The Inflation Reduction Act of 2022 (the “Inflation Reduction Act” or “IRA”) was signed into law on August 16, 2022. The IRA provides for investment in clean energy, promotes reductions in carbon emissions, and extends select Affordable Care Act premium reductions. The IRA is paid for through the implementation of a 15% corporate minimum tax on corporations with over \$1 billion of financial statement income, budget increases for the Internal Revenue Service, an excise tax on stock repurchases, and changes to Medicare rules. We are currently evaluating the expected impact of the IRA on its consolidated financial statements and related disclosures.

We recorded income tax expense during the nine months of fiscal 2022 of \$3.0 million compared to \$2.6 million for the same period in 2021. Our effective tax rate for the nine months of fiscal 2022 was 31%, compared to 36% in the corresponding prior year period. The year-over-year decrease in the effective tax rate was primarily due to changes in geographic mix of income and loss that includes jurisdictions with differing tax rates, various discrete tax items, and changes in income tax laws to address the unfavorable impact of the COVID-19 pandemic.

Our unrecognized tax benefits were \$204,000 as of July 31, 2022, and \$198,000 as of October 31, 2021, and in each case included accrued interest.

We recognize accrued interest and penalties related to unrecognized tax benefits as components of income tax expense. As of July 31, 2022, the gross amount of interest accrued, reported in Accrued expenses, was approximately \$36,000, which did not include the federal tax benefit of interest deductions.

We file U.S. federal and state income tax returns, as well as tax returns in several foreign jurisdictions. The statutes of limitations with respect to unrecognized tax benefits will expire between August 2022 and September 2024.

Currently, our subsidiaries in Taiwan and Germany are under tax audit for fiscal year 2018 and fiscal years 2017 through 2020, respectively.

13. FINANCIAL INSTRUMENTS

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

In accordance with this guidance, the following table represents the fair value hierarchy for our financial assets and liabilities measured at fair value as of July 31, 2022 and October 31, 2021 (in thousands):

	Assets		Liabilities	
	July 31, 2022	October 31, 2021	July 31, 2022	October 31, 2021
<u>Level 1</u>				
Deferred compensation	\$ 2,124	\$ 2,481	\$ —	\$ —
<u>Level 2</u>				
Derivatives	\$ 2,953	\$ 905	\$ 2,226	\$ 467

Included in Level 1 assets are mutual fund investments under a nonqualified deferred compensation plan. We estimate the fair value of these investments on a recurring basis using market prices that are readily available.

Included in Level 2 fair value measurements are derivative assets and liabilities related to gains and losses on foreign currency forward exchange contracts entered into with a third party. We estimate the fair value of these derivatives on a recurring basis using foreign currency exchange rates obtained from active markets. Derivative instruments are reported in the accompanying Condensed Consolidated Financial Statements at fair value. We have derivative financial instruments in the form of foreign currency forward exchange contracts as described in Note 3 of Notes to the Condensed Consolidated Financial Statements. The U.S. Dollar equivalent notional amounts of these contracts was \$131.1 million and \$94.6 million at July 31, 2022 and October 31, 2021, respectively.

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

14. CONTINGENCIES AND LITIGATION

From time to time, we are involved in various claims and lawsuits arising in the normal course of business. Pursuant to applicable accounting rules, we accrue the minimum liability for each known claim when the estimated outcome is a range of possible loss and no one amount within that range is more likely than another. We maintain insurance policies for such matters, and we record insurance recoveries when we determine such recovery to be probable. We do not expect any of these claims, individually or in the aggregate, to have a material adverse effect on our consolidated financial position or results of operations. We believe that the ultimate resolution of claims for any losses will not exceed our insurance policy coverages.

15. NEW ACCOUNTING PRONOUNCEMENTS

Recently Adopted Accounting Pronouncements:

In December 2019, FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which allows for companies to remove certain exceptions and clarifies certain requirements regarding franchise taxes, goodwill, consolidated tax expenses, and annual effective tax rate calculations. This standard is effective for our fiscal year 2022. We adopted this standard on November 1, 2021. This standard did not have a significant effect on our accounting policies or on our consolidated financial statements and related disclosures.

In March 2020, FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848) – Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. This standard provides temporary optional expedients and exceptions to the U.S. Generally Accepted Accounting Principles guidance on contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from LIBOR and other interbank offered rates to alternative reference rates, such as SOFR. This standard is effective for all entities beginning March 12, 2020 through December 31, 2022. We adopted this standard on November 1, 2021. This standard did not have a significant effect on our accounting policies or on our consolidated financial statements and related disclosures.

There have been no other significant changes in the Company's critical accounting policies and estimates during the nine months ended July 31, 2022.

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

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) contains information intended to help provide an understanding of our financial condition and other related matters, including our liquidity, capital resources and results of operations. The MD&A is provided as a supplement to, and should be read in conjunction with, our unaudited financial statements and the notes accompanying our unaudited financial statements appearing elsewhere in this report, as well as our audited financial statements, the accompanying notes and the MD&A included in our Annual Report on Form 10-K for the year ended October 31, 2021.

EXECUTIVE OVERVIEW

Hurco Companies, Inc. is an international, industrial technology company operating in a single segment. We design, manufacture and sell computerized (i.e., CNC) machine tools, consisting primarily of vertical machining centers (mills) and turning centers (lathes), to companies in the metal cutting industry through a worldwide sales, service and distribution network. Although the majority of our computer control systems and software products are proprietary, they predominantly use industry standard personal computer components. Our computer control systems and software products are primarily sold as integral components of our computerized machine tool products. We also provide machine tool components, automation integration equipment and solutions for job shops, software options, control upgrades, accessories and replacement parts for our products, as well as customer service, training and applications support.

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

The market for machine tools is international in scope. We have both significant foreign sales and significant foreign manufacturing operations. During the nine months of fiscal 2022, approximately 50% of our revenues were attributable to customers in Europe, where we typically sell more of our higher-performance, higher-priced VMX series machines. Additionally, approximately 12% of our revenues were attributable to customers in the Asia Pacific region, where we encounter greater pricing pressures.

We have three brands of CNC machine tools in our product portfolio: Hurco is the technology innovation brand for customers who want to increase productivity and profitability by selecting a brand with the latest software and motion technology. Milltronics is the value-based brand for shops that want easy-to-use machines at competitive prices. The Takumi brand is for customers that need very high speed, high efficiency performance, such as that required in the production, die and mold, aerospace, and medical industries. Takumi machines are equipped with industry standard controls instead of the proprietary controls found on Hurco and Milltronics machines. These three brands of CNC machine tools are responsible for the vast majority of our revenue. However, we have added other non-Hurco branded products to our product portfolio that have contributed product diversity and market penetration opportunity. These non-Hurco branded products are sold by our wholly-owned distributors and are comprised primarily of other general-purpose vertical milling centers and lathes, laser cutting machines, waterjet cutting machines, CNC grinders, compact horizontal machines, metal cutting saws and CNC swill lathes. ProCobots LLC (“ProCobots”) is our wholly-owned subsidiary that provides automation solutions that can be integrated with any machine tool. In addition, through our wholly-owned subsidiary in Italy, LCM, we produce high value machine tool components and accessories.

We principally sell our products through more than 180 independent agents and distributors throughout the Americas, Europe, and Asia. Although some distributors carry competitive products, we are the primary line for the majority of our distributors globally. We also have our own direct sales and service organizations in China, France, Germany, India, Italy, the Netherlands, Poland, Singapore, Taiwan, the United Kingdom, and certain parts of the United States, which are among the world’s principal machine tool consuming markets. The vast majority of our machine tools are manufactured and assembled to our specifications primarily by our wholly-owned subsidiary in Taiwan, HML. Machine castings to support HML’s production are manufactured at our wholly-owned subsidiary in Ningbo, China, NHML. Components to support our SRT line of five-axis machining centers, such as the direct drive spindle, swivel head, and rotary table, are manufactured by our wholly-owned subsidiary in Italy, LCM.

Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies in the countries in which those customers are located (primarily the Euro, Pound Sterling, and Chinese Yuan). 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 financial statements 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, which reflect translation to U.S. Dollars at exchange rates prevailing during the period covered by those financial statements.

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

We operate in the industrial equipment industry and have a global footprint that subjects us to various business risks in many different countries. Our operating results during fiscal years 2020, 2021 and the nine months of fiscal 2022 were affected by the international business disruption due to the outbreak of COVID-19 and lockdowns in certain markets, vendor delays, transportation issues, unusually high inflation, volatility of foreign currencies, competitive labor markets, uncertainty surrounding the U.K. Brexit activities, and political friction in the U.S and many regions of the world. We cannot predict the duration or scope of impact of the COVID-19 pandemic, as well as other aforementioned factors, and the potential impact to our operations and financial results cannot be reasonably estimated. To date, we have experienced some delays in our supply chain and have not completely ceased operations at any of our global facilities, but have implemented remote working capabilities, as appropriate or otherwise required under local law. We have also implemented adjustments in discretionary spending, delayed capital expenditures, and monitored production activities closely in an effort to weather the adverse business climate. We have also received stimulus in various countries to support operations and implemented tax deferrals and provisions that were available to us. More recently, we have begun to see inflationary pressures and input cost increases imposed in our supply chains on components for our products. We have also seen capacity for transportation and freight services limited significantly by container or vessel availability and delays at departing and receiving ports, all of which have contributed to significantly increased costs and prices associated with the global shipment of our products.

RESULTS OF OPERATIONS

Three Months Ended July 31, 2022 Compared to Three Months Ended July 31, 2021

Sales and Service Fees. Sales and service fees for the third quarter of fiscal 2022 were \$57.6 million, an increase of \$3.5 million, or 6%, compared to the corresponding prior year period, and included an unfavorable currency impact of \$4.3 million, or 8%, when translating foreign sales to U.S. dollars for financial reporting purposes.

Sales and Service Fees by Geographic Region

The following table sets forth net sales and service fees by geographic region for the third quarter ended July 31, 2022 and 2021 (dollars in thousands):

	2022		Three Months Ended July 31, 2021		\$ Change	% Change
Americas	\$ 23,736	41 %	\$ 19,150	35 %	\$ 4,586	24 %
Europe	28,932	50 %	28,403	53 %	529	2 %
Asia Pacific	4,972	9 %	6,625	12 %	(1,653)	(25)%
Total	\$ 57,640	100 %	\$ 54,178	100 %	\$ 3,462	6 %

Sales in the Americas for the third quarter of fiscal 2022 increased by 24%, compared to the corresponding period in fiscal 2021, primarily due to inflationary price increases and an increased volume of shipments of higher-performance Hurco and Takumi machines.

European sales for the third quarter of fiscal 2022 increased by 2%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of 14%, when translating foreign sales to U.S. dollars for financial reporting purposes. This increase was primarily attributable to inflationary price increases, an increased volume of shipments of higher-performance Hurco, Takumi and Milltronics machines in Germany and France, and increased sales of electro-mechanical components and accessories manufactured by our wholly-owned subsidiary, LCM, partially offset by a reduced volume of shipments of Hurco machines in Italy and the United Kingdom.

Asian Pacific sales for the third quarter of fiscal 2022 decreased by 25%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of 5%, when translating foreign sales to U.S. dollars for financial reporting purposes. The decrease in Asian Pacific sales primarily resulted from a reduced volume of shipments of Hurco and Takumi machines in China and Southeast Asia, partially offset by an increased volume of shipments of Hurco machines in India. The reduced volume of shipments of Hurco and Takumi machines in China was primarily due to recent COVID-19 lockdowns and similar restrictions in major Chinese markets pursuant to China's zero-tolerance COVID-19 policy.

Sales and Service Fees by Product Category

The following table sets forth net sales and service fees by product category for the third quarter ended July 31, 2022 and 2021 (dollars in thousands):

	Three Months Ended					
	2022		2021		\$ Change	% Change
Computerized Machine Tools	\$ 48,414	84 %	\$ 45,326	84 %	\$ 3,088	7 %
Computer Control Systems and Software						
†	652	1 %	612	1 %	40	7 %
Service Parts	6,588	11 %	6,251	11 %	337	5 %
Service Fees	1,986	4 %	1,989	4 %	(3)	0%
Total	\$ 57,640	100 %	\$ 54,178	100 %	\$ 3,462	6 %

† Amounts shown do not include computer control systems and software sold as an integrated component of computerized machine tools.

Sales of computerized machine tools for the third quarter of fiscal 2022 increased by 7%, compared to the corresponding prior year period, primarily due to inflationary price increases and increased shipments of higher-performance Hurco machines in North America and Germany. Sales of computer control systems and software for the third quarter of fiscal 2022 increased by 7%, compared to the corresponding prior year period, primarily due to an increase in sales of Hurco software in Germany, North America and France. Sales of service parts for the third quarter of fiscal 2022 increased by 5%, compared to the corresponding prior year period, due mainly to increased aftermarket sales and service of Hurco products in North America and the United Kingdom. All product categories included an unfavorable currency impact of 8%, when translating foreign sales to U.S. Dollars for financial reporting purposes.

Orders. Orders for the third quarter of fiscal 2022 were \$52.9 million, a decrease of \$13.8 million, or 21%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of \$4.1 million, or 6%, when translating foreign orders to U.S. dollars.

The following table sets forth new orders booked by geographic region for the third quarter ended July 31, 2022 and 2021 (dollars in thousands):

	Three Months Ended					
	2022		2021		\$ Change	% Change
Americas	\$ 21,652	41 %	\$ 23,837	36 %	\$ (2,185)	(9)%
Europe	26,429	50 %	33,998	51 %	(7,569)	(22)%
Asia Pacific	4,801	9 %	8,882	13 %	(4,081)	(46)%
Total	\$ 52,882	100 %	\$ 66,717	100 %	\$ (13,835)	(21)%

Orders in the Americas for the third quarter of fiscal 2022 decreased by 9%, compared to the corresponding period in fiscal 2021, primarily due to decreased customer demand for Hurco, Takumi and Milltronics machines, partially offset by inflationary price increases implemented during fiscal 2022.

European orders for the third quarter of fiscal 2022 decreased by 22%, compared to the corresponding prior year period, and included an unfavorable currency impact of 11%, when translating foreign orders to U.S. dollars. This decrease was driven primarily by decreased customer demand for Hurco machines across the European region, as well as decreased customer demand for electro-mechanical components and accessories manufactured by LCM, partially offset by inflationary price increases implemented during fiscal 2022 and increased demand for higher-performance Hurco and Takumi machines in Germany.

Asian Pacific orders for the third quarter of fiscal 2022 decreased by 46%, compared to the corresponding prior year period, and included an unfavorable currency impact of 5%, when translating foreign orders to U.S. dollars. The decrease in Asian Pacific orders year-over-year was driven primarily by decreased customer demand for Hurco and Takumi machines in China and Southeast Asia due to recent COVID-19 lockdowns and similar restrictions, slightly offset by increased demand for Hurco machines in India.

Gross Profit. Gross profit for the third quarter of fiscal 2022 was \$14.4 million, or 25% of sales, compared to \$13.0 million, or 24% of sales, for the corresponding prior year period. During the third quarter of fiscal 2021, we recorded approximately \$0.4 million, or 1% of sales, for the employee retention credit extended to companies under the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act and the American Rescue Plan Act of 2021 (the “employee retention credit”). While the employee retention credit did not recur in the third quarter of fiscal 2022, gross profit as a percentage of sales in the 2022 period benefited from increased sales of higher-performance machines, improved leverage of fixed overhead costs and inflationary price increases implemented during fiscal 2022.

Operating Expenses. Selling, general, and administrative expenses for the third quarter of fiscal 2022 were \$12.6 million, or 22% of sales, compared to \$10.3 million, or 19% of sales, in the corresponding fiscal 2021 period, and included a favorable currency impact of \$0.7 million, when translating foreign expenses to U.S. dollars for financial reporting purposes. The year-over-year increase in selling, general and administrative expenses in the third quarter of fiscal 2022 was driven primarily by increases in marketing and tradeshow expenses, sales commissions, and employee benefit costs, as well as increased one-time costs for administrative services. The increase in selling, general, and administrative expenses year-over-year also reflected the employee retention credit recorded in those expenses in the third quarter of fiscal 2021 of \$0.6 million, or 1% of sales during that period.

Operating Income. Operating income for the third quarter of fiscal 2022 was \$1.8 million compared to \$2.6 million for the corresponding period in fiscal 2021. The decrease in operating income was primarily due to the \$1.0 million, or 2% of sales, of employee retention credit recorded during the third quarter of fiscal 2021.

Other Income (Expense), Net. Other income (expense), net for the third quarter of fiscal 2022 and fiscal 2021 were each less than \$0.1 million.

Income Taxes. The effective tax rate for the third quarter of fiscal 2022 was 28%, compared to 41%, for the corresponding prior year period. The year-over-year decrease in the effective tax rate was primarily due to changes in geographic mix of income and loss that includes jurisdictions with differing tax rates, various discrete tax items, and changes in income tax laws to address the unfavorable impact of the COVID-19 pandemic.

Nine Months Ended July 31, 2022 Compared to Nine Months Ended July 31, 2021

Sales and Service Fees. Sales and service fees for the nine months of fiscal 2022 were \$187.4 million, an increase of \$21.1 million, or 13%, compared to the corresponding prior year period, and included an unfavorable currency impact of \$7.9 million, or 5%, when translating foreign sales to U.S. dollars for financial reporting purposes.

Sales and Service Fees by Geographic Region

The following table sets forth net sales and service fees by geographic region for the nine months ended July 31, 2022 and 2021 (dollars in thousands):

	Nine Months Ended July 31,					
	2022		2021		\$ Change	% Change
Americas	\$ 70,154	38 %	\$ 62,121	37 %	\$ 8,033	13 %
Europe	93,932	50 %	81,598	49 %	12,334	15 %
Asia Pacific	23,266	12 %	22,494	14 %	772	3 %
Total	\$ 187,352	100 %	\$ 166,213	100 %	\$ 21,139	13 %

Sales in the Americas for the nine months of fiscal 2022 increased by 13%, compared to the corresponding period in fiscal 2021, primarily due to inflationary price increases and an increased volume of shipments of higher-performance Hurco and Takumi machines.

European sales for the nine months of fiscal 2022 increased by 15%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of 9%, when translating foreign sales to U.S. dollars for financial reporting purposes. This increase was primarily driven by inflationary price increases, an increased volume of shipments of higher-performance Hurco, Takumi, and Milltronics machines across the European region, as well as increased sales of electro-mechanical components and accessories manufactured by LCM.

Asian Pacific sales for the nine months of fiscal 2022 increased by 3%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of 2%, when translating foreign sales to U.S. dollars for financial reporting purposes. The increase primarily resulted from inflationary price increases and an increased volume of shipments of Hurco and Takumi machines in Southeast Asia and India, partially offset by a reduced volume of shipments of Hurco and Takumi machines in China due to recent COVID-19 lockdowns and similar restrictions.

Sales and Service Fees by Product Category

The following table sets forth net sales and service fees by product category for the nine months ended July 31, 2022 and 2021 (dollars in thousands):

	Nine Months Ended July 31,					
	2022		2021		\$ Change	% Change
Computerized Machine Tools	\$ 158,774	85 %	\$ 139,211	84 %	\$ 19,563	14 %
Computer Control Systems and Software						
†	2,017	1 %	1,859	1 %	158	8 %
Service Parts	20,496	11 %	19,394	12 %	1,102	6 %
Service Fees	6,065	3 %	5,749	3 %	316	5 %
Total	\$ 187,352	100 %	\$ 166,213	100 %	\$ 21,139	13 %

† Amounts shown do not include computer control systems and software sold as an integrated component of computerized machine tools.

Sales of computerized machine tools for the nine months of fiscal 2022 increased by 14%, compared to the corresponding prior year period, primarily due to inflationary price increases and increased shipments of Hurco and Takumi machines across most regions and countries where our customers are located, other than China and the United Kingdom. Sales of computer control systems and software for the nine months of fiscal 2022 increased by 8%, compared to the corresponding prior year period, primarily due to an increase in software sales in Germany, North America and France. Sales of service parts for the nine months of fiscal 2022 increased by 6%, compared to the corresponding prior year period, due mainly to aftermarket sales of Hurco products in North America and the United Kingdom. Service fees for the nine months of fiscal 2022 increased by 5%, compared to the corresponding prior year period, due mainly to aftermarket service of Hurco and Takumi products in Germany, the United Kingdom and France. All product categories included an unfavorable currency impact of 5%, when translating foreign sales to U.S. Dollars for financial reporting purposes.

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Orders. Orders for the nine months of fiscal 2022 were \$182.6 million, a decrease of \$7.2 million, or 4%, compared to the corresponding period in fiscal 2021, and included an unfavorable currency impact of \$7.2 million, or 4%, when translating foreign orders to U.S. dollars.

The following table sets forth new orders booked by geographic region for the nine months ended July 31, 2022 and 2021 (dollars in thousands):

	Nine Months Ended				\$ Change	% Change
	2022		2021			
Americas	\$ 68,189	37 %	\$ 66,988	35 %	\$ 1,201	2 %
Europe	94,964	52 %	94,194	50 %	770	1 %
Asia Pacific	19,442	11 %	28,573	15 %	(9,131)	(32)%
Total	\$ 182,595	100 %	\$ 189,755	100 %	\$ (7,160)	(4)%

Orders in the Americas for the nine months of fiscal 2022 increased by 2%, compared to the corresponding period in fiscal 2021, primarily due to inflationary price increases, partially offset by decreased customer demand for Hurco and Milltronics machines.

European orders for the nine months of fiscal 2022 increased by 1%, compared to the corresponding prior year period, and included an unfavorable currency impact of 7%, when translating foreign orders to U.S. dollars. This increase was primarily attributable to inflationary price increases and increased customer demand for Hurco, Takumi and Milltronics machines in Germany, partially offset by decreased customer demand for Hurco machines in France, the United Kingdom, and Italy, and for electro-mechanical components and accessories manufactured by LCM.

Asian Pacific orders for the nine months of fiscal 2022 decreased by 32%, compared to the corresponding prior year period, and included an unfavorable currency impact of 2%, when translating foreign orders to U.S. dollars. The decrease in Asian Pacific orders year-over-year was driven primarily by decreased customer demand for Hurco and Takumi machines in China and Southeast Asia due to recent COVID-19 lockdowns and similar restrictions, slightly offset by increased demand for Hurco machines in India.

Gross Profit. Gross profit for the nine months of fiscal 2022 was \$46.9 million, or 25% of sales, compared to \$39.3 million, or 24% of sales, for the corresponding prior year period. During the nine months of fiscal 2021, we recorded approximately \$1.2 million, or 1% of sales, for the employee retention credit. While the employee retention credit did not recur in the nine months of fiscal 2022, gross profit as a percentage of sales in the 2022 period benefited from increased sales of higher-performance machines, improved leverage of fixed overhead costs and inflationary price increases implemented during fiscal 2022.

Operating Expenses. Selling, general, and administrative expenses for the nine months of fiscal 2022 were \$36.9 million, or 20% of sales, compared to \$32.2 million, or 19% of sales, in the corresponding fiscal 2021 period, and included a favorable currency impact of \$1.3 million, when translating foreign expenses to U.S. dollars for financial reporting purposes. The year-over-year increase in selling, general and administrative expenses in the nine months of 2022 was driven primarily by increases in marketing and tradeshow expenses, sales commissions, and employee benefit costs, as well as increased one-time costs for administrative services. The increase in selling, general, and administrative expenses year-over-year also reflected the employee retention credit recorded in those expenses in the nine months of fiscal 2021 of \$1.7 million, or 1% of sales during that period.

Operating Income. Operating income for the nine months of fiscal 2022 was \$10.0 million compared to \$7.1 million for the corresponding period in fiscal 2021. The increase in operating income was primarily driven by the increased sales volume.

Other Income (Expense), Net. Other income (expense), net for the nine months of fiscal 2022 decreased by \$0.4 million from the corresponding period in fiscal 2021, due mainly to an increase in foreign currency exchange losses in the nine months of fiscal 2022 compared to the same period in fiscal 2021.

Income Taxes. The effective tax rate for the nine months of fiscal 2022 was 31%, compared to 36% for the corresponding prior year period. The year-over-year decrease in the effective tax rate was primarily due to changes in geographic mix of income and loss that includes jurisdictions with differing tax rates, various discrete tax items, and changes in income tax laws to address the unfavorable impact of the COVID-19 pandemic.

LIQUIDITY AND CAPITAL RESOURCES

At July 31, 2022, we had cash and cash equivalents of \$73.5 million, compared to \$84.1 million at October 31, 2021. Approximately 14% of the \$73.5 million of cash and cash equivalents was denominated in U.S. Dollars. The balance was attributable to our foreign operations and is held in the local currencies of our various foreign entities, subject to fluctuations in currency exchange rates. We do not believe that the indefinite reinvestment of these funds offshore impairs our ability to meet our domestic working capital needs.

Working capital was \$202.3 million at July 31, 2022, compared to \$208.7 million at October 31, 2021. The decrease in working capital was primarily driven by decreases in cash and cash equivalents, accounts receivable and prepaid assets, partially offset by an increase in inventories, net.

Capital expenditures of \$1.6 million during the nine months of fiscal 2022 were primarily for capital improvements in existing facilities and software development costs. We funded these expenditures with cash on hand.

On March 10, 2021, we announced that our Board of Directors approved a share repurchase program in an aggregate amount of up to \$7.0 million. Repurchases under the program may be made in the open market or through privately-negotiated transactions from time to time through March 10, 2023, subject to applicable laws, regulations and contractual provisions. The program may be amended, suspended or discontinued at any time and does not commit us to repurchase any shares of our common stock. During the nine months of fiscal 2022, we repurchased \$2.9 million in shares of our common stock, and \$4.1 million remained available under the program as of July 31, 2022.

In addition, during the nine months ended July 31, 2022, we paid cash dividends to our shareholders of \$2.9 million. Future dividends are subject to approval of our Board of Directors and will depend upon many factors, including our results of operations, financial condition, capital requirements, regulatory and contractual restrictions, our business strategy and other factors deemed relevant by our Board of Directors from time to time.

On December 31, 2018, we and our subsidiary Hurco B.V. entered into the 2018 Credit Agreement with Bank of America, N.A., as the lender, which was subsequently amended on each of March 13, 2020, December 23, 2020 and December 17, 2021. The 2018 Credit Agreement provides for an unsecured revolving credit and letter of credit facility in a maximum aggregate amount of \$40.0 million. The 2018 Credit Agreement provides that the maximum amount of outstanding letters of credit at any one time may not exceed \$10.0 million, the maximum amount of outstanding loans made to our subsidiary Hurco B.V. at any one time may not exceed \$20.0 million, and the maximum amount of all outstanding loans denominated in alternative currencies at any one time may not exceed \$20.0 million. Under the 2018 Credit Agreement, we and Hurco B.V. are borrowers, and certain of our other subsidiaries are guarantors. The scheduled maturity date of the 2018 Credit Agreement is December 31, 2023.

Borrowings under the 2018 Credit Agreement bear interest at floating rates based on, at our option, either (i) a rate based upon the SOFR, the Sterling Overnight Index Average Reference Rate, the Euro Interbank Offering Rate, or another alternative currency-based rate approved by the lender, depending on the term of the loan and the currency in which such loan is denominated, plus 1.00% per annum, or (ii) a base rate (which is the highest of (a) the federal funds rate plus 0.50%, (b) the prime rate or (c) the one month SOFR-based rate plus 1.00%), plus 0.00% per annum. Outstanding letters of credit will carry an annual rate of 1.00%.

The 2018 Credit Agreement contains customary affirmative and negative covenants and events of default, including covenants (1) restricting us from making certain investments, loans, advances and acquisitions (but permitting us to make investments in subsidiaries of up to \$10.0 million); (2) restricting us from making certain payments, including (a) cash dividends, except that we may pay cash dividends as long as immediately before and after giving effect to such payment, the sum of the unused amount of the commitments under the 2018 Credit Agreement plus our cash on hand is not less than \$10.0 million, and as long as we are not in default before and after giving effect to such dividend payments and (b) payments made to repurchase shares of our common stock, except that we may repurchase shares of our common stock as long as we are not in default before and after giving effect to such repurchases and the aggregate amount of payments made by us for all such repurchases during any fiscal year does not exceed \$10.0 million; (3) requiring that we maintain a minimum working capital of \$125.0 million; and (4) requiring that we maintain a minimum tangible net worth of \$176.5 million. We may use the proceeds from advances under the 2018 Credit Agreement for general corporate purposes.

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In March 2019, our wholly-owned subsidiaries in Taiwan, HML, and China, NHML, closed on uncommitted revolving credit facilities with maximum aggregate amounts of 150 million New Taiwan Dollars and 32.5 million Chinese Yuan, respectively. As uncommitted facilities, both the Taiwan and China credit facilities are subject to review and termination by the respective underlying lending institution from time to time.

As of July 31, 2022, our existing credit facilities consisted of a €1.5 million revolving credit facility in Germany, the 150 million New Taiwan Dollars Taiwan credit facility, the 32.5 million Chinese Yuan China credit facility and the \$40.0 million revolving credit facility under the 2018 Credit Agreement. We had no debt or borrowings under any of our credit facilities at July 31, 2022.

At July 31, 2022, we had an aggregate of approximately \$51.4 million available for borrowing under our credit facilities and were in compliance with all covenants relating thereto.

We have an international cash pooling strategy that generally provides access to available cash deposits and credit facilities when needed in the U.S., Europe or Asia Pacific. We believe our access to cash pooling and our borrowing capacity under our credit facilities provide adequate liquidity to fund our global operations over the next twelve months and beyond, and allow us to remain committed to our strategic plan of product innovation, acquisitions, targeted penetration of developing markets, payment of dividends and our stock repurchase program.

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

CRITICAL ACCOUNTING ESTIMATES

Our MD&A is based upon our condensed 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 requires us to make judgments and estimates that affect the amounts reported in the condensed 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, which are described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2021, are frequently evaluated as our judgment and estimates are based upon historical experience and on various other assumptions that we believe to be reasonable under the circumstances. During the nine months of fiscal 2022, there were no material changes to our critical accounting estimates as described in the MD&A included in our Annual Report on Form 10-K for the year ended October 31, 2021.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

There have been no material changes related to our contractual obligations and commitments from the information provided in our Annual Report on Form 10-K for the fiscal year ended October 31, 2021.

OFF BALANCE SHEET ARRANGEMENTS

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of machines to customers that use financing. We follow FASB guidance for accounting for guarantees (codified in ASC 460). As of July 31, 2022, we had eight outstanding third party payment guarantees totaling approximately \$0.7 million. The terms of these guarantees are consistent with the underlying customer financing terms. Upon shipment of a machine, the customer assumes the risk of ownership. The customer does not obtain title, however, until the customer has paid for the machine. A retention of title clause allows us to recover the machine if the customer defaults on the financing. We accrue liabilities under these guarantees at fair value, which amounts are insignificant.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

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

These risks, uncertainties and other factors include, but are not limited to:

- The impact of the COVID 19 pandemic and other public health epidemics and pandemics on the global economy, our business and operations, our employees and the business, operations and economies of our customers and suppliers;
- The cyclical nature of the machine tool industry;
- Uncertain economic conditions, which may adversely affect overall demand, in the Americas, Europe and Asia Pacific markets;
- The risks of our international operations;
- Governmental actions, initiatives and regulations, including import and export restrictions, duties and tariffs and changes to tax laws;
- The effects of changes in currency exchange rates;
- Competition with larger companies that have greater financial resources;
- Our dependence on new product development;
- The need and/or ability to protect our intellectual property assets;
- The limited number of our manufacturing and supply chain sources;
- Increases in the prices of raw materials, especially steel and iron products;
- The effect of the loss of members of senior management and key personnel;
- Our ability to integrate acquisitions;
- Acquisitions that could disrupt our operations and affect operating results;
- Failure to comply with data privacy and security regulations;
- Breaches of our network and system security measures;
- Possible obsolescence of our technology and the need to make technological advances;
- Impairment of our assets;
- Negative or unforeseen tax consequences; and
- Uncertainty concerning our ability to use tax loss carryforwards.

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

Readers are cautioned not to place undue reliance on these forward-looking statements. While we believe the assumptions on which the forward-looking statements are based are reasonable, there can be no assurance that these forward-looking statements will prove to be accurate. We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. This cautionary statement is applicable to all forward-looking statements contained in this report.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**Interest Rate Risk**

Interest on borrowings under our bank credit agreements are tied to prevailing domestic and foreign interest rates. At July 31, 2022, we had no borrowings outstanding under any of our credit facilities.

Foreign Currency Exchange Risk

In the nine months of fiscal 2022, we derived approximately 62% of our revenues from customers located outside of the Americas, where we invoiced and received payments in several foreign currencies. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

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

We enter into foreign currency forward exchange contracts from time to time to hedge the cash flow risk related to forecasted inter-company sales and purchases denominated in, or based on, foreign currencies (primarily the Euro, Pound Sterling, and New Taiwan Dollar). We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. We 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 July 31, 2022, which are designated as cash flow hedges under FASB guidance related to accounting for derivative instruments and hedging activities, were as follows (in thousands, except weighted average forward rates):

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Dates
			Contract Date	July 31, 2022	
<u>Sale Contracts:</u>					
Euro	26,750	1.0838	28,992	27,595	Aug 2022 - July 2023
Sterling	5,750	1.2857	7,393	7,024	Aug 2022 - July 2023
<u>Purchase Contracts:</u>					
New Taiwan Dollar	980,000	28.1293 *	34,839	33,054	Aug 2022 - July 2023

* New Taiwan Dollars per U.S. Dollar

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Forward contracts for the sale or purchase of foreign currencies as of July 31, 2022, which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies and are not designated as hedges under FASB guidance, were as follows (in thousands, except weighted average forward rates):

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Dates
			Contract Date	July 31, 2022	
Sale Contracts:					
Euro	25,442	1.0439	26,559	25,992	Aug 2022
Sterling	4,709	1.2178	5,735	5,732	Aug 2022
Purchase Contracts:					
New Taiwan Dollar	713,985	29.5834 *	24,135	23,900	Aug 2022 - Oct 2022

* New Taiwan Dollars per U.S. Dollar

We are also exposed to foreign currency exchange risk related to our investment in net assets in foreign countries. To manage this risk, we have maintained a forward contract with a notional amount of €3.0 million. We designated this forward contract as a hedge of our net investment in Euro-denominated assets. We selected the forward method under FASB guidance related to the accounting for derivative 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 income (loss), net of tax, in the same manner as the underlying hedged net assets. This forward contract matures in November 2022. As of July 31, 2022, we had a realized gain of \$0.9 million and an unrealized gain of \$0.3 million, net of tax, recorded as cumulative translation adjustments in Accumulated other comprehensive income (loss) related to the hedging of our net investment in Euro-denominated assets. Forward contracts for the sale or purchase of foreign currencies as of July 31, 2022, which are designated as net investment hedges under this guidance were as follows (in thousands, except weighted average forward rates):

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Date
			Contract Date	July 31, 2022	
Sale Contracts:					
Euro	3,000	1.1557	3,467	3,084	Nov 2022

Item 4. CONTROLS AND PROCEDURES

We conducted an evaluation under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of July 31, 2022, pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the evaluation date.

There were no changes in our internal control over financial reporting during the three months ended July 31, 2022 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and lawsuits arising in the normal course of business. Pursuant to applicable accounting rules, we accrue the minimum liability for each known claim when the estimated outcome is a range of possible loss and no one amount within that range is more likely than another. We maintain insurance policies for such matters, and we record insurance recoveries when we determine such recovery to be probable. We do not expect any of these claims, individually or in the aggregate, to have a material adverse effect on our consolidated financial position or results of operations. We believe that the ultimate resolution of claims for any losses will not exceed our insurance policy coverages.

Item 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in Part I, Item 1A – Risk Factors in our Annual Report on Form 10-K for the year ended October 31, 2021. However, the COVID-19 pandemic could exacerbate or trigger the risks discussed in our Annual Report on Form 10-K for the year ended October 31, 2021, any of which could materially affect our business, financial condition and results of operations.

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

We did not repurchase any shares of our common stock in the third quarter of fiscal 2022.

Item 5. OTHER INFORMATION

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

Item 6. EXHIBITS

EXHIBIT INDEX

- 3.1 [Amended and Restated Articles of Incorporation of the Registrant, incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 31, 1997.](#)
- 3.2 [Amended and Restated By-Laws of the Registrant as amended through March 12, 2021, incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on March 12, 2021.](#)
- 31.1 [Certification by the Chief Executive Officer pursuant to Rule 13a-14\(a\) under the Securities Exchange Act of 1934, as amended.](#)
- 31.2 [Certification by the Chief Financial Officer pursuant to Rule 13a-14\(a\) under the Securities Exchange Act of 1934, as amended.](#)
- 32.1 [Certification by the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 32.2 [Certification by the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](#)
- 101 The following financial information from the Registrant's Quarterly Report on Form 10-Q for the quarter ended July 31, 2022, formatted in Inline XBRL: (i) Condensed Consolidated Statements of Operations; (ii) Condensed Consolidated Statements of Comprehensive Income (Loss); (iii) Condensed Consolidated Balance Sheets; (iv) Condensed Consolidated Statements of Cash Flows; (v) Condensed Consolidated Statements of Changes in Shareholders' Equity; and (vi) Notes to Condensed Consolidated Financial Statements.
- 104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

SIGNATURES

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

HURCO COMPANIES, INC.

By: /s/ Sonja K. McClelland

Sonja K. McClelland

Executive Vice President, Treasurer & Chief Financial Officer

September 2, 2022

CERTIFICATION PURSUANT TO RULE 13a-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Gregory Volovic, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hurco Companies, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)] for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Gregory Volovic

Gregory Volovic

Chief Executive Officer

September 2, 2022

CERTIFICATION PURSUANT TO RULE 13a-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, Sonja K. McClelland, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Hurco Companies, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures [as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)] and internal control over financial reporting [as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)] for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Sonja K. McClelland

Sonja K. McClelland

Executive Vice President, Treasurer & Chief Financial Officer

September 2, 2022

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Hurco Companies, Inc. (the "Company") on Form 10-Q for the period ended July 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies, pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gregory Volovic

Gregory Volovic

Chief Executive Officer

September 2, 2022

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Hurco Companies, Inc. (the "Company") on Form 10-Q for the period ended July 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certifies, pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Sonja K. McClelland

Sonja K. McClelland

Executive Vice President, Treasurer & Chief Financial Officer

September 2, 2022
