HURCO

Annual Report 2006

A YEAR OF GLOBAL PERFORMANCE

VISION, INNOVATION,

AND COMMITMENT

LEAD TO

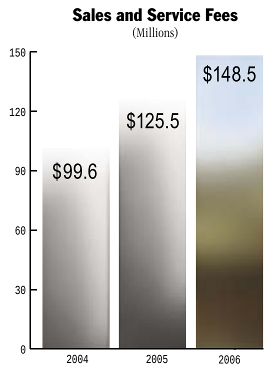
GLOBAL PERFORMANCE

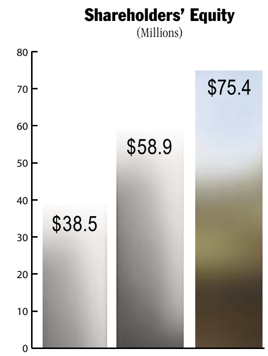
Contents

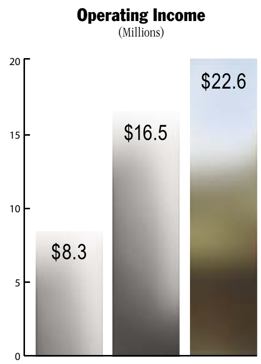
Financial Highlights

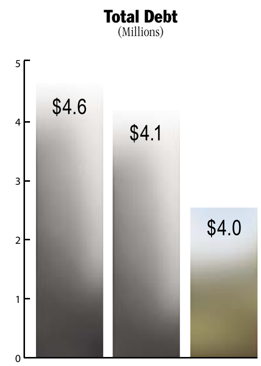
(In thousands except per share data and number of employees)

		2006	2005	% Change
Sales and service fees		$148,517	$125,509	18.3%
Operating income		$ 22,628	$ 16,501	37.1%
Net income		$ 15,479	$ 16,443	(5.9%)
Earning per common share (diluted)		$ 2.42	$ 2.60	(6.9%)
Order intake		$154,767	$122,862	26.0%
Working capital		$ 56,542	$ 43,057	31.3%
Total debt		$ 4,010	$ 4,136	(3.0%)
Shareholders' equity		$ 75,375	$ 58,944	27.9%
Number of employees		320	284	12.7%
Stock price	October 31	$ 26.06	$ 17.83	46.2%
	High	$ 37.47	$ 20.00	87.4%
	Low	$ 17.74	$ 10.25	73.1%









- **1968** Hurco founded by Edward Humston and Gerald Roch
- **1971** Hurco becomes a publicly held company
- **1976** Hurco develops and introduces "conversational programming"
- **1978** Hurco launches its first machining center, the MB1
- **1979** Hurco Europe, Ltd. (United Kingdom) founded
- **1980** Overseas sales account for 33% of Hurco business
- **1981** Hurco forms joint venture to market products in former West Germany
- **1984** UltiMax control introduced
- **1986** Introduction of BMC30, BMC40, BMC50 VMCs
- **1987** UltiMax 2 control introduced
- **1988** Hurco GmbH (Germany) founded

Hurco Companies, Inc., designs and manufactures Computer Numeric Controlled (CNC) machine tools for machinists in the metal cutting industry. Our products are used globally in machine shops of all sizes—small job shops, medium-sized precision tool and die shops, and tool rooms of large manufacturing facilities.

Hurco is known for revolutionizing the CNC machine tool industry more than two decades ago by introducing shop floor programming, called Hurco "Conversational" programming. The beauty of Conversational programming has always been its intuitive, user friendly interface that allows all machinists, even those who may have limited CNC knowledge, to quickly program a part without needing to know hundreds of G-Codes and M-codes that are contained within the industry's standard programming language (Industry Standard Numeric Code—called NC for short).

Another distinction of the Hurco CNC machine tool is the flexibility of the control that provides machinists with multiple programming options. The operator or owner can use the best method of programming for each job—Conversational, G-Code (NC), or by using a CAD/CAM system and transferring the program to the machine tool—whatever works best for them.

In 2006, Hurco completed development of the next generation control that will, again, define Hurco as the market leader in control innovation. The WinMax® Control software combines the proven platform of Microsoft Windows with the software expertise and industry knowledge of Hurco to provide unmatched productivity for the end user.

With headquarters in Indianapolis, Indiana, Hurco consists of 320 employees across the globe who strive to create the greatest machining and turning centers in the world. The development of extensible platforms across functions, including product and software development, sales and marketing, and information technology, has facilitated effective global growth that leverages the strength of the brand from one region to the next. Building upon this global business model enables the brand to flourish locally while maintaining a consistent global brand identity.

The Hurco team exemplifies the same qualities upon which Gerald Roch and Edward Humston founded the company in 1968—focused, innovative, dedicated, and passionate about the metal cutting industry and the end user of Hurco products. As a public company for 25 years, every cross functional team at Hurco understands the importance of fiscal responsibility and the need to always keep the Hurco customer at the forefront of each project.

This 2006 Hurco Annual Report provides a year in review for each strategic operational unit as well as a preview of what to expect for 2007.

WinMax

1991	1996	1997	1998	1999	2003	2004	2005	2006
Hurco France founded Hurco Southeast Asia founded Indianapolis Headquarters UltiMax 3 control launched	Max single-screen control introduced	Overseas sales account for 51% of Hurco business VMX line introduced	UltiMax 4 control introduced	Hurco S.r.l. (Italy) and Hurco Manufacturing Limited (Taiwan) established	VM line introduced 5-Axis VTXU debuts	TM Turning Centers introduced	Sales and income records set	Record sales, record income, new software and hardware introductions

Report to Shareholders

2006 was another record year for Hurco with record sales and a record number of new products. We achieved record sales of $148M—an 18% increase compared to the record sales figure of 2005. Even more important is the fact that we translated these record sales into record operating profits.

Since 2001, we have focused on three straightforward concepts: identifying our customers and understanding how to best serve them; defining our unique selling proposition by understanding what we do better than anyone else; and maximizing profits—for both the short term and the long term. In 2006, this cumulative focus on our core competencies came to fruition for all stakeholders—shareholders, customers, employees, and partners.

Focusing on our core competencies has allowed us to develop the Hurco brand and strengthen its presence globally. Using a disciplined approach, we have leveraged our extensible platforms to support our global business model and targeted expansion in emerging markets. These platforms encompass all areas of the business including product development, software development, marketing and sales, manufacturing, and information technology.

Customers

The pace of globalization did not slow down in 2006, nor did our pace for establishing new geographical markets and developing new customer relationships. We laid the groundwork to open a technical center in India early in 2007.

Additionally, we opened new markets for Hurco products in Indonesia, Australia, Vietnam, and South Africa. In the rapidly expanding Chinese market, we opened our second Technical Center in Shenzhen.

We maintained a healthy percentage of new customers in 2006, with approximately 40% of our sales being to first-time Hurco owners. We continue to broaden our product line and develop relevant features that will attract new customers and increase our value to existing Hurco customers.

Core Competencies

Making sophisticated machine tools that are easy to learn and easy to use is the essence of the Hurco story. We made a strategic decision to invest in the future and take a leadership position in our industry by developing WinMax® Control software. Our CNC expertise, a strong software development team, and the technology available, prompted us to develop this new control that will yield increased productivity, top-notch efficiency, and ultimately, more profitability for Hurco customers.

In addition to WinMax, we introduced several machine tool models that were designed to meet specific needs throughout the industry. Another key product announcement in 2006 was the enhancements made to our machining centers, including faster spindle speeds, faster travels, and increased capacity tool changers—improvements that will make our customers more productive.

Profitability

Just as our customers have learned to run lean, so have we. Our sales per employee ratio continues to improve—from $442,000 in 2005 to $464,116 in 2006. We have continued our aggressive cost reduction programs allowing us to invest the savings to expand our product line and strengthen the Hurco brand in emerging markets. Gross margin for fiscal 2006 was an all time high of 35%.

Shareholder's equity was increased from $58,944 to $75,375 in 2006—another record for our shareholders.

In order to facilitate further efficiencies in the development, design, and manufacture of Hurco machine tools across the globe, we opened a new component manufacturing facility in the Ningbo Economic and Technical Development Zone (NETD) in Ningbo, China. This facility will prove vital to the global supply chain of the company.

2006 was truly a year of Global Performance for Hurco.

Going Forward 2007

Hurco is well positioned for the future in terms of new products, engineering capabilities, global sales and service channels, and manufacturing capabilities. We are financially strong and believe the strategic planning and restructuring of the last five years will promote strength, stability, and financial health during the good times and the bad. We are excited about our opportunities to profitably grow our sales and market share in 2007.

We wish to thank our shareholders for their continued support in 2006 and we hope you share our enthusiasm for our future prospects. We want to thank our Board of Directors for their insight, guidance and support. We also want to thank our employees for their hard work and perseverance during a very productive year. We especially want to thank our loyal customers and welcome our new customers to Hurco. We look forward to growing with you and providing you with the most innovative and easy to use machine tools in the world.

In 2006, Hurco introduced more new products than in any previous year.

Michael Doar
Chairman and Chief Executive Officer

James D. Fabris
President and Chief Operations Officer

New products fuel future revenue.

WinMax® Control Software, with patented technology and 25 new features, provides a solid foundation for the future

Lathes with live tooling fill customer need for an integrated mill turn machine

VMX42SR
Space saving 5-axis machine

VMX60
A 60" machine with a small footprint

Instead of following the commoditization of machine tools trend that has infiltrated our industry, Hurco continued its leadership position in 2006 by introducing technology driven machine tools designed to meet the diverse needs of global customers. WinMax Control software leads the list of innovative new products we introduced in 2006.

Although the powerful control software of Hurco's UltiMax® and Max® controls are already world-renowned throughout the industry for being easy to learn and easy to use, the software team took it up a notch in 2006 by developing WinMax Control software—which will be the standard control software on all machining and turning centers early in 2007. Hurco officially introduced its WinMax Control software at the International Manufacturing Trade Show (IMTS) in September to the 1,800 customers who entered the Hurco booth. More than two-thirds of those customers participated in one-on-one, hands-on demonstrations to see how this control can benefit their operation.

"Simply put, WinMax is the best control software ever developed for the machine tool industry," said Jim Fabris. With intuitive software and real visual part representation, WinMax is a generation above any control being offered. From a customer's perspective, WinMax significantly reduces setup time and provides consistent and improved surface finish quality.

WinMax has more than 25 new features that use patented technology and includes hundreds of enhancements to existing UltiMax features. Not only is the intellectual property a value to shareholders as an investment in the future, the decision to use the proven platform of Microsoft® Windows® will yield benefits to shareholders and customers alike for decades to come. The immediate benefit of using the Windows platform to showcase Hurco's software features is more efficient software development. Additional benefits for the customer include simplified networking and a USB interface. For the future, using the Microsoft platform as the foundation of WinMax enables Hurco's software team to provide streamlined upgrades and future portability. Additionally, as commercial technologies are developed, use of Windows as the platform provides a path for compatibility.

WinMax is truly a window to limitless technology and an investment in the future–for customers and shareholders alike.

On top of designing a new control, the software team managed the needs and expectations of existing Hurco users while developing WinMax. As a growing company in the machine tool industry, Hurco relies heavily on loyal Hurco users—as they grow, we grow. The software team kept much of the same look and feel while improving favorite features, such as replacing the wire-frame graphics of the Advanced Verification Graphics feature with 3D solid rendering graphics that include dynamic rotation/pan/zoom and real time tool rendering.


Consider The Control Before You Buy

When an industry publication was planning an article about the importance of considering the control before purchasing a CNC machining center, they came to Hurco. Consider the Control Before You Buy appeared in the May 2006 issue of Moldmaking Technology and described the importance of meaningful, relevant software design features that enable a shop to maximize productivity. The UltiMax features that received the most attention were Graphical Data Block Search, Advanced Verification Graphics, Program Interrupt with real-time resume capabilities, and DXF Transfer.

Advanced Verification Graphics

with Solid 3D Rendering

Tool & Material Library

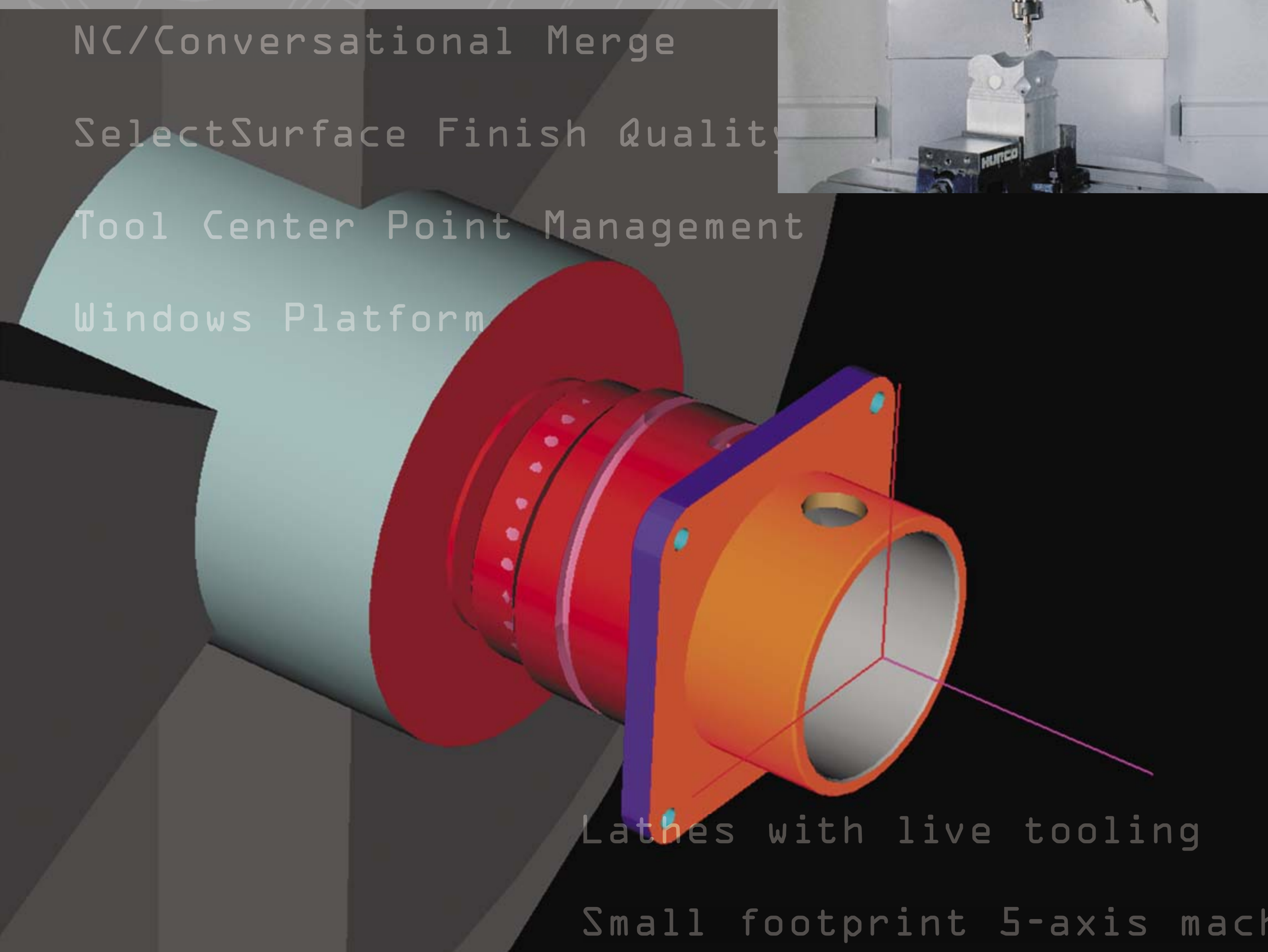
Swept Surface

NC/Conversational Merge

SelectSurface Finish Quality

Tool Center Point Management

Windows Platform



Lathes with live tooling

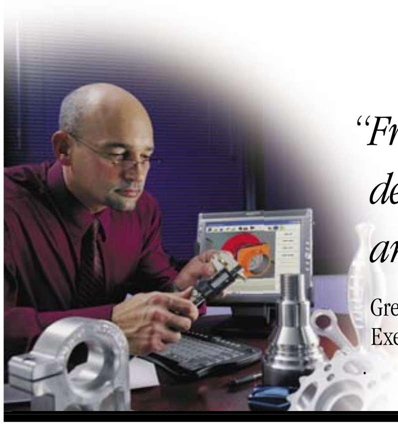
Small footprint 5-axis machine

Small footprint 60 inch machine

Increased spindle speeds

Faster rapids

Ceramic spindle bearings



"From a customer's perspective, WinMax® was specifically designed to slash setup time and to provide consistent and improved surface finish quality."

Greg Volovic
Executive Vice President, Software and Controls

In the future, the team will develop WinMax retrofit kits that existing Hurco customers can purchase to upgrade most Hurco machines purchased within the last five years—another "best in class" attribute that sets us apart from competitors.

Armed with WinMax, Hurco has made an investment that will pay off for years to come–for customers, shareholders, and employees.

The Hurco mechanical design team's pragmatic performance proves valuable.

When a company is known for its brilliantly designed control, the actual machine—the hardware—can sometimes end up living in the control's shadow. The Hurco mechanical design team continues to outdo itself despite the attention the control gets. A few of the feats they have achieved include work cubes that are on average 50% larger than competitive models, tables that are larger than competitive models, and solid machine construction by using larger linear rails, larger ball screws, and heavier servo drives. With superior frame design and the use of fine grain, high-grade cast iron, the Hurco machines are the sturdiest and toughest in their class.

This stainless steel, custom boat propeller made by Throttle Up illustrates the power of the Hurco VTXU 5-Axis machining center to produce complex parts with multiple contours.

And customers take notice—even customers who rave about the control talk about the importance of a rigid machine

"Another thing that impressed me about the Hurco early on, is the way they are built. They're built beefy," said Jon Heckman, the Tool Room Supervisor at DePuy Orthopaedics, Inc., who has 31 years of machining experience. Another three-decade machinist said the Hurco is better made than any machines close to its price range. "I don't want a throw-away machine. I want a machine that will last," said Edward Dean, owner of ATD Precision, who purchased his first Hurco machining center in 2006.

2006 has been a year of continual innovation for the Hurco mechanical design team. Some major accomplishments include the introduction of several new machines that meet customer demand.

The VMX42SR, Hurco's newest 5-Axis machine was designed with a swivel head and horizontal rotary table to meet the demands of 5-Axis machining without taking up the floor space typically required of a 5-Axis machine. Another win for the mechanical design team was working in unison with the software team to develop the WinMax software module that is specifically designed to greatly simplify simultaneous 5-Axis machining.

The TMM8 and TMM10, the slant bed lathes with Live Tooling, were being requested by customers almost as soon as the TM series of slant-bed lathes was launched in 2004. This mill-turn machine, also called an integrated mill machine, provides increased efficiency because the machinist doesn't need to refixture the part—turn and do minor milling operations on the same machine.

The VMX60 provides 60 inches of X-Axis travel while taking up less floor space. Saving space is always an issue for job shops and Hurco machines are well known for efficient design that help small job shops find a way to have a quality machining center without adding square footage to the operation.

Advanced Verification Graphics

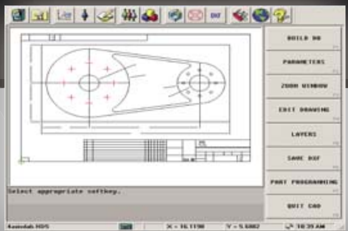
Using 3D solid rendering, dynamic rotation, and real time tool display, this WinMax feature is the most visible and one of the most powerful.

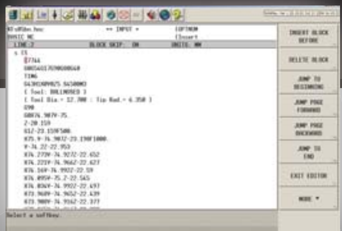
Tool & Material Library

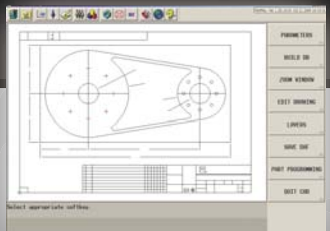
Tool and material data resides within the control's memory instead of with each individual part program.

Program Interrupt

A true program interrupt button that stops cutting, retracts the tool, and when pressed again, resumes right where it left off.





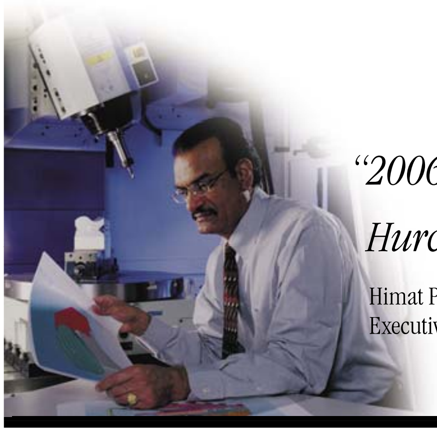


Graphical Data Block Search

A feature that leverages the power of the on-screen representation of the part—just touch the portion of the part that needs adjusted and the corresponding code appears. Eliminates the time consuming and frustrating process of searching through hundreds of lines of code.

Enhanced DXF Transfer

Not only can the CAD file be sent directly to the control, WinMax includes more editing capabilities of DXF files, which eliminates the need to send the file back to the CAD system.



"2006 has been a year of continual innovation for the Hurco mechanical design team."

Himat Patel
Executive Vice President, Machine Tool Design

Another challenge the team met in 2006 was to implement a cost effective plan to add more mechanical benefits to the VM line and to enhance the Power of Two (VMX^2) package for the high performance VMX line. Again,

they delivered with increased spindle speeds, greater capacity automatic tool changers, faster rapid traverse (increased from 1,181 ipm to 1,378 ipm), a dual touch-screen LCD, and ceramic spindle bearings.

All of this while containing costs and incorporating hardware changes required to support WinMax®.

Manufacturing manages growth to support Global Supply Chain.

The company's strategic plan for global growth includes leveraging core competencies of each region. All of the Hurco products are designed in our Indianapolis, Indiana, USA, headquarters, by a cohesive team of experienced engineers that apply rigorous standards to the design and performance of each machine.

The engineering design team works with our wholly owned manufacturing facility, Hurco Manufacturing Ltd. (HML), in Taiwan to assist in proper execution of the machine design during the manufacturing process. This global supply chain enables Hurco to engineer, design, and ship Hurco products with shorter lead times while containing costs to stay competitive and financially viable.

As part of the ongoing production cost reduction program, Hurco opened its component manufacturing facility in Ningbo, China, in 2006. In the future, the Ningbo facility can be expanded to serve Hurco's growing capacity needs. Eventually, machines designed specifically for the emerging Chinese profile can be manufactured at the Ningbo facility.

Hurco also continued implementation of its web-based global business system in 2006. This global business system ties together accounting, manufacturing, and sales functions globally.

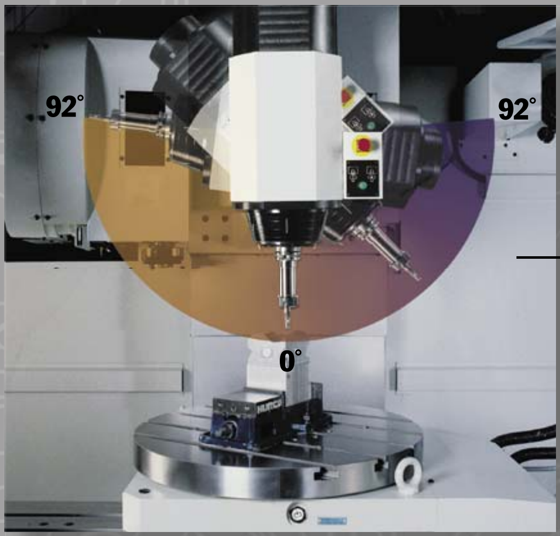
Another key to Hurco's global success includes product design that leverages economies of scale for components. Flexible product design and efficient manufacturing processes support cost effective product packages to meet local sales needs.

By focusing on efficient processes and extensible platforms, we believe Hurco has achieved one of the lowest cost manufacturing operations in the industry.

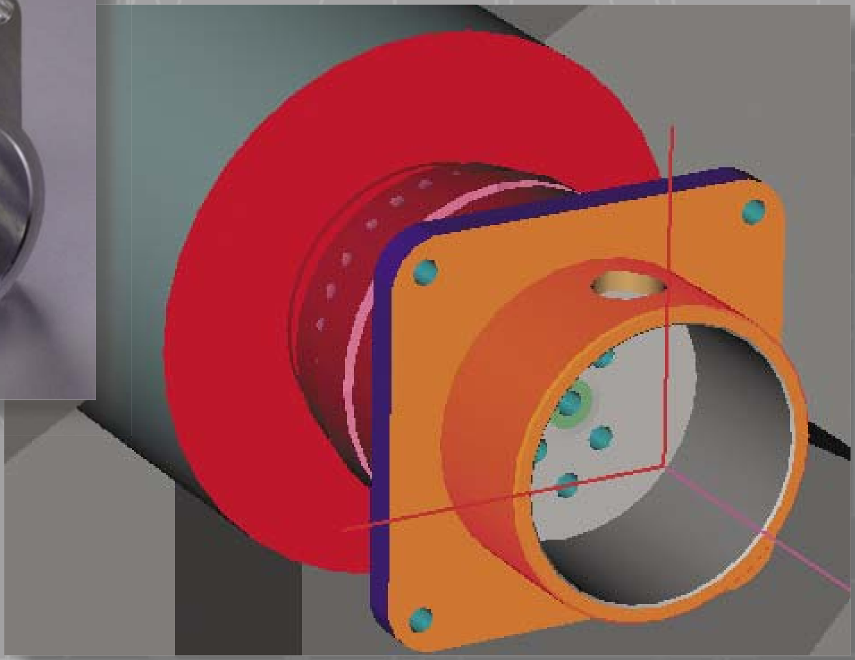
Sales and Marketing introduced Hurco to customers in four new regions.

Hurco achieved record sales in 2006 with a 26% increase over 2005 in units sold and 37% increase in profits. More than two-thirds of Hurco sales are outside of the United States while approximately 90 percent of global machine tool consumption is outside of the United States. In 2006, we continued our aggressive sales channel development by expanding sales representation in Canada, laying the groundwork to open a sales office in India, and developing the Technical Center in Shenzhen, China, that was opened in November of 2005.

Additionally, distributors were set up in Xian and Souzhou during 2006 to support service of Hurco machines in the Chinese market.



The use of a swivel head on the VMX42SR 5-Axis machining center is one design feature that supports a small footprint that is atypical of a 5-Axis machine.



This military connector exemplifies the type of part where a lathe with live tooling is beneficial. Turn, mill, and drill with just one setup.

TMM8 and TMM10 with live tooling

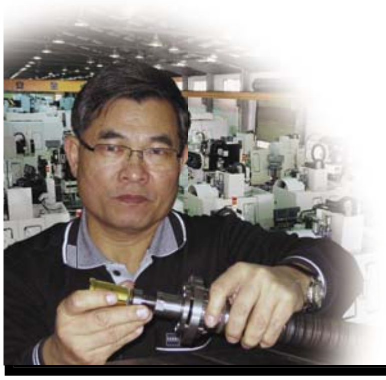
The popularity of the TM series of CNC slant-bed lathes introduced in 2004, prompted development of these integrated mill turn machines.

VMX42SR

The new 5-Axis machining center uses a swivel head and horizontal rotary table to meet the demands of 5-Axis machining without taking up the floor space 5-Axis machines typically require.

VMX60

Due to customer requests, the VMX60 was developed to fit between the VMX50 and the VMX64 in the popular VMX Series.



"This global supply chain enables Hurco to engineer, design, and ship products with shorter lead times while containing costs to stay competitive and financially viable."

Charlie Tsai
General Manager, Hurco Manufacturing Limited

Hurco machining and turning centers were introduced to several new markets in 2006—Indonesia, Australia, South Africa, Eastern Europe, and Vietnam. Global expansion is an integral part of our strategy to protect shareholder value from the cyclical nature of the machine tool industry. Every selling group is regionally based with a resident General Manager and staff who understand the nuances of the customers in their particular region.

The effective utilization of technology enables us to control the expense of selling machine tools globally. In 2006, we extended our web sites to include China, Southeast Asia, and Taiwan. The architecture for the web site ensures consistent brand presence while minimizing development costs and overhead by enabling each region to package their local content. In 2007, the web site architecture will be expanded to include India and to upgrade European web sites.

Assembly of controls at Hurco Automation Limited.

The largest industry tradeshow in North America, the International Manufacturing Trade Show (IMTS) was held in 2006. Sponsored by the Association for Manufacturing Technology (AMT), it is only held every two years. Hurco timed the introduction of its new products to coincide with IMTS. Sales leads at the Hurco booth were up 35% compared to 2004, while the overall show's attendance was up just 7% from 2004, according to data released by AMT.

Even more impressive was the percentage of customers who participated in one-on-one, hands-on demonstrations of the new WinMax® control at IMTS–nearly two-thirds of the 1,800 customers who entered the booth participated in a WinMax demo. Also significant, 70% of the 1,200 people who participated in the WinMax demonstrations had no prior experience with Hurco machine tools. A successful introduction of WinMax at IMTS was an important marker for future success as WinMax will be the standard control for all Hurco machining and turning centers in early 2007.

Once the customer has made the decision to go with Hurco, the reality of paying for the product becomes primary. To ease the hassle of financing and eliminate a possible barrier to finalizing a sale, we developed the Hurco Manufacturing Financing Program in 2006.

With targeted product offerings and expansion of our selling channels in emerging markets, the Hurco sales and marketing team is positioned to continue the momentum of market share growth and building the Hurco brand.

Customer Support seals the deal.

When it comes to purchasing machine tools, customers talk about machine capabilities, quality, and price. However, service and support are not far behind during the decision-making process.

Customer support after the sale is critical to Hurco customers because the vast majority of Hurco customers literally can't afford to have a machine down. As any shop owner will tell you, "I only make money when the machine's making chips."

Understanding this critical part of the purchasing decision, Hurco announced an extension to its VMX^2 Warranty for 2007. This extended support will provide peace of mind to our customers, especially first time Hurco customers who haven't experienced our commitment to quality.

Our wholly owned manufacturing facility ensures that rigorous quality processes are followed.

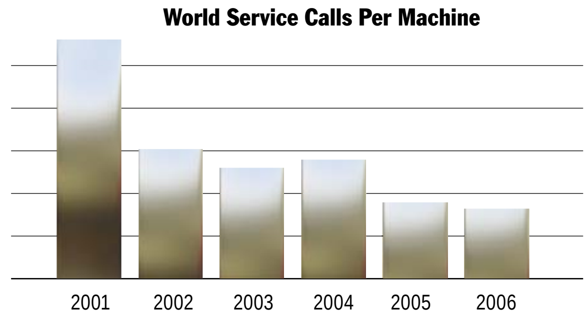
Every Hurco control is fully inspected before being fitted to our machine tools.

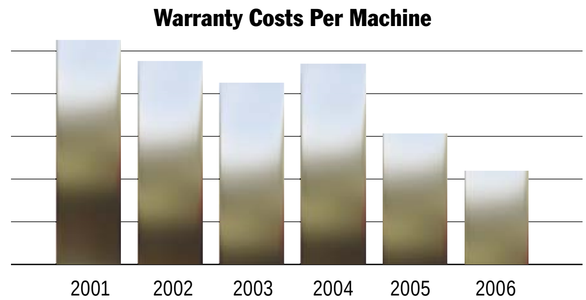
"Hurco USA achieved record unit sales in 2006 with a 25.3% increase over 2005."

Jim Kawaguchi
General Manager, Hurco USA

Application engineering support, training, regionally based service, maintenance assistance, and parts supply are critical to Hurco customers. Some companies view customer support as a cost center, but Hurco realizes that taking care of the customer is not only the right thing to do it's imperative for a company the size of Hurco to have a good reputation of taking care of its customers. As they grow, we grow.

In tandem with Hurco's direct support, trained and authorized distributor partners handle service and maintenance of machines locally to ensure efficient responsiveness to customers' needs.





Extensible platforms facilitate an efficient global business model that can be adapted to meet local customer needs.

The key to customer support is to identify problems early and eliminate them. The After Sales processes, planning, and tracking that were put into place several years ago are paying off with level service and warranty claims.

Due to customer satisfaction programs implemented during the last five years, service calls have dropped nearly 30% from 2001. Additionally, this yields savings for shareholders as warranty costs have dropped more than 54%.

Foresight during good times minimizes impact of industry downturns.

Being a cyclical industry, Hurco has been laying the groundwork during the good times to minimize the impact of the next inevitable downturn by making strategic product development decisions. We have also been pragmatic about global expansion and stayed true to our core competencies. Flexibility, adaptability, and strategic planning are critical to achieving long term success for any company. In this industry, however, such foresight is mandatory for long term viability.

With new products, strong teams of dedicated personnel throughout the world, and clear direction, Hurco is well on its way to make 2007 another good year.

North America

Hurco Companies, Inc.
Hurco USA

Serving North and South America

Hurco North America focuses on the machining industry in United States, Canada and Mexico. While sales in the United States have remained strong, we realize the potential for growth in both Canada and Mexico.

L.A. Technical Center

Indianapolis, Indiana

Hurco Europe, Ltd

Serving the United Kingdom, Ireland, Africa, the Middle East, and Scandinavia

From the UK headquarters in High Wycombe, Buckinghamshire, England, Hurco Europe markets and sells the full range of Hurco milling machines and machine tools. A strategically placed team of sales engineers and appointed agents operates throughout the region.

England

Netherlands

Hurco's facility in the Netherlands serves as a warehouse and shipping port for Hurco machine tools.

Hurco Germany (GmbH)

Serving Germany, Austria, Belarus, Bosnia-Herzegovina, Croatia, the Czech Republic, Hungary, Latvia, Lithuania, the Netherlands, Poland, Portugal, Romania, Russia, Slovakia, Spain, Turkey, Ukraine, and the Federal Republic of Yugoslavia

Based in Munich, Germany, Hurco GmbH has been extremely successful in selling and marketing Hurco machine tools to a nation ranked 4th in machine tool consumption.

Germany

France

Italy

Hurco France (S.a.r.l.)

Serving France

Located in Goussainville, just northeast of Paris, Hurco Sarl focuses on the manufacturing industry exclusively in France. The world's 9th largest consumer of machine tools, France is the home of a strong automotive and aerospace sector.

Hurco Italy (S.r.l.)

Serving Italy

Italy is the world's 6th largest consumer and producer of machine tools. Therefore, Hurco's presence in Italy continues to be important. Situated in the northwest part of the country, Hurco's Italian office is located in Trezzano, Milan.

Hurco China

Serving China

Hurco continues to aggressively and successfully market machine tools to China–the number one consumer of machine tools in the world.

Shenzhen Technical Center

In order to better serve the emerging machine tool market in China, Hurco recently opened the Technical Center in Shenzhen which will serve as an application and service center for the latest Hurco machine tools available to China.

Hurco India Pte. Ltd.

Serving India, Pakistan, Bangbledesh, and Sri Lanka

Ningbo

Singapore

Taiwan (HML/HAL)

Hurco Manufacturing Ltd.
Hurco Automation Ltd.

These manufacturing facilities are responsible for the assembly of Hurco machine tools and controls.

Hurco (S.E. Asia) Pte. Ltd.

Serving Singapore, Malaysia, Thailand, Australia, New Zealand, Philippines, India, Indonesia, Myanmar, and Korea

HURCO COMPANIES, INC.
ELEVEN-YEAR SELECTED FINANCIAL DATA

(In thousands except per share data and number of employees)

For the Fiscal Year Ended	2006	2005	2004
Sales and service fees	$148,517	$125,509	$99,572
Cost of sales and service (1)	$ 95,192	$ 82,951	$69,274
Operating expenses (SG&A)	$ 30,697	$ 26,057	$21,401
Restructuring and other expenses, net	$ --	$ --	$ 465
Operating income (loss)	$ 22,628	$ 16,501	$ 8,432
License fee income, net	$ --	$ --	$ --
Interest expense	$ 259	$ 355	$ 468
Other income (expense)	$ 745	$ (64)	$ (396)
Income before taxes	$ 23,114	$ 16,082	$ 7,568
Income tax expense (benefit) (4)	$ 7,635	$ (361)	$ 1,299
Net income (loss)	$ 15,479	$ 16,443	$ 6,269
Average shares outstanding -			
Basic	6,317	6,171	5,784
Diluted/Primary	6,397	6,336	6,026
Earnings per share			
Basic	$ 2.45	$ 2.66	$ 1.08
Diluted/Primary	$ 2.42	$ 2.60	$ 1.04
Capital expenditures	$ 3,301	$ 3,040	$ 2,052
Depreciation and amortization	$ 1,504	$ 1,331	$ 1,223
EBITDA	$ 24,877	$ 17,768	$ 9,259
EBITDA, excluding license fees and restructuring charge	$ 24,877	$ 17,768	$ 9,724
Gross profit margin %	35.9%	33.9%	30.4%
Operating income as % of sales	15.2%	13.1%	8.5%
Net return on sales	10.4%	13.1%	6.3%
Return on average equity	23.0%	33.8%	18.7%
Stock price range			
High	$ 37.47	$ 20.00	$ 17.37
Low	$ 17.74	$ 10.25	$ 2.52

At Fiscal Year End	2006	2005	2004
Working capital	$ 56,542	$ 43,057	$26,347
Current ratio	2.28	2.40	1.87
Total assets	$124,114	$ 94,114	$73,446
Total debt	$ 4,010	$ 4,136	$ 4,600
Shareholders' equity	$ 75,375	$ 58,944	$38,455
Total debt to capitalization %	5.1%	6.6%	10.7%
Shareholders' equity per share (2)	$ 11.78	$ 9.30	$ 6.38
Net operating assets per $ revenue (3)	$ 0.334	$ 0.363	$ 0.347
Number of employees	320	284	250

(1) Cost of Sales in fiscal 2002 includes restructuring write-downs of inventory of $1.1 million and in fiscal 1993 includes inventory adjustment of $3.4 million.

(2) Based on shares outstanding at fiscal year end - diluted

(3) Excluding cash and debt.

(4) Fiscal 2005 includes an approximate $2.3 million benefit from the reduction of valuation allowances on our deferred tax assets.

	2003	2002	2001	2000	1999	1998	1997	1996
	$ 75,532	$ 70,486	$ 92,267	$96,204	$88,238	$ 93,422	$95,729	$99,351
	$ 54,710	$ 55,240	$ 69,005	$ 70,827	$64,064	$ 65,483	$ 67,956	$70,930
	$ 18,749	$ 19,658	$ 24,040	$ 23,538	$ 21,259	$ 21,786	$ 21,047	$21,343
	$ (124)	$ 2,755	$ 143	$ 300	$ (103)	$ 1,162	$ --	$ --
	$ 2,197	$ (7,167)	$ (921)	$ 1,539	$ 3,018	$ 4,991	$ 6,726	$ 7,078
	$ --	$ 163	$ 723	$ 5,365	$ 304	$ 6,974	$ 10,095	$ 590
	$ 658	$ 634	$ 790	$ 939	$ 1,293	$ 876	$ 1,938	$ 3,211
	$ (119)	$ (36)	$ 168	$ (359)	$ 25	$ 99	$ (51)	$ (99)
	$ 1,420	$ (7,674)	$ (820)	$ 5,606	$ 2,054	$ 11,188	$ 14,832	$ 4,358
	$ 958	$ 589	$ 777	$ 571	$ 252	$ 1,934	$ 1,028	$ 94
	$ 462	$ (8,263)	$ (1,597)	$ 5,035	$ 1,802	$ 9,254	$13,804	$ 4,264
	5,582	5,583	5,670	5,952	5,980	6,498	6,536	5,786
	5,582	5,583	5,670	6,020	6,061	6,670	6,704	5,907
	$ 0.08	$ (1.48)	$ (0.28)	$ 0.85	$ 0.30	$ 1.42	$ 2.11	$ 0.74
	$ 0.08	$ (1.48)	$ (0.28)	$ 0.84	$ 0.30	$ 1.39	$ 2.06	$ 0.72
	$ 1,215	$ 1,716	$ 1,918	$ 1,899	$ 2,157	$ 2,328	$ 2,235	$ 1,879
	$ 1,429	$ 1,929	$ 2,196	$ 2,519	$ 2,428	$ 2,138	$ 2,078	$ 2,677
	$ 3,507	$ (5,111)	$ 2,166	$ 9,064	$ 5,775	$ 14,202	$18,848	$10,246
	$ 3,383	$ (2,519)	$ 1,586	$ 3,999	$ 5,368	$ 8,390	$ 8,753	$ 9,656
	27.6%	21.6%	25.2%	26.4%	27.4%	29.9%	29.0%	28.6%
	2.9%	(10.2%)	(1.0%)	1.6%	3.4%	5.3%	7.0%	7.1%
	0.6%	(11.7%)	(1.7%)	5.2%	2.0%	9.9%	14.4%	4.3%
	1.6%	(26.0%)	(4.3%)	13.4%	4.9%	27.4%	60.1%	36.1%
	$ 3.15	$ 3.35	$ 4.19	$ 5.88	$ 6.63	$ 9.25	$ 9.44	$ 7.25
	$ 1.30	$ 1.45	$ 2.08	$ 3.00	$ 3.38	$ 6.25	$ 4.25	$ 3.25

	2003	2002	2001	2000	1999	1998	1997	1996
	$22,236	$20,350	$ 31,293	$26,071	$ 33,276	$29,349	$22,852	$20,772
	2.10	1.96	2.72	2.13	2.70	2.14	2.18	1.89
	$ 57,958	$ 57,152	$ 66,217	$65,024	$ 69,632	$71,696	$58,748	$ 59,750
	$ 9,222	$ 8,885	$12,000	$ 3,736	$ 14,172	$ 8,358	$10,043	$ 22,110
	$ 28,741	$ 28,017	$ 35,468	$ 38,891	$ 36,148	$ 37,740	$29,776	$ 16,141
	24.3%	24.1%	25.3%	8.8%	28.2%	18.1%	25.2%	57.8%
	$ 5.15	$ 5.02	$ 6.36	$ 6.46	$ 5.99	$ 5.80	$ 4.44	$ 2.43
	$ 0.424	$ 0.462	$ 0.476	$ 0.408	$ 0.531	$ 0.458	$ 0.381	$ 0.366
	232	240	277	293	280	306	326	358

Executive Overview

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

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

The primary drivers of our operational performance in the past three years have been improved worldwide demand for our products and our expanded product line.

The machine tool industry is highly cyclical and changes in demand can occur abruptly. There was a significant decline in global demand that continued through the fourth quarter of fiscal 2003. During the downturn, we took actions to discontinue the production and sale of underperforming products, refocused on our core product lines and significantly reduced our operating costs. We also began introducing new product models in late fiscal 2002 and have continued this process. Our new models, together with an increase in worldwide demand for machine tools, are largely responsible for the continuing increase in our sales.

Approximately 88% of worldwide demand for machine tools comes from outside the United States. During fiscal 2005 and 2006, approximately two-thirds of our revenues were attributable to customers located abroad. Our sales to foreign customers are denominated, and payments by those customers are made in the prevailing currencies—primarily the Euro and Pound Sterling—in the countries in which those customers are located, and our product costs are incurred and paid primarily in the New Taiwan Dollar and the U.S. Dollar. Changes in currency exchange rates may have a material effect on our operating results and consolidated balance sheets as reported under U.S. Generally Accepted Accounting Principles. For example, when a foreign currency increases in value relative to the U.S. Dollar, sales made (and expenses incurred) in that currency, when translated to U.S. Dollars for reporting in our financial statements, are higher than would be the case when that currency has a lower value relative to the U.S. Dollar. In our comparison of period-to-period results, we discuss not only the increases or decreases in those results as reported in our financial statements (which reflect translation to U.S. Dollars at prevailing exchange rates), but also the effect that changes in exchange rates had on those results. For additional information on the impact of translation of foreign currencies and our hedging practices, see Note 1 of Notes to Consolidated Financial Statements.

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

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

Results of Operations

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

	Percentage of Revenues			Year-to-Year % Change	
				Increase (Decrease)	
	2006	2005	2004	06 vs. 05	05 vs. 04
Sales and Service Fees	100.0%	100.0%	100.0%	18.3%	26.0%
Gross Profit	35.9%	33.9%	30.4%	25.3%	40.5%
Selling, General and Administrative Expenses	20.7%	20.7%	21.5%	17.8%	21.8%
Restructuring Expense and Other Expenses, Net	--	--	.05%	--	N/A
Operating Income	15.2%	13.1%	8.5%	37.1%	95.7%
Interest Expense	0.2%	0.3%	.05%	(27.0%)	(24.1%)
Net Income	10.4%	13.1%	6.3%	(5.9%)	162.3%

Fiscal 2006 Compared to Fiscal 2005

Sales and Service Fees – Sales and service fees for fiscal 2006 were the highest in our 37-year history, totaling $148.5 million, an increase of $23.0 million, or 18.3%, over fiscal 2005, of which $24.6 million was attributable to operational growth offset by approximately $1.6 million of unfavorable effects of currency translation. Computerized machine tool sales, which also were the highest in our history, totaled $128.9 million, an increase of 20.2% from the $107.3 million recorded in 2005, primarily driven by strong worldwide demand for our products. Approximately $4.0 million, or 17.6% of the increase in sales of computerized machine tools was the result of sales of our new lathe machine line, which we introduced in the first quarter of fiscal 2005.

Net Sales and Service Fees by Geographic Region

The following table sets forth net sales and service fees by geographic region for the years ended October 31, 2006 and 2005 (in thousands):

	October 31				Increase	
	2006		2005		Amount	%
Americas	$ 50,563	34.0%	$ 43,194	34.4%	$ 7,369	17.1%
Europe	87,735	59.1%	75,225	59.9%	12,510	16.6%
Asia Pacific	10,219	6.9%	7,090	5.7%	3,129	44.1%
Total	$148,517	100.0%	$125,509	100.0%	$23,008	100%

In the Americas, sales and service fees increased $7.4 million, or 17.1%, due to the growth of our VM product line combined with continued demand for our higher end VMX product line and incremental sales of the lathe product line. Lathe unit shipments increased 15.0% in fiscal 2006 compared to fiscal 2005. Unit shipments of vertical machining centers (which exclude lathes) increased approximately 28.1% in fiscal 2006 compared to 16.8% for similar products in the United States as reported by the Association for Manufacturing Technology.

In Europe, our sales and service fees increased by $12.5 million, or 16.6%, which includes an unfavorable impact due to changes in currency rates of $1.8 million or 2.4%. Unit sales increased 19.2% when comparing fiscal 2006 to 2005.

Sales and service fees in the Asia Pacific region were not significantly affected by changes in currency exchange rates, but did reflect improved activity in Asian markets. Shipments of our lathe product line increased 9.0% and shipments of vertical machining centers increased 48.7% in fiscal 2006 compared to fiscal 2005.

Net Sales and Service Fees by Product Category

The following table sets forth net sales and service fees by product category for years ended October 31, 2006 and 2005 (in thousands):

	October 31				Increase	
	2006		2005		Amount	%
Computerized Machine Tools	$128,946	86.8%	$ 107,313	85.5%	$ 21,633	20.2%
Service Fees, Parts and Other	19,571	13.2%	18,196	14.5%	1,375	7.6%
Total	$ 148,517	100.0%	$125,509	100.0%	$23,008	18.3%

Sales of computerized machine tools totaled $128.9 million in fiscal 2006, an increase of $21.6 million, or 20.2%, primarily driven by strong worldwide demand for our existing products. Approximately $4.0 million of the increase in sales of computerized machine tools was a result of sales of our new lathe machine line, which was introduced in the first quarter of fiscal 2005.

Orders and Backlog – New order bookings for fiscal 2006 totaled $154.8 million, an increase of $31.9 million, or 26.0%, as compared to $122.9 million recorded in fiscal 2005. Orders were strong in all geographic regions in fiscal 2006. Unit orders increased 33.4%, 29.4% and 66.7% in North America, Europe and Asia Pacific, respectively. Orders for fiscal 2006 compared to fiscal 2005 were unfavorably affected by approximately $1.7 million due to changes in currency exchange rates. Backlog was $16.1 million at October 31, 2006, compared to $10.0 million at October 31, 2005. We do not believe backlog is a useful measure of past performance or indicative of future performance. Backlog orders as of October 31, 2006 are expected to be fulfilled in Fiscal 2007.

Gross Margin – Gross margin for fiscal 2006 was 35.9%, an increase over the 33.9% margin realized in the corresponding 2005 period, due principally to the increased sales volume.

Operating Expenses – Selling, general and administrative expenses for fiscal 2006 of $30.7 million increased $4.6 million, or 17.6%, from those of fiscal 2005. The increase was primarily due to a $2.6 million increase in global sales and marketing expenditures and a $2.0 million increase in general and administrative expenses. The increased global sales and marketing expenditures include increased expenses for local and international trade shows, increased European agent sales commissions and marketing expenses for expansion of sales into emerging markets. The principal factor contributing to the increase in general and administrative expenses was consulting and audit fees for compliance with the internal control-reporting requirement of Section 404 of the Sarbanes Oxley Act of 2002, which became applicable to us in fiscal 2006.

Operating Income – Operating income for fiscal 2006 totaled $22.6 million, or 15.2% of sales, compared to $16.5 million or 13.1% of sales, in the prior year.

Other Income (Expense) – Other income (expense), net in fiscal 2006 relates primarily to currency exchange losses on inter-company receivables and payables denominated in foreign currencies, net of gains or losses on related forward contracts.

Provision for Income Taxes – Hurco was fully taxable in 2006 and incurred income tax expense of $7.6 million. In contrast we had no income tax expense in 2005 primarily due to the utilization of net operating loss carryforwards of approximately $9.8 million.

Net Income – Net income for fiscal 2006 was $15.5 million, or $2.42 per share, compared to $16.4 million, or $2.60 per share, in the prior year. The improvement in net income was primarily due to increased sales of our computerized machine tools and improved gross margins, partially offset by increased operating expenses and tax provision.

Fiscal 2005 Compared to Fiscal 2004

Sales and Service Fees – Sales and service fees for fiscal 2005 were $125.5 million, an increase of $25.9 million, or 26%, over fiscal 2004, of which $23.4 million was attributable to operational growth and approximately $2.5 million was due to the effects of translating foreign sales to U.S. Dollars. Computerized machine tool sales totaled $107.3 million, an increase of 28% from the $83.6 million recorded in 2004, primarily driven by strong worldwide demand for our existing products. Approximately $6 million, or 25%, of the increase in sales of computerized machine tools was the result of sales of our new lathe machine line, which was introduced in the first quarter of fiscal 2005.

Net Sales and Service Fees by Geographic Region

The following tables set forth net sales and service fees by geographic region for the years ended October 31, 2005 and 2004 (in thousands):

	October 31				Increase	
	2005		2004		Amount	%
Americas	$ 43,194	34.4%	$ 32,423	32.5%	$ 10,771	33%
Europe	75,225	59.9%	60,395	60.7%	14,830	25%
Asia Pacific	7,090	5.7%	6,754	6.8%	336	5%
Total	$125,509	100.0%	$ 99,572	100.0%	$ 25,937	26%

In the Americas, sales and service fees increased $10.7 million, or 33%, due primarily to the growth of our VMX signature product line and sales of the lathe product line. Shipments of VMX units increased 35% in fiscal 2005 compared to fiscal 2004 while shipments of our more moderately priced VM product line increased 6% during that same period. Unit shipments of vertical machining centers (which exclude lathes) increased approximately 15% in fiscal 2005 compared to 9% for similar products in the United States as reported by the Association for Manufacturing Technology.

In Europe, our sales and service fees increased by $14.8 million, or 25%, as a result of increased unit sales and the favorable effect of stronger European currencies. Approximately $2.3 million, or 16%, of the increase in our sales and service fees was attributable to changes in currency exchange rates. The increase in sales and service fees was consistent in all of our European markets.

Sales and service fees in the Asia Pacific region were not significantly affected by changes in currency exchange rates, but did reflect improved activity in Asian markets.

Net Sales and Service Fees by Product Category

The following table sets forth net sales and service fees by product category for years ended October 31, 2005 and 2004 (in thousands):

	October 31				Increase	
	2005		2004		Amount	%
Computerized Machine Tools	$107,313	85.5%	$ 83,663	84.0%	$ 23,650	28%
Service Fees, Parts and Other	18,196	14.5%	15,909	16.0%	2,287	14%
Total	$125,509	100.0%	$ 99,572	100.0%	$ 25,937	26%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Sales of computerized machine tools totaled $107.3 million in fiscal 2005, an increase of $23.7 million, or 28%, of which $ 2.5 million was attributable to the favorable effects of currency translation. Unit shipments of computerized machine tools increased 26%, fueled by a 19% increase in shipments of products in the VMX product line and the release of the lathe product line. The average net selling price per unit of computerized machine tool models increased 2% in fiscal 2005 compared to fiscal 2004, as a result of a greater number of units of higher priced VMX models in the total product mix. The average net selling price per unit, when measured in local currencies, was substantially unchanged.

Orders and Backlog – New order bookings for fiscal 2005 totaled $122.9 million, an increase of $19.4 million, or 19%, as compared to $103.5 million recorded in fiscal 2004. The increase in orders was attributable primarily to the VMX and lathe product lines. Unit orders for the VMX product line increased by 15% in fiscal 2005 compared to the prior year, while unit orders of the VM product increased 3% during that same period. Orders were strong in all geographic regions in fiscal 2005 and unit orders increased 18%, 15% and 13% in North America, Europe and Asia Pacific, respectively. Approximately $2.4 million, or 13%, of the increase was attributable to changes in currency exchange rates. Backlog was $10.0 million at October 31, 2005, compared to $12.8 million at October 31, 2004. We do not believe backlog is a useful measure of past performance or indicative of future performance.

Gross Margin – Gross margin for fiscal 2005 was 33.9%, an increase over the 30.4% margin realized in the corresponding 2004 period, due principally to the increased sales volume.

Operating Expenses – Selling, general and administrative expenses for fiscal 2005 of $26.1 million increased $4.7 million, or 21.8%, from those of fiscal 2004. The increase was primarily due to a $1.8 million increase in sales and marketing expenditures, a $1.6 million increase in general and administrative expenses, a $400,000 increase in product development spending, a $500,000 increase in European agents commissions and a $300,000 increase from the translation of foreign currencies to U.S. Dollars for financial reporting purposes.

Operating Income – Operating income for fiscal 2005 totaled $16.5 million, or 13.1% of sales, compared to $8.4 million or 8.5% of sales, in the prior year. Operating income in fiscal 2004 was net of a $465,000 severance charge.

Other Income (Expense) – Other income (expense), net in fiscal 2005 relates primarily to currency exchange losses on inter-company receivables and payables denominated in foreign currencies, net of gains or losses on related forward contracts.

Provision (Benefit) for Income Taxes – At the end of fiscal 2004, we had deferred tax assets of approximately $7.0 million that were primarily attributable to net operating losses and tax credits in the United States and certain foreign jurisdictions. Because of the highly cyclical nature of our industry, competitive pressures that could impact pricing, and the risks associated with new product introductions, we believed there was uncertainty as to the future realization of the benefits from these deferred tax assets and, therefore, we maintained a 100% valuation allowance against those assets.

During fiscal 2005, due to the substantial improvement in our operating results, especially in the fourth quarter of the year, we utilized approximately $3.7 million of the net operating loss carryforwards, all of which were subject to a valuation allowance. After examining a number of factors, including our operating results for fiscal 2005, and particularly the fourth quarter, which exceeded our internal projections, and our projections of near term future operating results, we determined that it was more likely than not that we would ultimately realize the benefits of all our remaining domestic deferred tax assets and a significant portion of our foreign deferred tax assets. Accordingly, we reduced our remaining valuation allowance to $221,000, all of which related to foreign net operating losses for which there remains uncertainty as to the future realization of the related tax benefits.

As a result of our utilization in fiscal 2005 of net operating losses against which we had previously maintained a 100% valuation allowance and the reduction of all but $221,000 of the valuation allowance on our remaining deferred tax assets at the end of fiscal 2005, we recorded a tax benefit of approximately $2.3 million, which is net of approximately $1.1 million recorded as additional paid-in-capital for the tax effects of the exercise by employees of stock options during both fiscal 2005 and 2004. The fiscal 2005 income tax provision, excluding the recorded tax benefit of $2.3 million, was $2.0 million compared to $1.3 million in fiscal 2004.

Net Income – Net income for fiscal 2005 was $16.4 million, or $2.60 per share, compared to $6.3 million, or $1.04 per share in the prior year. The improvement in net income was primarily due to a substantial increase in sales of our computerized machine tools, improved gross margin, and a favorable tax benefit partially offset by an increase in operating expenses.

Liquidity and Capital Resources

At October 31, 2006, we had cash and cash equivalents of $29.8 million compared to $17.6 million at October 31, 2005. Approximately 39% of the $29.8 million of cash and cash equivalents is denominated in US Dollars. The remaining balances are denominated in the local currencies of our various foreign entities and are subject to fluctuations in currency exchange rates.

Working capital, excluding cash and short-term debt, was $26.8 million at October 31, 2006 compared to $25.6 million at October 31, 2005. Inventories increased by $12.7 million as a result of increased volume and the introduction of new products. The inventory increase was offset by $9.3 million of accounts payable and accrued expenses of $3.4 million, related to increased income tax liability. We expect our operating working capital requirements to increase in fiscal 2007 as our sales and service fees increase. We expect to fund any such increase with cash flow from operations and borrowings under our bank credit facilities.

Capital expenditures were $3.3 million in fiscal 2006, $3.0 million in fiscal 2005, and $2.1 million in fiscal 2004. Capital expenditures were primarily for an integrated computer system, software development projects and purchases of equipment. We funded these expenditures with cash flow from operations.

Total debt at October 31, 2006 was $4.0 million representing 5.0% of total capitalization, which aggregated $79.4 million, compared to $4.1 million, or 6.6% of total capitalization, at October 31, 2005 had no borrowings outstanding under our domestic and European bank credit facilities. See Note 4 of Notes to Consolidated Financial Statements for further discussions on debt.

Contractual Obligations and Commitments

The following is a table of contractual obligations and commitments as of October 31, 2006 (all amounts in thousands):

Payments Due by Period	Total	Less than 1 Year	1-3 Years	3-5 Years Years	More than 5 Years
Long-Term Debt	$4,010	$ 136	$3,874	$ --	$ --
Operating Leases	3,918	1,425	1,744	749	--
Deferred Credits and Other	525	--	--	--	525
Total	$8,453	$1,561	$5,618	$749	$525

In addition to the contractual obligations and commitments disclosed above, we also have a variety of other obligations for the procurement of materials and services, none of which subject us to any material non-cancellable commitments. While some of these obligations arise under long-term supply agreements, we are not committed under these agreements to accept or pay for requirements that are not needed to meet our production needs. We have no material minimum purchase commitments or "take-or-pay" type agreements or arrangements.

We expect capital spending in fiscal 2007 to be approximately $7.0 million, which includes investments for our Ningbo manufacturing operation, capitalized software and discretionary items.

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. At October 31, 2006, we had outstanding 58 such guarantees totaling approximately $1.8 million. Upon shipment, the customer has the risk of ownership. The customer does not obtain title until the machine is paid in full. We believe that the proceeds obtained from liquidation of the machine would cover any payments required by the guarantee.

Critical Accounting Policies

Our accounting policies, including those described below, require management to make significant estimates and assumptions using information available at the time the estimates are made. Such estimates and assumptions significantly affect various reported amounts of assets, liabilities, revenues and expenses. If our future experience differs materially from these estimates and assumptions, our results of operations and financial condition could be affected.

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

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

Service fees from maintenance contracts are deferred and recognized in earnings on a pro rata basis over the term of the contract. Sales related to software products are recognized when shipped in conformity with American Institute of Certified Public Accountants' Statement of Position 97-2 Software Revenue Recognition. The software does not require production, modification or customization and at the time of shipment persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed and determinable, and collectibility is reasonably assured.

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

Deferred Tax Asset Valuation – As of October 31, 2006, we have deferred tax assets of $3.9 million. These deferred tax assets relate primarily to net operating loss carryforwards in certain foreign jurisdictions and other future taxable and tax deductible items resulting in temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. The benefit of the foreign net operating loss carryforwards does not have an expiration date and no limitation on utilization of specific amounts each year. Realization of those benefits is entirely dependent upon generating future taxable earnings in the specific tax jurisdictions. We regularly evaluate the realization of these benefits to determine if it is more likely than not that we will realize all of our net deferred tax assets.

Capitalized Software Development Costs – Costs incurred to develop new computer software products and significant enhancements to software features of existing products are capitalized as required by Statement of Financial Accounting Standards (SFAS) No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed", and amortized over the estimated product life of the related software. The determination as to when in the product development cycle technological feasibility has been established, and the expected product life, require judgments and estimates by management and can be affected by technological developments, innovations by competitors and changes in market conditions affecting demand. We capitalized $2.1 million in fiscal 2006, $1.2 million in fiscal 2005, and $1.3 million in fiscal 2004 related to software development projects. At October 31, 2006, we have an asset of $5.6 million for capitalized software development projects, a significant portion of which relates to projects currently in progress and subject to development risk and market acceptance. We periodically review the carrying values of these assets and make judgments as to ultimate realization considering the above-mentioned risk factors.

Derivative Financial Instruments – Critical aspects of our accounting policy for derivative financial instruments include conditions requiring that the critical terms of a derivative instrument be essentially the same as those of the forecasted transaction being hedged. Another important element of our policy demands that formal documentation be maintained as required by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Failure to comply with these conditions would result in a requirement to recognize changes in market value of derivative instruments in earnings. We routinely monitor significant estimates, assumptions, and judgments associated with derivative instruments, and compliance with formal documentation requirements.

Stock Based Compensation – Prior to fiscal 2006, we applied the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for stock-based compensation. As a result, no compensation expense was recognized for stock options granted with exercise prices equivalent to the fair market value of the stock on the date of grant. Effective November 1, 2005, we adopted SFAS No. 123(R), "Share Based Payment," using the modified prospective method. As of November 1, 2005 we began applying the provisions of SFAS No. 123(R) to option grants (of which there have been none), as well as to the nonvested portion of outstanding options granted before that date. Compensation expense was determined at the date of grant using the Black-Scholes valuation model. We expect to record additional compensation expense of approximately $5,000 ratably through the first quarter of fiscal 2007 for the remaining options that vest during the period November 1, 2006 through January 31, 2007.

Estimates – The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires us to make estimates and assumptions that affect the reported amounts presented and disclosed in our consolidated financial statements. Significant estimates and assumptions in these consolidated financial statements require the exercise of judgment and are used for, but not limited to, allowance for doubtful accounts, estimates of future cash flows, and other assumptions associated with intangible and long-lived asset impairment tests, useful lives for depreciation and amortization, warranty programs, income taxes and deferred tax valuation allowances, lease classification, and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Interest Rate Risk

We had no borrowings outstanding under our bank credit facilities at October 31, 2006 and have not borrowed from our bank credit facilities since February 2005. Our only debt at October 31, 2006 is a first mortgage loan with a fixed interest rate of 7.375%. As a result, a one percentage point (1%) increase in our variable borrowing interest rate would have had no impact on our fiscal 2006 results. Note 4 of Notes to Consolidated Financial Statements set forth the interest rates related to our current credit facilities.

Foreign Currency Exchange Risk

In fiscal 2006, approximately two-thirds of our revenues, including export sales, were derived from foreign markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

Our products are sourced from foreign suppliers or built to our specifications by our wholly owned subsidiary in Taiwan, or other overseas contract manufacturers. These 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 our exchange rate risk associated with product purchases relates to the New Taiwan Dollar.

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

Forward contracts for the sale or purchase of foreign currencies as of October 31, 2006 which are designated as cash flow hedges under SFAS No. 133 were as follows:

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Dates
			Contract Date	October 31, 2006	
Sale Contracts:					
Euro	28,800,000	$1.2863	$37,045,440	$ 37,055,162	Nov 2006-Oct 2007
Sterling	4,800,000	$1.8798	$ 9,023,040	$ 9,160,656	Nov 2006-Oct 2007
Purchase Contracts:					
New Taiwan Dollar	900,000,000	32.43*	$ 27,750,627	$27,420,566	Nov 2006-July 2007

*NT Dollars per U.S. Dollar

We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables demonimated in foreign currencies. These derivative instruments are not designated as hedges under SFAS 133, "Accounting Standards for Derivative Instruments and Hedging Activities." The forward contracts for the sale or purchase of those currencies related to receivables and payables as of October 31, 2006 are as follows:

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars		Maturity Dates
			Contract Date	October 31, 2006	
Sale Contracts:					
Euro	12,706,793	$ 1.2718	$16,160,499	$16,261,443	Nov 2006-Dec 2006
Singapore Dollar	10,480,235	$ 1.5710	$ 6,671,060	$ 6,755,003	Nov 2006-Mar 2007
Sterling	1,066,880	$1.8838	$ 2,009,789	$ 2,035,906	Nov 2006-Dec 2006
Purchase Contracts:					
New Taiwan Dollar	463,700,000	32.91*	$14,089,172	$14,016,816	Nov 2006-Jan 2007

*NT Dollars per U.S. Dollar

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Shareholders and
Board of Directors of Hurco Companies, Inc.:

Management of Hurco Companies, Inc., (the "Company") has assessed the effectiveness of internal controls over financial reporting as of October 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting.

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

In management's opinion, the Company's internal controls over financial reporting as of October 31, 2006, are effective based on the criteria specified above.

Our assessment of the effectiveness of the Company's internal control over financial reporting as of October 31, 2006 has been audited by Crowe Chizek and Company LLC, as stated in their report which appears herein.

/s/ Michael Doar

Michael Doar, Chairman of the Board & Chief Executive Officer

/s/ John G. Oblazney

John G. Oblazney, Vice President & Chief Financial Officer

/s/ Sonja K. McClelland

Sonja K. McClelland, Corporate Controller, Assistant Secretary

(Principal Accounting Officer)

Indianapolis, Indiana

January 12, 2007

Report of Independent Registered Public Accounting Firm

To the Shareholders and
Board of Directors of Hurco Companies, Inc.

We have audited the accompanying consolidated balance sheet of Hurco Companies, Inc. and Subsidiaries as of October 31, 2006 and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year ended October 31, 2006. In connection with our audit of the consolidated financial statements, we also have audited the financial statement schedule as it relates to the fiscal year 2006 information which is listed in the index under Item 15. We have also audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Hurco Companies, Inc. maintained effective internal control over financial reporting as of October 31, 2006, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Hurco Companies, Inc. management is responsible for these financial statements and the financial statement schedule, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements and the financial statement schedule, an opinion on management's assessment, and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

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

In our opinion, the 2006 consolidated financial statements referred to above present fairly in all material respects, the financial position of Hurco Companies, Inc. and Subsidiaries as of October 31, 2006, and the results of their operations and their cash flows for the year ended October 31, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule as it relates to the fiscal year 2006 information, when considered in relation to the basic 2006 consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein. Also, in our opinion, management's assessment that Hurco Companies, Inc. and Subsidiaries maintained effective internal control over financial reporting as of October 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Furthermore, in our opinion, Hurco Companies, Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of October 31, 2006, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/Crowe Chizek and Company LLC

Indianapolis, Indiana

January 12, 2007

Report of Independent Registered Public Accounting Firm

To the Shareholders and
Board of Directors of Hurco Companies, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Hurco Companies, Inc. and its subsidiaries at October 31, 2005, and the results of their operations and their cash flows for each of the two years in the period ended October 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index appearing under Item 15(a) (2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/PricewaterhouseCoopers LLP

Indianapolis, Indiana

January 18, 2006

HURCO COMPANIES, INC.
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended October 31		
	2006	2005	2004
	(Dollars in thousands, except per share amounts)		
Sales and service fees	$148,517	$125,509	$99,572
Cost of sales and service	95,192	82,951	69,274
Gross profit	53,325	42,558	30,298
Selling, general and administrative expenses	30,697	26,057	21,401
Restructuring expense and other expense, net (Note 15)	--	--	465
Operating income	22,628	16,501	8,432
Interest expense	259	355	468
Variable options expense	--	--	322
Earnings from equity investments	865	418	387
Other income (expense), net	(120)	(482)	(461)
Income before income taxes	23,114	16,082	7,568
Provision (benefit) for income taxes (Note 6)	7,635	(361)	1,299
Net income	$ 15,479	$ 16,443	$ 6,269
Earnings per common share – basic	$ 2.45	$ 2.66	$ 1.08
Weighted average common shares outstanding – basic	6,317	6,171	5,784
Earnings per common share – diluted	$ 2.42	$ 2.60	$ 1.04
Weighted average common shares outstanding – diluted	6,397	6,336	6,026

The accompanying notes are an integral part of the Consolidated Financial Statements.

HURCO COMPANIES, INC.
CONSOLIDATED BALANCE SHEETS

ASSETS	As of October 31	
	2006	2005
	(Dollars in thousands, except per share amounts)	
Current assets:		
Cash and cash equivalents	$ 29,846	$ 17,559
Accounts receivable, less allowance for doubtful accounts of $635 in 2006 and $842 in 2005	22,248	20,100
Inventories	43,343	29,530
Deferred tax assets	2,768	3,043
Other	2,677	3,586
Total current assets	100,882	73,818
Property and equipment:		
Land	761	761
Building	7,234	7,205
Machinery and equipment	12,952	13,170
Leasehold improvements	1,147	1,102
	22,094	22,238
Less accumulated depreciation and amortization	(12,944)	(13,187)
	9,150	9,051
Deferred tax assets – long-term	1,121	1,346
Software development costs, less accumulated amortization	5,580	3,752
Investments and other assets	7,381	6,147
	$124,114	$94,114
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 24,482	$ 17,051
Accounts payable-related parties	2,123	2,087
Accrued expenses and other	15,673	9,879
Accrued warranty expenses	1,926	1,618
Current portion of long-term debt	136	126
Total current liabilities	44,340	30,761
Non-current liabilities:		
Long-term debt	3,874	4,010
Deferred credits and other	525	399
	4,399	4,409
Commitments and contingencies (Notes 10 and 11)		
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, 6,346,520 and 6,220,220 shares issued and outstanding in 2006 and 2005, respectively	635	622
Additional paid-in capital	50,011	48,701
Retained earnings	28,480	13,001
Accumulated other comprehensive income (loss)	(3,751)	(3,380)
Total shareholders' equity	75,375	58,944
	$124,114	$94,114

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

HURCO COMPANIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended October 31		
	2006	**2005**	**2004**
		(Dollars in thousands)	
Cash flows from operating activities:			
Net income	$ 15,479	$16,443	$6,269
Adjustments to reconcile net income to			
Net cash provided by (used for) operating activities:			
Provision for doubtful accounts	(207)	119	286
Equity in income of affiliates	(865)	(418)	(387)
Depreciation and amortization	1,504	1,331	1,223
Restructuring and other charges	--	--	465
Tax benefit from exercise of stock options (prior to Adoption of SFAS 123(R)	--	1,146	--
Change in assets/liabilities			
(Increase) decrease in accounts receivable	(1,312)	(3,606)	(3,992)
(Increase) decrease in inventories	(12,726)	(660)	(4,947)
Increase (decrease) in accounts payable	9,318	(1,191)	8,623
Increase (decrease) in accrued expenses	3,423	2,653	(197)
(Increase) decrease in deferred tax asset	491	(4,389)	--
Other	(1,059)	549	(537)
Net cash provided by operating activities	14,046	11,977	6,806
Cash flows from investing activities:			
Proceeds from sale of property and equipment	16	--	26
Purchase of property and equipment	(1,212)	(1,879)	(762)
Software development costs	(2,089)	(1,161)	(1,290)
Change in restricted cash	--	277	345
Other proceeds (investments)	(335)	224	(53)
Net cash used for investing activities	(3,620)	(2,539)	(1,734)
Cash flows from financing activities:			
Advances on bank credit facilities	--	4,977	20,468
Repayments on bank credit facilities	--	(5,124)	(24,520)
Repayments of term debt	--	(200)	(538)
Repayment of first mortgage	(126)	(117)	(108)
Tax benefit from exercise of stock options (prior to Adoption of SFAS 123(R)	744	--	--
Proceeds from exercise of common stock options	562	797	2,128
Net cash provided by (used for) financing activities	1,180	333	(2,570)
Effect of exchange rate changes on cash	681	(461)	458
Net increase in cash	12,287	9,310	2,960
Cash and cash equivalents at beginning of year	17,559	8,249	5,289
Cash and cash equivalents at end of year	$29,846	$ 17,559	$8,249
Supplemental disclosures:			
Cash paid for:			
Interest	$ 314	$ 331	$ 439
Income taxes	$ 3,920	$ 1,509	$ 286

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

HURCO COMPANIES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in thousands except Shares Issued and Outstanding)	Common Stock Shares Issued & Outstanding	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balances, October 31, 2003	5,575,987	$557	$44,695	$(9,711)	$(6,800)	$28,741
Net income	--	--	--	6,269	--	6,269
Translation of foreign currency financial statements	--	--	--	--	1,227	1,227
Unrealized gain of derivative instruments	--	--	--	--	90	90
Comprehensive income						7,586
Exercise of common stock options	443,607	45	2,083	--	--	2,128
Balances, October 31, 2004	6,019,594	602	46,778	(3,442)	(5,483)	38,455
Net income	--	--	--	16,443	--	16,443
Translation of foreign currency financial statements	--	--	--	--	(838)	(838)
Unrealized gain of derivative instruments	--	--	--	--	2,941	2,941
Comprehensive income						18,546
Exercise of common stock options	200,626	20	777	--	--	797
Tax benefit from exercise of stock options	--	--	1,146	--	--	1,146
Balances, October 31, 2005	6,220,220	622	48,701	13,001	(3,380)	58,944
Net income	--	--	--	15,479	--	15,479
Translation of foreign currency financial statements	--	--	--	--	1,288	1,288
Unrealized loss of derivative instruments	--	--	--	--	(1,659)	(1,659)
Comprehensive income						15,108
Exercise of common stock options	126,300	13	549	--	--	562
Tax benefit from exercise of stock options	--	--	744	--	--	744
Stock-based compensation expense	--	--	17	--	--	17
Balances, October 31, 2006	6,346,520	$635	$ 50,011	$28,480	$ (3,751)	$75,375

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation – The consolidated financial statements include the accounts of Hurco Companies, Inc. (an Indiana corporation) and its wholly owned and controlled subsidiaries. We have a 35% and 24% ownership interest in two affiliates accounted for using the equity method. Our combined investments in affiliates are approximately $3.3 million and are included in Investments and Other Assets on the accompanying Consolidated Balance Sheets. Intercompany accounts and transactions have been eliminated.

Statements of Cash Flows – We consider all highly liquid investments purchased with maturity of three months or less to be cash equivalents. Cash flows from hedges are classified consistent with the items being hedged.

Translation of Foreign Currencies – All balance sheet accounts of non-U.S. subsidiaries are translated at the exchange rate as of the end of the year and recorded as a component of Accumulated Other Comprehensive Income (Loss). Income and expenses are translated at the average exchange rates during the year. Cumulative foreign currency translation adjustments as of October 31, 2006, were a net loss of $3.3 million and are included in Accumulated Other Comprehensive Income (Loss) in shareholders' equity. These foreign currency translation adjustments are recorded net of tax as they relate to permanent investments in international subsidiaries. Foreign currency transaction gains and losses are recorded as income or expense as incurred.

Hedging – We enter into foreign currency forward exchange contracts periodically to hedge certain forecasted inter-company sales and forecasted inter-company and third party purchases of product denominated in foreign currencies (primarily 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 the sales and purchases denominated in foreign currencies will be adversely affected by changes in exchange rates. These forward contracts have been designated as cash flow hedge instruments, and are recorded in the Consolidated Balance Sheets at fair value in Other Current Assets and Accrued Expenses. Gains and losses resulting from changes in the fair value of these hedge contracts are deferred in Accumulated Other Comprehensive Income (Loss) and recognized as an adjustment to cost of sales in the period that the sale of the related hedged item 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 item being hedged.

At October 31, 2006, we had approximately $448,000 of losses related to cash flow hedges deferred in Accumulated Other Comprehensive Income (Loss) net of tax. Of this amount, $289,000 represents unrealized losses related to future cash flow hedge instruments that remain subject to currency fluctuation risk. These deferred losses will be recorded as an adjustment to Cost of Sales in the periods through October 31, 2007, in which the sale of the related hedged item is recognized, as described above. At October 31, 2005, we had $1.2 million of gains related to cash flow hedges deferred in Accumulated Other Comprehensive Income (Loss). Net gains on cash flow hedge contracts, which we reclassified from Accumulated Other Comprehensive Income (Loss) to Cost of Sales, were $698,000 for the period ended October 31, 2006, compared to net losses reclassified in the periods ending October 31, 2005 and 2004, of $747,000 and $2.8 million, respectively.

HURCO COMPANIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

We also enter into foreign currency forward exchange contracts to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies. These derivative instruments are not designated as hedges under SFAS 133, "Accounting Standards for Derivative Instruments and Hedging Activities" (SFAS 133) and, as a result, changes in fair value are reported currently as Other Expense, Net in the Consolidated Statements of Income consistent with the transaction gain or loss on the related foreign denominated receivable or payable. Such net transaction losses were $423,000, $476,000, and $246,000 for the years ended October 31, 2006, 2005 and 2004, respectively.

Inventories – Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out method.

Property and Equipment – Property and equipment are carried at cost. Any impairment would be recognized based on an assessment of future operations (including cash flows) to ensure that assets are appropriately valued. Depreciation and amortization of assets are provided primarily under the straight-line method over the shorter of the estimated useful lives or the lease terms as follows:

	Number of Years
Building	40
Machines	7-10
Shop and office equipment	3-7
Leasehold improvements	3-40

Total depreciation expense for the years ended October 31, 2006, 2005 and 2004 was $1.1 million, $1.0 million, and $932,000, respectively.

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

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

Service fees from maintenance contracts are deferred and recognized in earnings on a pro rata basis over the term of the contract. Sales related to software products are recognized when shipped in conformity with American Institute of Certified Public Accountants' Statement of Position 97-2.

Software Revenue Recognition – The software does not require production, modification or customization. At the time of shipment, persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed and determinable and collectibility is reasonably assured.

Product Warranty – Expected future product warranty expense is recorded when the product is sold. See Note 11 of Notes to Consolidated Financial Statements on further discussion of warranties.

Research and Development Costs – The costs associated with research and development programs for new products and significant product improvements are expensed as incurred and are included in Selling, General and Administrative Expenses. Research and development expenses totaled $2.5 million, $2.4 million, and $2.0 million, in fiscal 2006, 2005, and 2004, respectively.

Costs incurred to develop computer software products and significant enhancements to software features of existing products to be sold or otherwise marketed are capitalized, after technological feasibility is established. Software development costs are amortized to Cost of Sales on a straight-line basis over the estimated product life of the related software, which ranges from three to five years. We capitalized costs of $2,089,000 in 2006, $1,161,000 in 2005, and $1,290,000 in 2004 related to software development projects. Amortization expense was $363,000, $329,000, and $291,000, for the years ended October 31, 2006, 2005, and 2004, respectively. Accumulated amortization at October 31, 2006 and 2005 was $3.0 million and $2.6 million, respectively. Any impairment of the carrying value of the capitalized software development costs would be recognized based on an assessment of future operations (including cash flows) to ensure that assets are appropriately valued.

Estimated amortization expense for the existing amortizable intangible assets for the years ending October 31, is as follows:

Fiscal Year	Amortization Expense
2007	$ 888
2008	1,112
2009	1,112
2010	1,003
2011	1,003

Earnings Per Share – Basic and diluted earnings per common share are based on the weighted average number of our shares of common stock outstanding. Diluted earnings per common share give effect to outstanding stock options using the treasury method. The impact of stock options on weighted average shares for the years ended October 31, 2006, 2005 and 2004 was 80,000, 165,000, and 242,000 respectively.

Income Taxes – We record income taxes under SFAS 109 "Accounting for Income Taxes." SFAS 109 utilizes the liability method for computing deferred income taxes.

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In the ordinary course of global business, there may be many transactions and calculations where the ultimate tax outcome is uncertain. The calculation of tax liabilities involves dealing with uncertainties in the application of complex tax laws. The company recognizes potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on an estimate of the ultimate resolution of whether, and the extent to which, additional taxes will be due. Although the company believes the estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different than what is reflected in the historical income tax provisions and accruals. Such differences could have a material impact on the income tax provision and operating results in the period in which such determination is made.

As part of its financial process, the company must assess the likelihood that its deferred tax assets can be recovered. If recovery is not likely, the provision for taxes must be increased by recording a reserve in the form of a valuation allowance for the deferred tax assets that are estimated not to be ultimately recoverable. In the process, certain relevant criteria are evaluated including the existence of deferred tax liabilities that can be used to absorb deferred tax assets, the taxable income in prior carryback years that can be used to absorb net operating losses and credit carrybacks, and taxable income in future years. The company's judgment regarding future profitability may change due to future market conditions, changes in U.S. or international tax laws and other factors. These changes, if any, may require material adjustments to these deferred tax assets and an accompanying reduction or increase in net income in the period when such determinations are made.

In addition to the risks to the effective tax rate described above, the effective tax rate reflected in forward-looking statements is based on current enacted tax law. Significant changes during the year in enacted tax law could materially affect these estimates.

Estimates – The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles requires us to make estimates and assumptions that affect the reported amounts presented and disclosed in our consolidated financial statements. Significant estimates and assumptions in these consolidated financial statements require the exercise of judgment and are used for, but not limited to, allowance for doubtful accounts, estimates of future cash flows and other assumptions associated with intangible and long-lived asset impairment tests, useful lives for depreciation and amortization, warranty programs, income taxes and deferred tax valuation allowances, lease classification, and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

Stock Based Compensation – Prior to fiscal 2006, we applied the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for stock-based compensation. As a result, no compensation expense was recognized for stock options granted with exercise prices equivalent to the fair market value of the stock on the date of grant. Effective November 1, 2005, we adopted SFAS No. 123(R), "Share Based Payment," using the modified prospective method. As of November 1, 2005, we began applying the provisions of SFAS No. 123(R) to option grants (of which there have been none), as well as to the nonvested portion of outstanding options granted before that date. Compensation expense is determined at the date of grant using the Black-Scholes valuation model. We expect to record additional compensation expense of approximately $5,000 ratably through the first quarter of fiscal 2007 for the remaining options that vest during the period November 1, 2006 through January 31, 2007.

The adoption of this pronouncement had no effect on compensation cost recorded in fiscal 2005 and 2004 related to stock options, which will continue to be disclosed on a pro forma basis only.

(in thousands, except per share data)	**2005**	**2004**
Net income, as reported	$16,443	$6,269
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(23)	(95)
Pro forma net income	16,420	6,174
Earnings (loss) per share:		
Basic as reported	$ 2.66	$ 1.08
Basic pro forma	$ 2.66	$ 1.07
Diluted as reported	$ 2.60	$ 1.04
Diluted pro forma	$ 2.59	$ 1.02

As of October 31, 2006, there were no outstanding non-qualified options that had been granted outside of the 1990 and 1997 plans to current members of the Board of Directors.

2. BUSINESS OPERATIONS

Nature of Business – We design and manufacture computer control systems, software and computerized machine tools for sale through our own distribution system to the worldwide machine tool industry.

The end market for our products consists primarily of precision tool, die and mold manufacturers, independent job shops, and specialized short-run production applications within large manufacturing operations. Industries served include: aerospace, defense, medical equipment, energy, automotive/transportation, electronics and computer industries. Our products are sold through independent agents and distributors in countries throughout North America, Europe and Asia. We also maintain direct sales operations in England, France, Germany, Italy, Singapore and China.

Credit Risk – We sell products to customers located throughout the world. We perform ongoing credit evaluations of customers and generally do not require collateral. Allowances are maintained for potential credit losses. Concentration of credit risk with respect to trade accounts receivable is limited due to the large number of customers and their dispersion across many geographic areas. Although a significant amount of trade receivables are with distributors primarily located in the United States, no single distributor or region represents a significant concentration of credit risk.

Manufacturing Risk – Our computerized machine tools and integrated computer controls are produced primarily in Taiwan by our wholly owned subsidiary and our affiliated contract manufacturers. We also source one of the proprietary UltiMax® and Max® computer components from a single domestic supplier. Any interruption from these sources would restrict the availability of our computerized machine tool systems and would adversely affect operating results.

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3. INVENTORIES

Inventories as of October 31, 2006 and 2005 are summarized below (in thousands):	2006	2005
Purchased parts and sub assemblies	$ 7,645	$ 6,561
Work-in-process	7,608	5,403
Finished goods	28,090	17,566
	$43,343	$29,530

4. DEBT AGREEMENTS

Long-term debt as of October 31, 2006 and 2005, consisted of (in thousands):	2006	2005
Domestic bank revolving credit facility	$ --	$ --
European bank credit facility	--	--
First Mortgage	4,010	4,136
	4,010	4,136
Less current portion	136	126
	$ 3,874	$ 4,010

As of October 31, 2006, long-term debt was payable as follows (in thousands):	
Fiscal 2007	$ 136
Fiscal 2008	145
Fiscal 2009	3,729
Fiscal 2010	--
Thereafter	--
	$ 4,010

As of October 31, 2006 and 2005, we had $262,000 and $829,000, respectively, of outstanding letters of credit issued to non-U.S. suppliers for inventory purchase commitments. As of October 31, 2006, we had unutilized credit facilities of $11.6 million available for either direct borrowings or commercial letters of credit.

Domestic Bank Credit Facility – We had no borrowings outstanding under our domestic bank credit facility at October 31, 2006 and 2005. Interest on the domestic bank credit facility was at rates ranging from 6.0% to 7.5% at October 31, 2006 and from 4.0% to 6.25% at October 31, 2005.

Effective October 26, 2004, we amended our $8.0 million domestic bank credit agreement to extend the maturity date to January 31, 2008, and convert it to an unsecured facility except for a continuation of the pledge of stock of two subsidiaries. Borrowings may be made in U.S. Dollars, Euros or Pounds Sterling. Interest on all outstanding borrowings is payable at LIBOR for the respective currency plus an applicable margin, or, at our option, the bank's prime rate plus a specified margin based on the ratio of our Total Funded Debt to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) ratio, as follows:

Ratio of Total Funded Debt/EBITDA ratio	LIBOR Margin	Prime Margin
Greater than 3.0	2.75%	0%
Greater than 2.5 and less than or equal to 3.0	2.0%	(.25%)
Greater than 2.0 and less than or equal to 2.5	1.5%	(.50%)
Less than or equal to 2.0	1.0%	(.75%)

The ratio of our Total Funded Debt to EBITDA at October 31, 2006 was .16. The applicable margin is adjusted on the first day of the month following the month after each quarter end. The availability under the facility is not limited by a borrowing base, unless the ratio exceeds 3.0.

The agreement requires that Maximum Consolidated Total Indebtedness to Consolidated Total Capitalization, as defined in the agreement, not exceed 0.275 to 1.0 and our fixed charge coverage ratio not be less than 1.25 to 1.0. The agreement also requires that we have positive net income for the four previous quarters.

First Mortgage – On April 30, 2002, we obtained a $4.5 million first mortgage loan on our Indianapolis corporate headquarters. The loan bears interest at a rate of 7.375% and matures in April 2009. We are required to make principal payments over the seven-year term of the loan, based on a twenty-year amortization schedule. The proceeds from the first mortgage loan, together with other available cash, were used to repay bank debt.

European Bank Credit Facility – The terms and conditions of the October 2004 domestic bank credit facility amendment also apply to the revolving credit and overdraft facility for our U.K. subsidiary.

On January 11, 2006, we renewed this credit facility with a European bank for €1.5 million. The termination date is unspecified. Interest on the facility is payable at a floating rate, 6.63% at October 31, 2006. Although the facility is uncollateralized, the bank reserves the right to require collateral in the event of increased risk evaluation. Borrowings outstanding under this facility at October 31, 2006 and 2005 were $0.

Economic Development Revenue Bonds – The remaining installment of the Economic Development Revenue Bonds was paid on September 1, 2005.

Total debt at October 31, 2006 was $4.0 million, representing 5.0% of total capitalization, which aggregated $79.4 million, compared to $4.1 million, or 6.6% of total capitalization, at October 31, 2005. We were in compliance with all loan covenants and had unused credit availability of $11.6 million at October 31, 2006. We believe that cash flow from operations and borrowings available to us under our credit facilities will be sufficient to meet our anticipated cash requirements in fiscal 2007.

5. FINANCIAL INSTRUMENTS

The carrying amounts for trade receivables and payables approximate their fair values. The fair value of long-term debt, including the current portion, is estimated based on quoted market prices for similar issues or on current rates offered to us for debt with the similar terms and maturities.

We also have financial instruments in the form of foreign currency forward exchange contracts as described in Note 1 of Notes to Consolidated Financial Statements. The U.S. Dollar equivalent notional amount of these contracts was $112.7 million at October 31, 2006. The net fair value of these derivative instruments recorded in Accrued Expenses at October 31, 2006 was $289,000. Current market prices were used to estimate the fair value of the foreign currency forward exchange contracts.

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

HURCO COMPANIES, INC.
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6. INCOME TAXES

Deferred tax assets and liabilities are determined based on the difference between the U.S. Generally Accepted Accounting Principals financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Significant components of our deferred tax assets and liabilities at October 31, 2006 and 2005 were as follows (in thousands):

	October 31	
	2006	**2005**
Tax effects of future tax deductible items related to:		
Current:		
Inter-company profit in inventory	$3,307	$1,672
Accrued inventory reserves	968	834
Accrued warranty expenses	136	164
Deferred compensation	185	151
Other accrued expenses	736	498
Total current deferred tax assets	5,332	3,319
Non-current:		
Goodwill	54	61
Total deferred tax assets	5,386	3,380
Tax effects of future taxable differences related to:		
Accelerated tax deduction and other tax over book deductions related to property, equipment and software	(2,552)	(1,699)
Total deferred tax liabilities	(2,552)	(1,699)
Net tax effects of temporary differences	2,834	1,682
Tax effects of carryforward benefits:		
U.S. federal and state net operating loss carryforwards, expiring 2007-2027	34	312
Foreign net operating loss carryforwards, with no expiration	1,033	1,544
U.S. federal and state general business tax credits, expiring 2006-2026	100	882
U.S. Alternative minimum tax credit with no expiration	--	190
Tax effects of carryforwards	1,167	2,928
Tax effects of temporary differences and carryforwards, net	4,001	4,610
Less valuation allowance	112	221
Net deferred tax asset	$3,889	$4,389

Except as indicated above, our carryforwards and tax credits expire at specific future dates and utilization of certain carryforwards and tax credits are limited to specific amounts each year. Realization is entirely dependent upon generating sufficient future earnings in specific tax jurisdictions prior to the expiration of the loss carryforwards and tax credits. Net operating losses utilized were approximately $3.2 million in 2006 and approximately $9.8 million in 2005.

We operate in a highly cyclical industry and incurred significant operating losses in fiscal 2001 and 2002 for which a valuation allowance was maintained. During the fourth quarter of fiscal 2005, after examining a number of factors, including historical results and near term earning projections, this valuation allowance was reduced to $221,000. The valuation allowance on our remaining deferred tax assets at the end of fiscal 2006 is $112,000.

In the fiscal year ended October 31, income (loss) before income taxes and the provision (benefit) for income taxes consisted of the following:

Income (loss) before income taxes (in thousands):	Year Ended October 31		
	2006	**2005**	**2004**
Domestic	$13,688	$ 9,834	$3,424
Foreign	9,426	6,248	4,144
	$ 23,114	$16,082	$7,568
The provision for income taxes consists of:			
Current:			
Federal	$ 4,306	$ 3,457	$ --
State	1,053	279	11
Foreign	2,767	2,259	1,240
	8,126	5,995	1,251
Deferred:			
Federal	(787)	(4,685)	48
State	--	(553)	--
Foreign	296	(1,118)	--
	(491)	(6,356)	48
	$ 7,635	$ (361)	$1,299
Differences between the effective tax rate and U.S. federal income tax rate were (in thousands):			
Tax at U.S. statutory rate	$ 7,858	$ 5,468	$2,649
Effect of tax rates of international jurisdictions in excess (less than) of U.S. statutory rates	(37)	81	8
State income taxes	883	279	11
Deferred tax asset valuation adjustment	109	(2,342)	--
Utilization of net operating loss carryforwards	--	(3,740)	(1,369)
Permanent items	(632)	(155)	--
Others	(546)	48	--
Provision (benefit) for income taxes	$ 7,635	$ (361)	$1,299

We have not provided any U.S. income taxes on the undistributed earnings of our foreign subsidiaries or equity method investments based upon our determination that such earnings will be indefinitely reinvested. Estimated undistributed earnings of foreign investments and subsidiaries at October 31, 2006 are approximately $18.7 million. In the event these earnings are later distributed to the U.S., such distributions could result in additional U.S. tax that may be offset, at least in part by associated foreign tax credits.

7. EMPLOYEE BENEFITS

We have defined contribution plans that include a majority of our employees, under which our contributions are discretionary. The purpose of these plans is generally to provide additional financial security during retirement by providing employees with an incentive to save throughout their employment. Our contributions to the plans are based on employee contributions or compensation. Our contributions totaled $382,300, $243,800, and $253,900, for the years ended October 31, 2006, 2005 and 2004, respectively.

We also have life insurance agreements with our executive officers. In fiscal 2005, we purchased the insurance policies from the executive officers. The insurance premiums we paid will be repaid from the cash surrender value of the policies when the policies are terminated or exercised.

8. STOCK OPTIONS

In March 1997, we adopted the 1997 Stock Option and Incentive Plan (the 1997 Plan), which allows us to grant awards of options to purchase shares of our common stock, stock appreciation rights, restricted shares and performance shares. In March 2005 an amendment to the plan increased the number of shares available for grant by 250,000 shares. Under the provision of the amended 1997 Plan, 1,000,000 shares of common stock may be issued and the maximum number of shares of common stock that may be granted to any individual is 200,000 shares. Options granted under the 1997 Plan are exercisable for a period up to ten years after date of grant and vest in equal annual installments as specified by the Compensation Committee of our Board of Directors at the time of grant. The exercise price of options intended to qualify as incentive stock options may not be less than 100% of the fair market value of a share of common stock on the date of grant. As of October 31, 2006, options to purchase 87,700 shares had been granted and remained unexercised under the 1997 Plan.

In 1990, we adopted the 1990 Stock Option Plan (the 1990 Plan), which allowed us to grant options to purchase shares of our common stock and related stock appreciation rights and limited rights to officers and our key employees. Under the provisions of the 1990 Plan, the maximum number of shares of common stock, which could be issued under options and related rights, was 500,000. There was no annual limit on the number of such shares with respect to which options and rights could be granted. Options granted under the 1990 Plan are exercisable for a period up to ten years after the date of grant and vested in equal installments over a period of three to five years from the date of grant. The option price could not be less than 100% of the fair market value of a share of common stock on the date of grant and no options or rights could be granted under the 1990 Plan after April 30, 2001. As of October 31, 2006, options to purchase 1,000 shares had been granted and remained unexercised under the 1990 Plan.

A summary of the status of the options under the 1990 and 1997 Plans as of October 31, 2006, 2005 and 2004 and the related activity for the year is as follows:

	Shares Under Option	Weighted Average Exercise Price Per Share
Balance October 31, 2003	788,600	$3.69
Granted	--	--
Cancelled	--	--
Expired	(2,000)	2.13
Exercised	(383,607)	3.67
Balance October 31, 2004	403,053	$3.71
Granted	--	--
Cancelled	--	--
Expired	(2,000)	2.15
Exercised	(185,653)	3.82
Balance October 31, 2005	215,400	$3.63
Granted	--	--
Cancelled	--	--
Expired	(400)	2.15
Exercised	(126,300)	4.45
Balance October 31, 2006	88,700	$2.46

The total intrinsic value of stock options exercised during the twelve months ended October 31, 2006 and 2005 was approximately $2.7 million and $2.6 million, respectively.

As of October 31, 2006, the total intrinsic value of outstanding stock options already vested and expected to vest was $2.1 million. The intrinsic value of options that are outstanding and exercisable as of October 31, 2006 was $1.9 million. Stock options outstanding and exercisable on October 31, 2006 are as follows:

Range of Exercise Prices Per Share	Shares Under Option	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life in Years
Outstanding			
$2.125 – 5.125	88,300	$2.44	4.8
5.813 – 8.250	400	5.81	2.1
$2.125 – 8.250	88,700	$2.46	4.8
Exercisable			
$2.125 – 5.125	86,740	$2.45	--
5.813 – 8.250	400	5.81	--
$2.125 – 8.250	87,140	$2.46	--

During fiscal 2006, options to purchase 126,300 shares were exercised resulting in cash proceeds of approximately $562,500. The tax benefit from the exercise of stock options is approximately $744,000.

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Prior to fiscal 2006, we applied the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for stock-based compensation. As a result, no compensation expense was recognized for stock options granted with exercise prices equivalent to the fair market value of the stock on the date of grant. Effective November 1, 2005, we adopted SFAS No. 123(R), "Share Based Payment," using the modified prospective method. As of November 1, 2005 we began applying the provisions of SFAS No. 123(R) to option grants (of which there have been none), as well as to the nonvested portion of outstanding options granted before that date. Compensation expense is determined at the date of grant using the Black-Scholes valuation model. We expect to record additional compensation expense of approximately $5,000 ratably through the first quarter of fiscal 2007 for the remaining options that vest during the period November 1, 2006 through January 31, 2007.

As a result of adopting SFAS No. 123(R), our income before taxes and net income for the year ended October 31, 2006 were reduced by approximately $20,000 and $12,000, respectively, as compared to the amounts that would have been reported if we continued to account for share-based compensation under APB Opinion No. 25. There was no effect on basic and diluted earnings per share as a result of the adoption of SFAS No. 123(R).

Prior to our adoption of SFAS No. 123(R), we presented all tax benefits of deduction resulting from the exercise of stock options as operating cash flows in the Condensed Consolidated Statement of Cash Flows. SFAS 123(R) requires cash flows resulting from tax deductions in excess of recognized compensation cost from the exercise of stock options (excess tax benefits) to be classified as financing cash flows.

On November 11, 2001, our former CEO was granted 110,000 options at $2.11 and all of his previous option grants were cancelled. These options were subject to variable plan accounting, which resulted in a charge to expense in fiscal 2004 of $322,000. As of October 31, 2006, all options subject to variable plan accounting have been exercised.

9. RELATED PARTY TRANSACTIONS

We own approximately 24% of one of our Taiwanese-based contract manufacturers. This investment of $1.3 million is accounted for using the equity method and is included in Investments and Other Assets on the Consolidated Balance Sheets. Purchases of product from this contract manufacturer totaled $2.0 million, $2.7 million and $4.4 million for the years ended October 31, 2006, 2005 and 2004, respectively. Sales of product to this contract manufacturer were $70,000, $117,000 and $199,000 in fiscal 2006, 2005 and 2004 respectively. Trade payables to this contract manufacturer were $256,000 at October 31, 2006, and $509,000 at October 31, 2005. Trade receivables were $32,000 at October 31, 2006, and $136,000 at October 31, 2005.

As of October 31, 2006, we owned 35% of Hurco Automation, Ltd. (HAL), a Taiwan based company. HAL's scope of activities includes the design, manufacture, sales and distribution of industrial automation products, software systems and related components, including control systems and components produced under contract for sale exclusively to us. We are accounting for this investment using the equity method. The investment of $2.0 million at October 31, 2006 is included in Investments and Other Assets on the Consolidated Balance Sheets. Purchases of product from this supplier amounted to $10.5 million, $7.7 million and $6.6 million in 2006, 2005 and 2004, respectively. Sales of product to this supplier were $2.0 million, $1.8 million and $1.9 million for the years ended October 31, 2006, 2005 and 2004, respectively. Trade payables to HAL were $1.9 million and $1.6 million at October 31, 2006 and 2005, respectively. Trade receivables from HAL were $235,000 and $242,000 at October 31, 2006 and 2005, respectively.

Summary financial information for the two affiliates accounted for using the equity method of accounting is as follows:

(in thousands)	2006	2005	2004
Net Sales	$58,286	$50,896	$23,469
Gross Profit	10,932	8,947	7,780
Operating Income	4,209	2,676	2,210
Net Income	3,727	2,313	1,479
Current Assets	$27,903	$21,553	$16,194
Non-current Assets	7,684	1,824	2,031
Current Liabilities	20,156	14,857	17,215

10. CONTINGENCIES AND LITIGATION

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

11. GUARANTEES

During fiscal 2003, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34." FIN 45 clarifies the requirements of FASB Statement No. 5, Accounting for Contingencies, relating to the guarantor's accounting for, and disclosures of, the issuance of certain types of guarantees.

From time to time, our subsidiaries guarantee third party payment obligations in connection with the sale of certain machines to customers that use financing. At October 31, 2006, we had 58 outstanding third party guarantees totaling approximately $1.8 million. The terms of our subsidiaries guarantees are consistent with the underlying customer financing terms. Upon shipment, the customer has the risk of ownership. The customer does not obtain title until the machine is paid in full. A retention of title clause allows us to obtain the machine if the customer defaults on the lease. We believe that the proceeds obtained from liquidation of the machine would cover any payments required by the guarantee.

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

	10/31/06	10/31/05
Balance, beginning of period	$ 1,618	$ 1,750
Provision for warranties during the period	2,139	1,709
Charges to the accrual	(1,893)	(1,778)
Impact of foreign currency translation	62	(63)
Balance, end of period	$ 1,926	$ 1,618

12. OPERATING LEASES

We lease facilities, certain equipment and vehicles under operating leases that expire at various dates through 2014. Future payments required under operating leases as of October 31, 2006, are summarized as follows (in thousands):

2007	$ 1,425
2008	1,016
2009	728
2010	530
Thereafter	219
Total	$ 3,918

Lease expense for the years ended October 31, 2006, 2005, and 2004 was $1.9 million, $1.8 million, and $1.5 million, respectively.

We recorded $180,000 of lease income from subletting 50,000 square feet of our Indianapolis facility. The sublease expires on April 30, 2010.

13. QUARTERLY HIGHLIGHTS (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006 (In thousands, except per share data)				
Sales and service fees	$31,894	$36,861	$36,597	$43,164
Gross profit	10,927	13,179	12,835	16,384
Gross profit margin	34.3%	35.8%	35.1%	38.0%
Selling, general and administrative expenses	6,296	7,140	7,392	9,869
Operating income	4,631	6,039	5,443	6,515
Provision (benefit) for income taxes	1,618	2,250	1,646	2,120
Net income	3,033	3,929	3,802	4,714
Income per common share – basic	$ 0.49	$ 0.62	$ 0.60	$ 0.75
Income per common share – diluted	$ 0.48	$ 0.62	$ 0.59	$ 0.74

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005 (In thousands, except per share data)				
Sales and service fees	$30,246	$30,990	$29,555	$34,718
Gross profit	9,740	10,767	9,863	12,188
Gross profit margin	32.2%	34.7%	33.3%	35.1%
Selling, general and administrative expenses	6,187	6,363	6,637	6,870
Operating income	3,553	4,404	3,226	5,318
Provision (benefit) for income taxes	369	781	317	(1,828)(1)
Net Income	3,030	3,299	2,879	7,235
Income per common share – basic	$ 0.50	$ 0.53	$ 0.46	$ 1.16
Income per common share – diluted	$ 0.48	$ 0.52	$ 0.45	$ 1.13

(1)The fourth quarter included a $2.3 million adjustment to the tax provision to reverse our deferred tax asset valuation allowance. See Note 6 of Notes to Consolidated Financial Statements.

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14. SEGMENT INFORMATION

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

We sell our products through more than 150 independent agents and distributors in countries throughout North America, Europe and Asia. The Hurco line is the primary line for the majority of our distributors globally even though some may carry competitive products. We also have our own direct sales personnel in England, France, Germany, Italy, Singapore and China, which are among the world's principal machine tool consuming countries. During fiscal 2006, no distributor accounted for more than 5% of our sales and service fees. Approximately 88% of the worldwide demand for computerized machine tools and computer control systems comes from outside the U.S. In fiscal 2006, approximately two-thirds of our revenues were from overseas customers and no single end-user of our products accounted for more than 5% of our total sales and service fees.

The following table sets forth the contribution of each of our product groups to our total sales and service fees during each of the past three fiscal years (in thousands):

Net Sales and Service Fees by Product Category	**Year ended October 31**		
	2006	**2005**	**2004**
Computerized Machine Tools	$128,946	$ 107,313	$83,663
Computer Control Systems and Software *	4,694	4,129	3,604
Service Parts	10,494	9,991	8,696
Service Fees	4,383	4,076	3,609
Total	$148,517	$125,509	$99,572

*Amounts shown do not include CNC systems sold as an integrated component of computerized machine systems.

The following table sets forth revenues by geographic area, based on customer location, for each of the past three fiscal years were (in thousands):

Revenues by Geographic Area	**Year Ended October 31**		
	2006	**2005**	**2004**
United States	$ 50,563	$ 40,666	$30,654
Germany	54,570	36,039	31,206
United Kingdom	17,781	11,917	8,818
Other Europe	15,383	26,061	20,361
Total Europe	87,734	74,017	60,385
Asia and Other	10,220	10,826	8,533
Total Foreign	97,954	84,843	68,918
	$148,517	$125,509	$99,572

Long-lived tangible assets by geographic area were (in thousands):	**As of October 31**		
	2006	**2005**	**2004**
United States	$ 8,308	$ 8,034	$ 7,458
Foreign countries	2,934	3,117	1,489
	$ 11,242	$ 11,151	$ 8,947

15. RESTRUCTURING EXPENSE AND OTHER EXPENSE, NET

On November 23, 2004, we entered into a separation and release agreement with Roger J. Wolf, who retired from his position as Senior Vice President and as Chief Financial Officer. Under the agreement, Mr. Wolf received severance compensation totaling $465,000. As of October 31, 2006, all severance related to this agreement had been paid.

16. NEW ACCOUNTING PRONOUNCEMENTS

In the first quarter of fiscal 2004 we adopted the Financial Accounting Standards Board Interpretation No. 46 (FIN 46) Consolidation of Variable Interest Entities. This Interpretation requires existing unconsolidated variable interest entities to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties. The adoption of this standard did not have an effect on the consolidated financial statements.

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

In the first quarter of fiscal 2006, we adopted the Financial Accounting Standards Board Statement No. 123R, "Share Based Payment," which requires companies to expense the value of director and employee stock options and similar awards for interim and annual periods beginning after June 15, 2005. As of November 1, 2005 we began applying the provisions of SFAS No. 123(R) to option grants, as well as to the nonvested portion of outstanding options granted before that date. The impact of adopting this statement is reflected in Note 8 of Notes to Consolidated Financial Statements.

On November 24, 2004, the FASB issued Statement No. 151, "Inventory Costs", which amends the guidance on ARB No. 43, "Inventory Pricing" to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). The Statement requires accounting for these costs be recognized as period costs and expensed in the current period regardless of whether or not they meet the criterion defined under ARB No. 43 as "abnormal." In addition, this Statement requires that allocation of fixed production overheads to the cost of inventory be based upon normal production capacities. The provisions in Statement 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We adopted the provisions of this Statement during fiscal 2006 and the adoption did not have a material effect on the consolidated financial statements.

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

HURCO COMPANIES, INC. LEADERSHIP

Board of Directors

Stephen H. Cooper, Attorney, Independent Business Consultant (2)
Robert W. Cruickshank, Independent Business Consultant (1,2,3)
Michael Doar, Chairman and Chief Executive Officer, Hurco Companies, Inc.
Michael P. Mazza, Independent Business Consultant(2)
Richard T. Niner, General Partner, Wind River Associates (1)
O. Curtis Noel, Independent Business Consultant (3)
Charlie Rentschler, Vice President of Wall Street Access(1)
Gerald V. Roch, Independent Business Consultant

1 Nominating and Governance Committee
2 Audit Committee
3 Compensation Committee

Corporate Officers and Division Executives

Michael Doar
Chairman and Chief Executive Officer

James D. Fabris
President and Chief Operating Officer

John G. Oblazney
Vice President, Secretary, Treasurer and Chief Financial Officer

David E. Platts
Vice President, Technology

Sonja K. McClelland
Corporate Controller, Assistant Secretary

James D. Kawaguchi
General Manager, Hurco U.S.A.

Gerhard Kohlbacher
President, Hurco Germany

David Waghorn
General Manager, Hurco United Kingdom

Phillippe Chevalier
General Manager, Hurco France

Paolo Casazza
General Manager, Hurco Italy

William Chan
General Manager, Hurco Southeast Asia

Charlie Tsai
General Manager, Hurco Manufacturing Limited (Taiwan)

CORPORATE INFORMATION

Annual Meeting

All shareholders are invited to attend our annual meeting, which will be held on March 14, 2007 at 10 a.m. Eastern Standard Time at Hurco's Corporate Offices, One Technology Way, Indianapolis, Indiana.

Transfer Agent

Computershare, P.O. Box 43078, Providence, RI 02940-3078

Legal Counsel

Corporate Law: Baker & Daniels LLP
Patent Law: Baker & Daniels LLP

Independent Auditors

Crowe Chizek and Company LLC, 3815 River Crossing Parkway, Suite 300, P.O. Box 40977, Indianapolis, IN 46240-0977

Investor Relations

John G. Oblazney, Vice President, Secretary, Treasurer and Chief Financial Officer, One Technology Way, Indianapolis, Indiana 46268, Telephone (317) 293-5309

Stock Market Information

Hurco Common Stock is traded on the Nasdaq National Market under the ticker symbol HURC. Stock price quotations are printed daily in major newspapers.
The following table sets forth the high and low sales prices of the shares of Common Stock for the periods indicated, as reported by the Nasdaq National Market.

	2006		2005	
Fiscal Quarter Ended	**High**	**Low**	**High**	**Low**
January 31	$35.30	$ 17.74	$ 19.40	$ 12.65
April 30	$ 37.47	$23.75	$ 19.38	$ 10.50
July 31	$ 32.98	$20.42	$20.00	$ 10.25
October 31	$29.26	$19.80	$ 19.09	$13.81

The Company does not currently pay dividends on its Common Stock and intends to continue to retain earnings for working capital, capital expenditures and debt reduction.

There were approximately 202 holders of record of Hurco Common Stock as of January 12, 2007.

Disclosure Concerning Forward-Looking Statements

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

The Executive Leadership extends special appreciation to Gerald Roch, co-founder of Hurco and a vital member of the Hurco Board of Directors during the past five years. Mr. Roch will retire from the board this year, but his entrepreneurial spirit, industry expertise, and foresight will continue to positively influence us as we continue to make Hurco a leader in technology and innovation.

Hurco Companies, Inc.

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