HURCO®

Annual Report 2005

Indianapolis, Indiana USA

Parts that took three hours to machine on a sub-contractor's EDM are now made in-house in just 30 minutes using our Hurco VM1.

Rayco Machine
Indianapolis, Indiana USA

Schopfloch, Germany

Die Homag AG besteht darauf ihre Auszubildenden an Hurco Maschinen auszubilden, um somit in der Zukunft eine noch bessere Konsistenz und Effizienz in der Fertigung zu erzielen.

AG Homag
Schopfloch, Germany

Dongguan, China

GD Tech 利用 **Hurco** 的独特对话编程控制系统,增加生产效率和减少了对员工的训练时间.

GD Tech
Dongguan, China

Contents

Hurco designs and manufactures sophisticated, yet shop-floor friendly CNC machine tools used in the worldwide metal cutting industries. Our products are used in machine shops of all sizes – from small "job shops" to medium-sized precision tool and die shops and even in the tool rooms of large manufacturing facilities. Hurco machine tools are used in a wide variety of industries including automotive, aerospace, defense, medical device manufacturing and more. Based in Indianapolis, Indiana, the company was founded in 1968 by Edward Humston and Gerald Roch. After becoming a publicly held corporation in 1971, Hurco expanded overseas with the founding of Hurco Europe Ltd. in the U.K. Hurco's patented "conversational programming" was introduced to the manufacturing shop floor in 1976. Today Hurco is a global organization with offices and distributors throughout North America, Europe and Asia. Nearly two-thirds of our sales are derived overseas.

At the heart of every one of our machine tools is the unique interactive graphical Hurco control, which gives Hurco a competitive advantage in the industry. Known for its ease of use and versatility, the Hurco control can be programmed in the way that works best for each shop or each individual job. Parts can be programmed on the shop floor using our easy-to-learn conversational language or with G-Code, a programming language widely used in machine shops. Programming can also be generated offline with popular CAM software or with our PC-based Winmax® software. DXF files from CAD systems can also be used to program parts on the Hurco control. The control also allows shops to automate processes for greater productivity and efficiency. No other machine tool control offers this much flexibility and power while still being easy to learn and use.

2005 Financial Highlights

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

		2005	2004	% Change
Sales and service fees		$ 125,509	$ 99,572	26.0%
Operating income		$ 16,501	$ 8,432	95.7%
Net income		$ 16,443	$ 6,269	162.3%
Earning per common share (diluted)		$ 2.60	$ 1.04	150.0%
Order intake		$ 122,862	$ 103,500	18.7%
Backlog		$ 10,031	$ 12,746	(21.3%)
Working capital		$ 43,057	$ 26,347	63.4%
Total debt		$ 4,136	$ 4,600	(10.1%)
Shareholders' equity		$ 58,944	$ 38,455	53.3%
Number of employees		284	250	13.6%
Stock price	October 31	$ 17.83	$ 14.33	24.4%
	High	$ 20.00	$ 17.37	15.1%
	Low	$ 10.25	$ 2.52	306.7%

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 MB1, our first machining center

1979 Hurco Europe, Ltd. (United Kingdom) founded

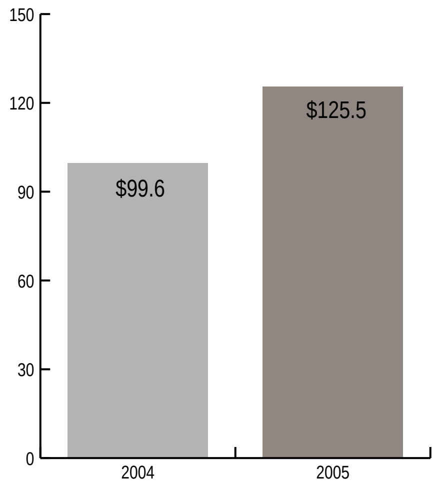
1980 Overseas sales account for 33% of Hurco business

1981 Hurco forms joint venture to market products in former West Germany

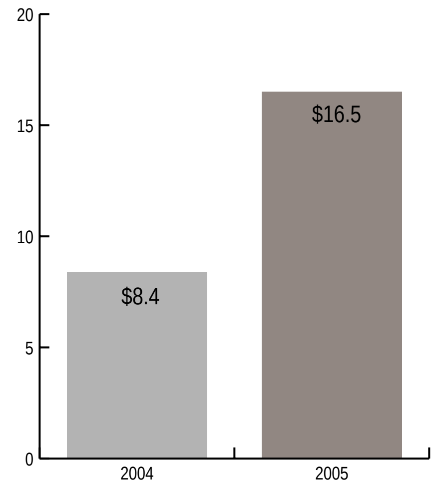
1984 Ultimax control introduced

1986 Introduction of BMC30, BMC40, BMC50 VMCs

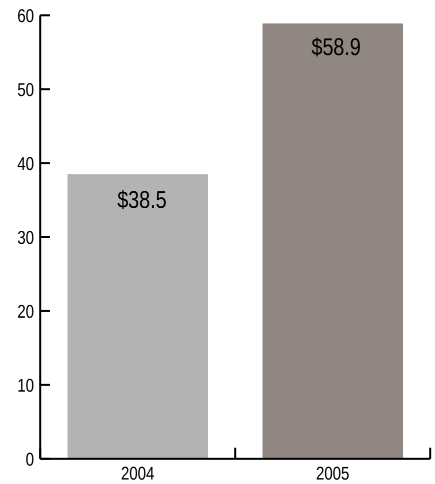
1987 Ultimax 2 control introduced



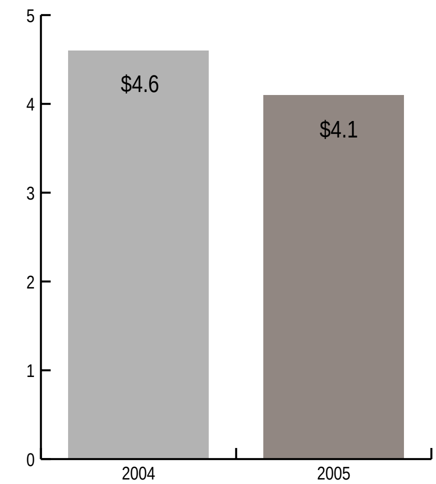
Revenue
(Millions)



Operating Profit
(Millions)



Shareholders' Equity
(Millions)



Debt
(Millions)

1988
Hurco GmbH (Germany) founded

1991
Hurco S.a.r.l. (France) founded
Hurco Pte. Ltd. (Southeast Asia) founded
Corporate Headquarters in Indianapolis
Ultimax 3 control launched

1996

Max single-screen control introduced

1997
Overseas sales account for 51% of Hurco business
VMX line introduced

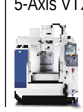
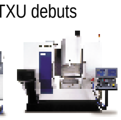

1998

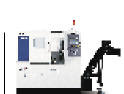
Ultimax 4 control introduced

1999
Hurco S.r.l. (Italy) and Hurco Manufacturing Limited (Taiwan) established

2000

WinMax Desktop launched

2003
VM line introduced
5-Axis VTXU debuts



2004

TM Turning Centers introduced

2005
Sales and income records set

Report to Shareholders

James D. Fabris *Michael Doar*

The year 2005 was the best year in Hurco's history. Hurco posted record sales and record net income in 2005. These milestones also translated into record returns for our shareholders.

While these results speak volumes on their own, they are particularly gratifying in light of the precipitous decline in the machine tool market starting in 2001. At that time we placed our focus on three key areas: Customers, core competencies and profitability. This focus, along with a lot of hard work has paid off.

Customers

Our customer base continues to grow and change as the world becomes more interconnected and competitive. Machine tool consumption in the United States makes up approximately 10% of the entire worldwide market. As of 2005, nearly two-thirds of our machines were sold outside of the United States. China, the world's largest consumer of machine tools, continues to play an important role in our company. In November of 2005, Hurco opened the Shenzhen Technical

Office in Nanshan Shenzhen, China to a highly receptive audience of potential new customers. A Shenzhen showroom will open soon.

In the established markets, first-time Hurco customers account for approximately 40% of sales. As we continue to globally expand our delivery channels in the emerging markets, we expect this number to increase significantly. Worldwide, our customers have recognized that Hurco's easy-to-use machine tools can provide them with a competitive advantage.

Core Competencies

Making machine tools easier to use and more efficient has been a core part of the Hurco story from the very beginning. Software and control system development have played a key role in Hurco's new product introduction. Late in the year 2004 we introduced the TM Series of slant-bed turning centers and have been steadily gaining market share throughout 2005. New products, those that have been introduced in the last three years, represent approximately 50% of our sales. While some OEMs might be tempted to rest, Hurco is investing more resources to expanding the product line and strengthening the process automation software and controls options. We anticipate a record number of new product introductions in 2006, which will include new machine systems, accessories and flexible, powerful software offerings —all focused on making our customers more productive and efficient.

Profitability

In addition to being a leader and innovator in the machine tool industry, Hurco strives to be profitable for our shareholders. We accomplish this by adding value to our customers' operations. Hurco machine tool users are able to produce parts more efficiently to be competitive and profitable in their respective industries. The Hurco business model has also resulted in a highly efficient use of working capital. During 2005 we were able to grow sales by $25 million while generating $12 million of cash from operations. This was accomplished while only increasing inventory and accounts receivable by $3.4 million. As a result, sales per employee increased nearly 11% in 2005 to $442,000. Moreover, we've recently implemented new production cost reduction programs that will make our machines even more competitive in the future. Not only does this successful execution pay off in terms of immediate financial results, it also allows us to reinvest in research, technology and products for the future of the company. All of these efforts and a favorable economy have resulted in a 53% increase in shareholder equity.

Going Forward

The highly competitive worldwide machine tool market is cyclical in nature; however, we have learned to structure our business in such a way as to maximize our success at both the high and low ends of the spectrum. It is our belief that the market will remain strong for several years. With the success of our current offerings and the introduction of new products, accessories and services, Hurco will continue to profitably increase sales and gain market share.

We wish to thank the shareholders for the investments they have made in Hurco during these times. Your confidence and support are greatly appreciated. We also want to thank our employees for their hard work and dedication in achieving our goals. Most of all we would like to thank our customers for the opportunities to supply them with innovative machine tools.

James D. Fabris
President and Chief Operating Officer

Michael Doar
Chairman and Chief Executive Officer

COMPANY	RAYCO MACHINE
LOCATION	INDIANAPOLIS, INDIANA USA
PRIMARY BUSINESS	AUTOMOTIVE RACING PARTS
MACHINE TOOLS	VM1 AND TM8

Hurco has had a tremendous impact on our motor sports business. Parts that took three hours to machine on a sub-contractor's EDM are now made in-house in just 30 minutes using our Hurco VM1.

Located in the racing capital of the world, Rayco produces many parts for the racing industry, particularly with several open-wheel racing teams and organizations associated with the IRL's IndyCar® Series and the ChampCar® World Series, both based in Indianapolis. Rayco's parts must withstand the most torturous conditions and forces in the industry.

The new TM8 CNC slant-bed turning center sits next to the VM1 creating a complete machining cell. Although Hurco is known for its easy-to-use conversational, shop floor programming, most of the programming for the TM8 and VM1 at Rayco are done offline via MasterCam® and then run as G-Code. Many parts are completed using a combination of the Hurco vertical machining centers and the new Hurco lathe.

Greg Cox, Vice President of Rayco, is a perfect example of a customer who has been sold on the reliability of the Hurco machine and the value of one of the industry's most flexible controls. The performance of the new TM8 has opened up new business opportunities and he hopes to expand his operation with more Hurco turning centers.

2005 was a great year for Hurco. We sold more machines than in any previous year...but it is only the beginning.

The year 2005 brought great expansion to Hurco's customer base through an expanded product line and the continued implementation of our business model.

Lathes Spin New Opportunities

Our new turning centers (lathes) have generated new sales with existing Hurco users and new customers. The rollout of the TM Series of CNC slant-bed turning centers marked the first time in our 37-year history that we have offered turning centers. Vertical machining centers make up no more than 20-25% of the machine tool market worldwide while turning centers make up another 40% of the total market. With the successful launch of the TM Series, Hurco's machine tool products now target at least 60% of the world's addressable machine tool market. The TM Series is innovative and unique in that it combines productive machine specifications and solid iron with Hurco's powerful and flexible MAX control. Not surprisingly, the industry was ripe for a turning center with this type of control. Not only has it been welcomed by customers already familiar with Hurco, it has also been embraced by first-time Hurco customers, opening doors for future sales.

Rayco Machine utilizes their VM1 vertical machining center and TM8 CNC turning center to create parts for the racing industry. The flexible and fast Hurco control allows Rayco to create and machine parts quickly and efficiently—a must for race teams.

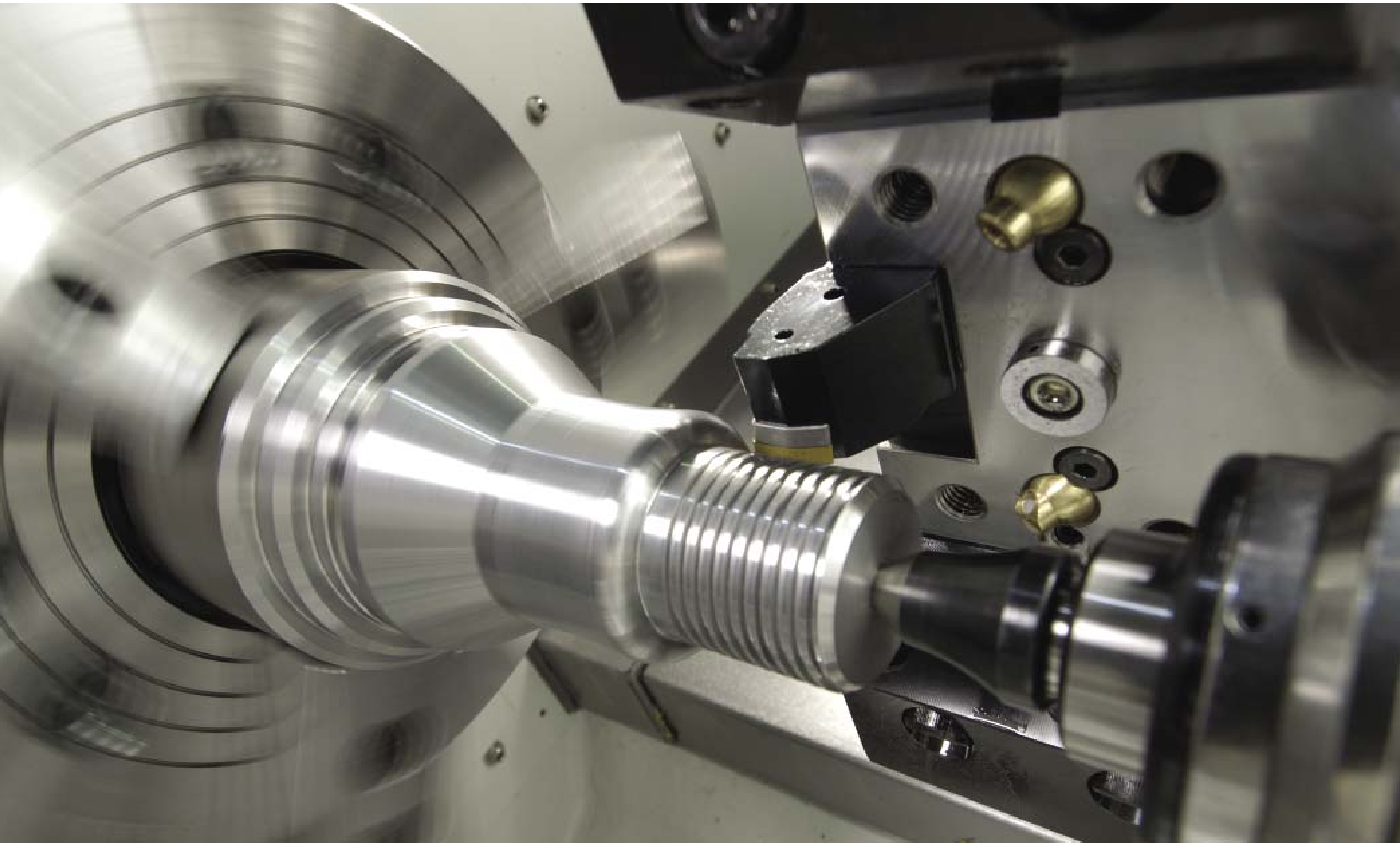
High Performance Machines Expand Customer Base

The year also featured the impact of the VTXU 5-axis vertical machining center and the HTX500 horizontal machining center. These high performance machines are now being used to create such products as high-end laser beam mirrors, complex tool and die sets and mass-produced woodworking tools. The VTXU is ideal for 5-axis positioning work on complex, multi-sided parts where reductions in setup time and overall part accuracy are crucial. The easy-to-master 5-sided conversational programming requires only one part setup and the machine is compatible with most 5-axis CAM programs. The HTX500 is Hurco's first horizontal machining system and offers the speed, precision and reduced cycle systems typically found in machines costing twice as much.

Implemented Business Model

In addition to expanding our sales and product lines, Hurco continues to implement and expand its strategically planned business model worldwide. Our global supply chain, manufacturing and distribution capabilities allow us to engineer, build and ship our products to customers with a short lead-time and at a lower cost. Our focused supply chain model allows us to navigate through the cyclical nature of the machine tool industry, maintaining our ability to bring new products to the market while many of our competitors' technologies remain stagnant. We have the ability to track global customer installations and monitor product performance, which enables us to continually implement timely and effective improvement programs, increasing our product reliability and customer satisfaction. Because of our successful and effective supply chain, we can consistently provide the same high quality machine and control systems at all locations that are compatible with localized market demand. The machine tool market has changed significantly over the past 10 years. Currently, 90% of worldwide machine tool consumption is outside of the United States. Hurco's selling organizations are strategically positioned to provide full service to customers within their specific markets. Every selling group has a resident General Manager and staff who are positioned to work closely with Hurco customers to understand their application requirements. We're strategically planning to grow in each of these emerging markets while also adding new markets. In November, Hurco successfully

Chicago-based Bryco Machine completed these parts using a Hurco milling and turning cell consisting of a BMC30 and TM6. These small to medium lot jobs are profitable even for a production-oriented shop like Bryco with the speed and flexibility of the Hurco control.



COMPANY	AG HOMAG
LOCATION	SCHOPFLOCH, GERMANY
PRIMARY BUSINESS	SPECIALIZED MACHINING SYSTEMS
MACHINE TOOLS	MULTIPLE MACHINING CENTERS

AG Homag insists on instructing their apprentices on their Hurco machines to provide consistency and even greater efficiency in the future.

As a manufacturer of specialized machining systems used in furniture production and construction part manufacturing, AG Homag understands the importance of a reliable, precision machine with a powerful, versatile control. Many of the parts created in their manufacturing facility require very small production lots—one to ten pieces. The company had been using the same CNC control for every machine in an effort to create consistency and flexibility throughout their worldwide organization. However, a Hurco demonstration revealed how much time could be saved with the Hurco machine. Their best programmer needed thirty minutes to program a part on their existing machine, while the Hurco operator programmed the same part in just seven minutes using the Ultimax® control. After visiting several existing Hurco customers they made the switch. The easy-to-use Hurco control allows AG Homag's machinists to program on the shop floor. In addition, they import DXF files from their existing CAD systems directly to the Hurco control that creates the program. AG Homag appreciates the precision and reliability of their Hurco machine tools. Now with over twenty Hurco vertical machining centers in their operation, AG Homag insists on instructing their apprentices on the Hurco machines to provide consistency and even greater efficiency in the future.

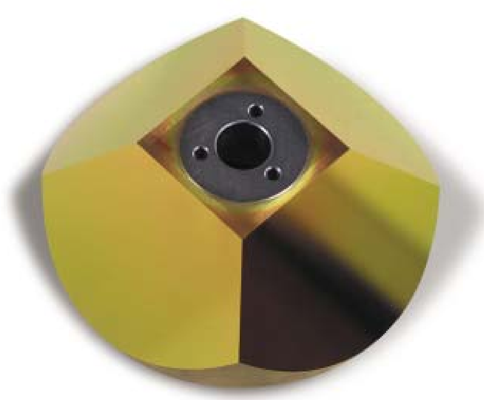
opened a Technical Center in Shenzhen, China–a growing manufacturing and technology center of China with nearly 15 million residents. In 2005 we launched a new Web site design that allows potential customers and current customers to fully investigate the virtues of Hurco machine tools.

Hurco Meets the Demands of Manufacturers Worldwide

Machine shops throughout the world are facing many of the same challenges when it comes to keeping their business productive: a shortage of skilled, trained machine operators; a global need to batch manufacture; and the need for the automation of manufacturing processes. We believe our machine offerings and our unique control is perfectly suited to face these challenges head on.

Population Increases While Skilled Workers Decrease

Regardless of the exploding population in the emerging world markets, there is a shortage of skilled or trained machine tool operators. Even mature markets face the problem of a diminishing skilled workforce. According to a National Association of Manufacturers (NAM) study, 80% of surveyed manufacturers are currently experiencing a moderate to severe shortage of skilled employees. The versatile Hurco control is the ideal solution to this problem. Our patented conversational shop-floor programming is easy to learn and use. In many cases, new operators can be using the machine and programming parts after only one day of training. Other shops shift the programming away from the shop floor and rely more on offline resources like CAM software. Hurco's flexible control is designed to be programmed this way as well.



Lincoln Laser machined this diamond-turned pyramidal mirror on the Hurco VTXU 5-Axis machine. This high-tech company turned to Hurco in order to stay competitive by reducing set-up times on complex parts.

Meeting the Demands of Lean Manufacturing

Regardless of where they are located in the world, today's shops must deal with the demands of modern-day manufacturing. Whether their customers refer to it as "lean," "just-in-time," "on-demand," or by some other name, shop owners need to be able to produce a variety of small to medium lot jobs in very little time. To stay productive in this type of environment, a shop needs to have flexible machines with quick set-ups and automated manufacturing processes. Hurco's control is specifically designed for this type of fast and versatile operation.

Automation Increases Productivity and Saves Time

When a shop is dealing with several different orders each day of different lot sizes, dimensions and set-ups, it's vital that the machine tool can be quickly readied to go from job to job. With sophisticated, yet easy-to-use controls and programming software driving greater efficiency on the machine shop floor, Hurco's systems are able to dramatically increase productivity and accuracy while shortening cycle times. This means the machine tool operator is able to produce more parts in less time by eliminating steps in the process.

The Hurco control allows users to machine parts or products the way that works best for their shop. Programming can be done on the shop floor via Hurco's easy-to-use conversational language or with G-Code. Additionally, parts can be programmed offline with popular CAM software or exported directly to the control from CAD systems.

COMPANY	GD TECH
LOCATION	DONGGUAN, CHINA
PRIMARY BUSINESS	ELECTRONICS, AEROSPACE, MEDICAL
MACHINE TOOLS	MULTIPLE MACHINING CENTERS

GD Tech decreased their training time and increased their overall efficiency using the conversational programming available on Hurco's unique control.

GD Tech opened its doors in 2003 and provides specialized metal parts and parts processing for the electronics, aerospace and medical device industries, among others. Based in Dongguan Chang'anzhen, the company employs over 150 people in its 6561 square foot facility. Among GD Tech's machines are 17 Hurco VM Series and VMX Series vertical machining centers. GD Tech appreciates the power, speed, accuracy and great value of their Hurco machining centers. They are able to meet even the most demanding needs of their customers. More importantly, they are able to decrease their training time and increase their overall efficiency using the conversational programming available on Hurco's unique control. Hurco's relationship with GD Tech extends beyond the sale of machines. They have consistently provided technical support and training, which has made all the difference. Due to increased business, GD Tech plans to expand to a 13,000 square foot location in Shanghai in 2006 with plans to purchase more machines to increase overall productivity. What began as the purchase of a single machine has turned into a loyal, long-term relationship.

Core competencies

Controls and Automation Software Development

Hurco is not only committed to the development of metal cutting machines, we are also devoted to designing and implementing the software used to program and automate our machines at the control and from a remote computer. This is a crucial advantage for Hurco as we are not dependent on other companies to develop controls for our machine tools and yet our controls are the most versatile and easy-to-use in the industry. Hurco's conversational control was, and still is revolutionary—the first of its kind – and it still has not been duplicated. Part programs that take up hundreds of lines using G-Code are reduced to just a few lines using conversational programming. Conversational programming is as simple as answering questions about the dimensions of the part. The Hurco control uses the information to create the program and make the part. Hurco's shop-floor software gives the operator the ability to write a new program even while the machine is cutting the current one (concurrent programming). However, the Hurco control is not limited to conversational programming—giving us another advantage in the machining industry. Parts can be programmed on the shop floor with G-Code (the most common programming language in the industry) or programmed offline with popular CAM software or via DXF files generated by CAD systems. Simply put, there is no control like it in the industry. It's ease of use and versatility gives every Hurco machining center or turning center an advantage over the competition. In addition to building machining centers and turning centers with innovative, easy-to-use controls and solid iron, Hurco is also committed to offering systems that are fast and accurate. We continually devote our efforts to the development of motion control and tool path generation to improve overall throughput. Furthermore, we've adopted the latest technology to provide faster tool changes in our machining and turning operations.

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

Manufacturing Cost Center

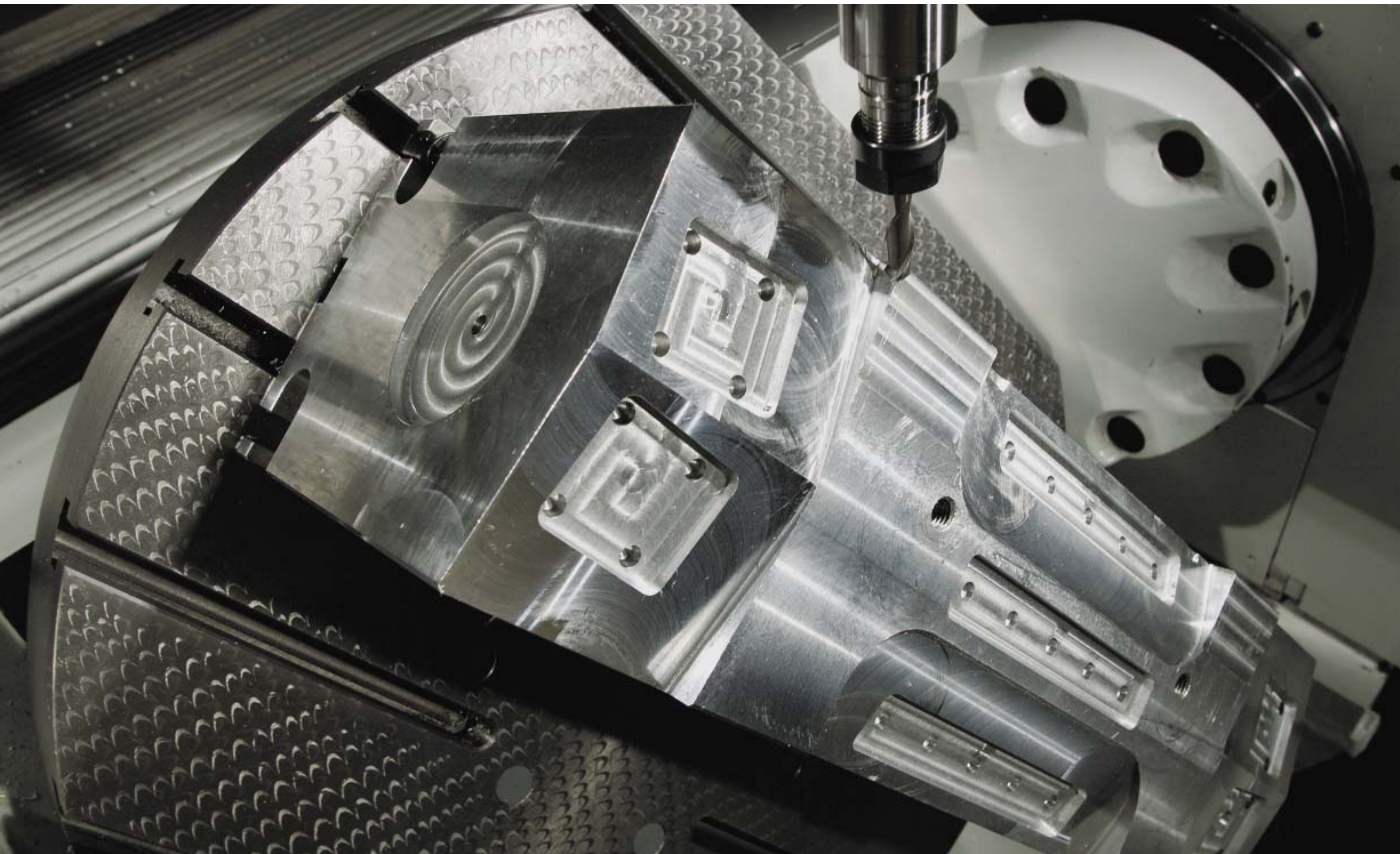
At Hurco, we've streamlined the engineering, manufacturing and shipping processes of our machine tools and controls to be more efficient for our customers throughout the world. Not only does this allow us to ship products faster, but we are also able to implement new capabilities and product offerings faster than our competitors. In addition, we monitor all of our installations to ensure proper performance and to provide customer service and training as needed. As a result, Hurco machines are more reliable and customer satisfaction continues to grow.

One of Hurco's newest customers uses a VMX50 to create a stamping die for the production of this automotive exhaust system component.

Worldwide Presence with Global Business Model

We are firmly committed to serving our existing customer base while continuing to develop new markets. We strive to provide full service solutions to all of our customers through our worldwide selling companies. Every regional Hurco office is staffed with a General Manager and professionals who understand the needs of the market. We will expand into emerging markets by opening new sales and service offices. In 2005, we continued our expansion into China with the opening of a new Technical Center in Shenzhen, one of the fastest growing manufacturing centers in the world. The new Hurco Web site is also a vital tool in educating our current and potential customers. While we continue to develop new content for this site, we are also using this content to develop or re-launch our regional sites.

Hurco's VTXU vertical machining center provides 5-axis machining with the versatile Hurco control.



COMPANY	VERITAS TOOLS, INC.
LOCATION	OTTAWA, CANADA
PRIMARY BUSINESS	HAND TOOLS
MACHINE TOOLS	HTX500

Veritas's work-in-process inventory has been reduced by 70%

Veritas recently purchased three HTX500 horizontal machining centers for their woodworking tool manufacturing operation. With product demand expanding, Veritas realized that it could no longer continue with its traditional batch machining processes. They decided to configure their new Hurco horizontals with simple fixturing such that a complete plane assembly would emerge after each cycle. The large pallets make it easy for Veritas to use standard tombstones with standard vise fixtures for holding the plane parts. This allows Veritas to quickly change production to meet current demand. Each machine is permanently set up to machine up to six different planes, making it quick and easy to change from one size plane to the next. With only complete assemblies being produced, work-in-process inventory is greatly reduced. The results are very impressive. Veritas's work-in-process inventory has been reduced by 70% and time to process and assemble can be as short as two days. With their reduction in total cost, their overall return on investment has been excellent.

Value

Perhaps one of Hurco's greatest strengths is our ability to offer our machine tools at a competitive price. The VM line and TM line offer incredible value for vertical machining centers and turning centers, respectively. By combining the two systems in a shop to create a milling and turning cell, users are able to create complex parts at a fraction of the cost for a multi-purpose machine. The VMX line provides leading technology and productivity at one of the lowest costs in the industry while the VTXU and HTX500 are high-performance machining centers that are not high-priced. A new entrepreneurial spirit is emerging in the manufacturing industry. New shops are opening and existing shops are learning how to become more productive with new machining technology. With the recent addition of our new Hurco Financing program in the United States, new customers will be able to take advantage of our product offerings.

Growth for 2006

Hurco will continue to strengthen its product line in 2006 and beyond with the expansion of existing lines, new accessory offerings and major software upgrades. In addition, Hurco will continue to expand globally to capitalize on established and emerging markets.

Assembly of controls at Hurco Automation Limited.

Mill and Lathe Expansion

Hurco recently introduced the TM Series of slant-bed turning centers. This line will soon be expanded to include live tooling. Other lines of turning centers are also planned to add higher performance machines with sub-spindles and additional options, creating a breadth of turning machine choices to complement Hurco's lines of vertical machining centers. Moreover, our vertical machining centers will also be expanded to include more machine models and control configurations to meet global demand. New models will be available in the VMX Series in 2006 while gantry models and other new machines are in the planning stages.

New Accessory and Software Offerings

Hurco is also focusing more attention on machine accessories to add versatility and flexibility to our machining centers and turning centers. As a result, a complete line of rotary tables will be introduced in 2006. Furthermore, the coming year will mark a major upgrade to Winmax®, our offline, PC-based programming software. The latest version of Winmax will allow shops to reduce setup and programming times to increase productivity. Furthermore, new software options will increase throughput and allow users to save and utilize their best machining practices more consistently.

Hurco's global supply chain, including our wholly-owned manufacturing facility, allows us to engineer, build and ship our products to customers with a short lead-time and at a lower cost than our competitors.

COMPANY	DIE TRON, INC.
LOCATION	GRAND RAPIDS, MICHIGAN
PRIMARY BUSINESS	DIES
MACHINE TOOLS	VTXU

With the VTXU, set-up times are significantly reduced—in many cases, by actual calendar days.

Die Tron designs and constructs progressive line and transfer dies for the automotive industry. Their customers demand efficient dies to make complex parts with as few hits as possible. However, complex parts require complex dies, often with a great deal of off-angle work. Consequently, the long set-up times and necessary multiple machining passes (required due to a lack of rigidity) was simply inefficient and did not allow Die Tron's business to flourish and grow.

Based on the performance of their existing Hurco machines, Die Tron purchased a Hurco VTXU 5-axis machining center to deal with these manufacturing challenges. The VTXU has already made a significant impact on set-up and machining times at Die Tron. With the VTXU, setup times are significantly reduced—in many cases, by actual calendar days. In addition to reducing time and cost on set-ups, the system provides the rigidity and accuracy required, while maintaining throughput and surface finish. Multiple cuts are no longer required.
Die Tron's ingenuity and willingness to adapt to the changing market has enabled them to survive in the competitive automotive die-making industry. By adding machines with intuitive controls and short lead-times Die Tron has moved from surviving to thriving.

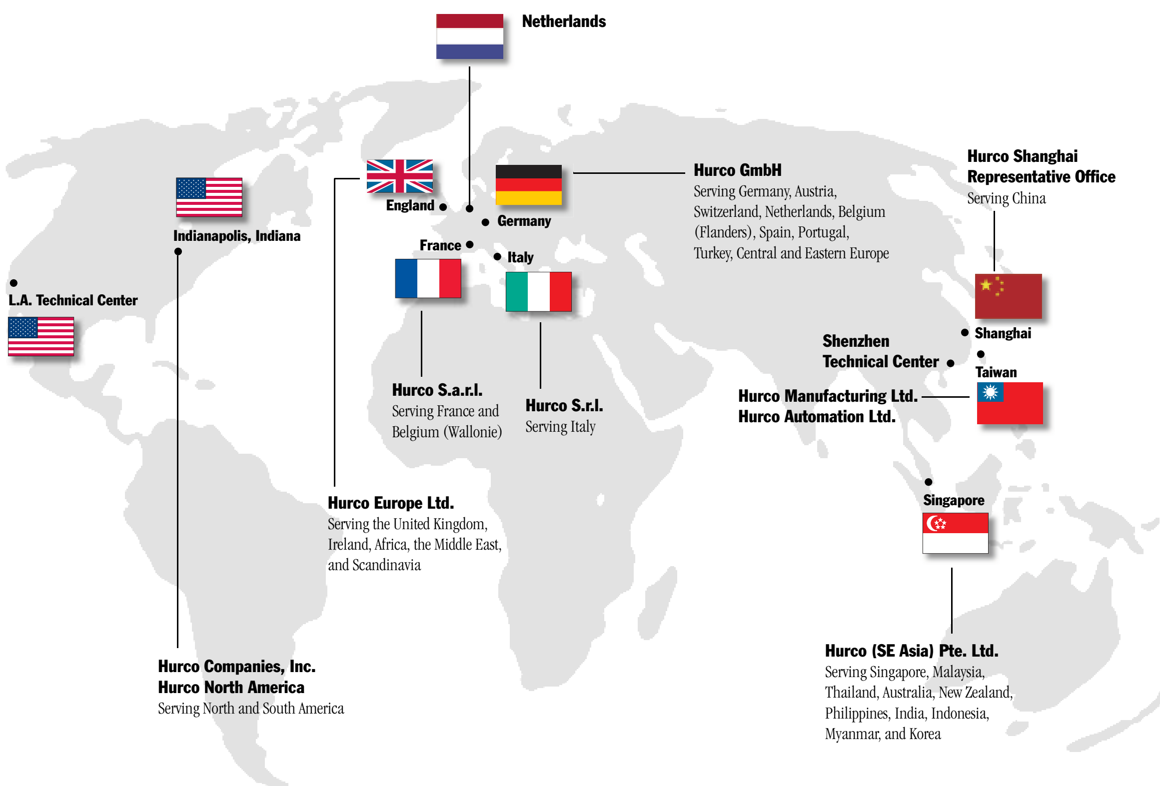
This automotive system component is created via a progressive stamping die that is machined using a VMX50.

Continued Global Expansion

Hurco's long-term strategy is to have a selling and service presence in all of the world's major machine tool markets. Consequently, we continue to analyze the consumption of machines throughout the global economy. We have already expanded our reach in China, the world's largest consumer of machine tools, with the opening of the new Technical Center in Shenzhen. While the market in China continues to grow, neighboring countries like India are ready to emerge. We have already begun laying the foundation for our expansion into India in 2006. The next few years will also mark our planned growth in Canada, Mexico and Brazil.

Challenges for 2006

Hurco's challenges are easily defined and yet require the dedication of our entire worldwide organization to be achieved. Simply put, we need to increase our market share in our existing territories and increase our territories to include emerging markets throughout the globe. With the current growth of the machine tool industry, our competitors are also eager to capture a larger segment of the market worldwide. For this reason, we must continue to make machines and controls that offer power and flexibility at a great value. By adding new lines and expanding our existing offerings, we are able to sell new machines to existing Hurco users and create new customers. We have already witnessed this in 2005 with the rollout of the new TM Series of slant-bed turning centers along with the impact of the VTXU 5-axis machines and the HTX500 horizontal machining centers. It is also imperative that we have the best sales channels in the industry while we expand our reach into new areas of the world.



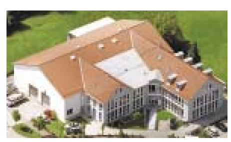
North America

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. Manufacturing continues to grow in Canada and Hurco is poised to be a contributor, specifically to suppliers in the aerospace industry and emerging automotive industry.

Hurco Europe, Ltd.

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

Hurco Germany (GmbH)

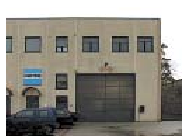


Based in Munich, Germany, Hurco GmbH has been extremely successful in selling and marketing Hurco machine tools to a nation known for both the consumption (ranked 3rd) and production (ranked 2nd) of machine tools. In addition to Germany, Hurco GmbH serves Austria, Belarus, Belgium, Bosnia-Herzegovina, Croatia, the Czech Republic, Hungary, Latvia, Lithuania, the Netherlands, Poland, Portugal, Romania, Russia, Slovakia, Spain, Turkey, Ukraine and the Federal Republic of Yugoslavia.

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

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

Hurco Italy (S.r.l.)



Italy is the world's third 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 Netherlands

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

Hurco China

The number one consumer in our industry, China purchases over 20% of the machine tools produced in the world! Hurco continues to aggressively and successfully market machine tools to this nation.

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

Hurco S.E. Asia

Hurco Southeast Asia serves the markets in Singapore, Malaysia, Thailand, Australia, New Zealand, Philippines, India, Indonesia, Myanmar, and Korea.

Taiwan (HML/HAL)

Hurco Manufacturing Ltd. (HML) and Hurco Automation Ltd. (HAL) are located in Taiwan. These manufacturing facilities are responsible for the assembly of Hurco machine tools and controls.

HURCO 2005

HURCO COMPANIES, INC.

TEN-YEAR SELECTED FINANCIAL DATA

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

For the Fiscal Year Ended	2005	2004	2003
Sales and service fees	$125,509	$99,572	$75,532
Cost of sales and service (1)	82,951	69,274	54,710
Operating expenses (SG&A)	26,057	21,401	18,749
Restructuring and other expenses, net	-	465	(124)
Operating income (loss)	16,501	8,432	2,197
License fee income, net	-	-	-
Interest expense	355	468	658
Other income (expense)	(64)	(396)	(119)
Income before taxes	16,082	7,568	1,420
Income tax expense (benefit) (4)	(361)	1,299	958
Net income (loss)	$ 16,443	$ 6,269	$ 462
Average shares outstanding -			
Basic	6,171	5,784	5,582
Diluted/Primary	6,336	6,026	5,582
Earnings per share			
Basic	$ 2.66	$ 1.08	$ 0.08
Diluted/Primary	$ 2.60	$ 1.04	$ 0.08
Capital expenditures	3,040	2,052	1,215
Depreciation and amortization	1,331	1,223	1,429
EBITDA	17,768	9,259	3,507
EBITDA, excluding license fees and restructuring charge	18,851	10,807	4,466
Gross profit margin %	33.9%	30.4%	27.6%
Operating income as % of sales	13.1%	8.5%	2.9%
Net return on sales	13.1%	6.3%	0.6%
Return on average equity	33.8%	18.7%	1.6%
Stock price range			
High	$ 20.00	$ 17.37	$ 3.15
Low	$ 10.25	$ 2.52	$ 1.30

At Fiscal Year End	2005	2004	2003
Working capital	$ 43,057	$26,347	$22,236
Current ratio	2.40	1.87	2.10
Total assets	$ 94,114	$73,446	$57,958
Total debt	4,136	4,600	9,222
Shareholders' equity	58,944	38,455	28,741
Total debt to capitalization %	6.6%	10.7%	24.3%
Shareholders' equity per share (2)	$ 9.30	$ 6.38	$ 5.15
Net operating assets per $ revenue (3)	$ 0.363	$ 0.347	$ 0.424
Number of employees	284	250	232

(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.

2002	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
$ 70,486	$ 92,267	$96,204	$88,238	$93,422	$95,729	$99,351
55,240	69,005	70,827	64,064	65,483	67,956	70,930
19,658	24,040	23,538	21,259	21,786	21,047	21,343
2,755	143	300	(103)	1,162	--	--
(7,167)	(921)	1,539	3,018	4,991	6,726	7,078
163	723	5,365	304	6,974	10,095	590
634	790	939	1,293	876	1,938	3,211
(36)	168	(359)	25	99	(51)	(99)
(7,674)	(820)	5,606	2,054	11,188	14,832	4,358
589	777	571	252	1,934	1,028	94
$(8,263)	$(1,597)	$ 5,035	$ 1,802	$ 9,254	$13,804	$ 4,264
5,583	5,670	5,952	5,980	6,498	6,536	5,786
5,583	5,670	6,020	6,061	6,670	6,704	5,907
$ (1.48)	$ (0.28)	$ 0.85	$ 0.30	$ 1.42	$ 2.11	$ 0.74
$ (1.48)	$ (0.28)	$ 0.84	$ 0.30	$ 1.39	$ 2.06	$ 0.72
1,716	1,918	1,899	2,157	2,328	2,235	1,879
1,929	2,196	2,519	2,428	2,138	2,078	2,677
(5,111)	2,166	9,064	5,775	14,202	18,848	10,246
(1,436)	1,586	3,999	5,368	8,390	8,753	9,656
21.6%	25.2%	26.4%	27.4%	29.9%	29.0%	28.6%
(10.2%)	(1.0%)	1.6%	3.4%	5.3%	7.0%	7.1%
(11.7%)	(1.7%)	5.2%	2.0%	9.9%	14.4%	4.3%
(26.0%)	(4.3%)	13.4%	4.9%	27.4%	60.1%	36.1%
$ 3.35	$ 4.19	$ 5.88	$ 6.63	$ 9.25	$ 9.44	$ 7.25
$ 1.45	$ 2.08	$ 3.00	$ 3.38	$ 6.25	$ 4.25	$ 3.25

2002	**2001**	**2000**	**1999**	**1998**	**1997**	**1996**
$ 20,350	$ 31,293	$26,071	$33,276	$29,349	$22,852	$20,772
1.96	2.72	2.13	2.70	2.14	2.18	1.89
$ 57,152	$ 66,217	$65,024	$69,632	$71,696	$58,748	$59,750
8,885	12,000	3,736	14,172	8,358	10,043	22,110
28,017	35,468	38,891	36,148	37,740	29,776	16,141
24.1%	25.3%	8.8%	28.2%	18.1%	25.2%	57.8%
$ 5.02	$ 6.36	$ 6.46	$ 5.99	$ 5.80	$ 4.44	$ 2.43
$ 0.462	$ 0.476	$ 0.408	$ 0.531	$ 0.458	$ 0.381	$ 0.366
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 manufactured in Taiwan to our specifications by our wholly owned subsidiary, Hurco Manufacturing Limited (HML), and an affiliate. We sell our products through approximately 230 independent agents and distributors in approximately 50 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 improved performance in the last three years are improved worldwide demand for our products, our expanded product line and the impact of changes in foreign currency.

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 since then. Our new models, together with an increase in worldwide demand for machine tools, are largely responsible for the continuing increase in our sales during the last two fiscal years.

Approximately 89% of worldwide demand for machine tools comes from outside the United States. During fiscal 2004 and 2005, approximately two-thirds of our sales and service fees were attributable to customers located abroad. Our sales to foreign customers are denominated, and payments by those customers are made, in the prevailing currencies—primarily the Euro and Pound Sterling—in the countries in which those customers are located, and our product costs are incurred and paid primarily in the New Taiwan Dollar and U.S. Dollars. Changes in currency exchange rates can have a material effect on our operating results as reported under 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.

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

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

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)	
	2005	2004	2003	05 vs. 04	04 vs. 03
Sales and service fees	100.0%	100.0%	100.0%	26.0%	31.8%
Gross profit	33.9%	30.4%	27.6%	40.5%	45.5%
Selling, general and Administrative expenses	20.7%	21.5%	24.8%	21.8%	14.1%
Restructuring expense and Other expenses, net	--	.05%	(0.2%)	N/A	N/A
Operating income	13.1%	8.5%	2.9%	95.7%	283.8%
Interest expense	.03%	.05%	0.9%	(24.1%)	(28.9%)
Net income	13.1%	6.3%	0.6%	162.3%	1256.9%

Fiscal 2005 Compared With Fiscal 2004

Sales and Service Fees – Sales and service fees for fiscal 2005 were the highest in our 37-year history, totaling $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 for financial reporting purposes. Computerized machine tool sales, which also were the highest in our history, 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 December 2004.

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, 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 currency 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%

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 at all Hurco locations 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. As a result, we will not disclose backlog in future SEC filings.

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 of the year, 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.

Fiscal 2004 Compared With Fiscal 2003

Net income for fiscal 2004 was $6.3 million, or $1.04 per share, compared to $462,000, or $.08 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, which was attributable to demand for our newer models introduced in 2003 and 2004, and improving market conditions, and also reflected the benefit of stronger European currencies in relation to the U.S. Dollar.

We introduced the VM product line in the fourth quarter of fiscal 2002 to improve our competitiveness in the entry-level machining center market. The VM product line has been successful in both the domestic and international markets. In the United States, we believe we have an approximate 15% market share in the entry-level machining center market. In fiscal 2004 and 2003, we shipped 522 and 310 VM units, respectively, worldwide, which resulted in approximately $18 million and $11 million, respectively, of incremental computerized machine tool sales.

Our operating results for fiscal 2004 were favorably impacted by further strengthening of foreign currencies, particularly the Euro, in relation to the U.S. Dollar, when translating foreign sales and service fees into U.S. Dollars for financial reporting purposes. As noted in the following table, approximately 61% of our net sales and service fees in fiscal 2004 were derived from European markets. The weighted average exchange rate between the U.S. Dollar and the Euro during fiscal 2004 was $1.2248, as compared to $1.0981 for fiscal 2003, an increase of 11.5%.

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, 2004 and 2003 (in thousands):

	October 31,				Increase	
	2004		2003		Amount	%
Americas	$ 32,423	32.5%	$ 24,313	32.2%	$ 8,110	33%
Europe	60,395	60.7%	48,277	63.9%	12,118	25%
Asia Pacific	6,754	6.8%	2,942	3.9%	3,812	130%
Total	$ 99,572	100.0%	$ 75,532	100.0%	$ 24,040	32%

Total sales and service fees on a worldwide basis were $99.6 million in fiscal 2004, compared to $75.5 million in the prior fiscal year, a $24.0 million, or 32%, increase. However, $6.4 million, or 27%, of the increase in total sales and service fees was due to changes in currency exchange rates.

In the Americas, sales and service fees increased $8.1 million, or 33%, due primarily to the continued growth of the VM product line. Shipments of VM units increased 61% in fiscal 2004 compared to fiscal 2003 while shipments of our higher priced VMX product line increased 29% during that same period. The increase in our sales and service fees in the United States reflects a 73% increase in unit orders for our vertical machining centers in fiscal 2004 compared to fiscal 2003. That percentage increase was substantially greater than the industry-wide increase of 46% for unit orders for vertical machining centers in the United States, as reported by The Association for Manufacturing Technology.

In Europe, our sales and service fees increased by $12.1 million, or 25%, as a result of increased unit sales and the favorable effect of stronger European currencies. Approximately $6.3 million, or 52%, of the increase in our sales and service fees was attributable to changes in currency exchange rates.

Sales and service fees in the Asia Pacific region were not significantly affected by currency 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, 2004 and 2003 (in thousands):

	October 31,				Increase	
	2004		2003		Amount	%
Computerized Machine Tools	$ 83,663	84.0%	$ 60,977	80.7%	$ 22,686	37%
Service Fees, Parts and Other	15,909	16.0%	14,555	19.3%	1,354	9%
Total	$ 99,572	100.0%	$ 75,532	100.0%	$ 24,040	32%

Hurco established new records for computerized machine tool sales and new order bookings in fiscal 2004. Sales of computerized machine tools totaled $83.7 million, an increase of $22.7 million, or 37%, of which $ 5.7 million was attributable to the favorable effects of currency translation. Unit shipments of computerized machine tools increased 35%, fueled by a 68% increase in shipments of products in the VM product line. The average net selling price per unit of computerized machine tool models was substantially unchanged in fiscal 2004 compared to fiscal 2003, notwithstanding the disproportionate increase in shipments of our lower-priced VM models, due primarily to the beneficial effects of currency translation. However, the average net selling price per unit, measured in local currencies, declined approximately 7.0% due primarily to the greater portion of those VM products in the total product mix.

New order bookings for fiscal 2004 totaled $103.5, an increase of $25.7 million, or 33%, as compared to $77.9 million recorded in fiscal 2003. Approximately $6.3 million, or 25% of the increase, was attributable to changes in currency exchange rates. The increase in constant U.S. Dollars was attributable primarily to orders for the VM product line. Unit orders for the VM product line increased by 83% in fiscal 2004 compared to the prior year, while unit orders of the VMX product increased 18% during that same period. Backlog was $12.8 million at October 31, 2004 compared to $ 8.2 million at October 31, 2003.

Gross margin for fiscal 2004 was 30.4%, an increase over the 27.6% margin realized in the corresponding 2003 period, due principally to increased sales volume and the favorable effects of stronger European currencies.

Selling, general and administrative expenses for fiscal 2004 of $21.4 million increased $2.7 million, or 14.1%, from those of the corresponding 2003 period primarily due to currency translation effects, increased commissions to European selling agents associated with the increase in European sales and increased sales and marketing expenditures.

Operating income for fiscal 2004 totaled $8.4 million, or 8.5% of sales, compared to $2.2 million, or 2.9% of sales, in the prior year. Operating income in fiscal 2004 was net of a $465,000 one-time severance charge.

Variable option expense of $322,000 is related to certain stock options, which were subject to variable plan accounting as described in Note 8 to the Consolidated Financial Statements. These stock options have all been exercised so no additional variable option expense is expected.

Other income (expense), net, in fiscal 2004 includes currency exchange losses on inter-company receivables and payables denominated in foreign currencies, net of gains or losses on related forward contracts, profits of subsidiaries accounted for using the equity method, and other non-operating income and expense items.

The provision for income taxes is related to the earnings of two foreign subsidiaries. In the United States and certain other foreign jurisdictions, we have net operating loss carryforwards for which we have a 100% valuation reserve at October 31, 2004 because the significant size of those carry forwards relative to our current rate of earnings creates uncertainty about the realization of the tax benefits in future years. The provision for income tax increased in fiscal 2004 solely because of increased earnings from our taxable foreign subsidiaries.

Liquidity and Capital Resources

At October 31, 2005, we had cash and cash equivalents of $17.6 million compared to $8.5 million at October 31, 2004. Cash generated from operations totaled $12.0 million and $6.8 million at October 31, 2005 and 2004, respectively. We also generated cash of approximately $800,000 and $2.1 million in fiscal 2005 and 2004, respectively, from the sale of common stock to employees upon the exercise of common stock options.

Working capital, excluding cash and short-term debt, was $25.6 million at October 31, 2005 compared to $18.1 million at October 31, 2004. Accounts receivable increased by $2.8 million in fiscal 2005 due to the increase in sales and deferred tax assets increased by $3.0 due to the reversal of the valuation allowance. We expect our operating working capital requirements to increase in fiscal 2006 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 investments during the year consisted of an integrated computer system and normal expenditures for software development projects and purchases of equipment. We funded these expenditures with cash flow from operations.

Total debt at October 31, 2005 was $4.1 million representing 7% of total capitalization, which aggregated $63.1 million, compared to $4.6 million, or 11% of total capitalization, at October 31, 2004. 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 2006.

Contractual Obligations and Commitments

The following is a table of contractual obligations and commitments as of October 31, 2005 (in thousands):

		Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-Term Debt	$4,136	$ 126	$4,010	$ --	$ --
Operating Leases	4,201	1,543	2,173	291	194
Deferred Credits and Other	399	--	--	--	399
Total	$ 8,736	$ 1,669	$ 6,183	$ 291	$ 593

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.

With respect to capital expenditures, we expect capital spending in fiscal 2006, exclusive of capitalized software development costs, to be approximately $2.0 million, which includes discretionary items.

Off Balance Sheet Arrangements

From time to time, our European subsidiaries guarantee third party lease financing residuals in connection with the sale of certain machines in Europe. At October 31, 2005, we had outstanding 38 third party guarantees totaling approximately $1.8 million. A retention of title clause allows our European subsidiaries to repossess a machine that is the subject of a lease guarantee if the customer defaults on its lease. 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 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 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, 2005, we have deferred tax assets of $4.6 million for which we have recorded $221,000 valuation allowance. These deferred tax assets relate primarily to net operating loss carryforwards in the United States and certain foreign jurisdictions, as well as federal business tax credits carried forward in the United States. The benefit of some of these carryforwards expires at certain dates and utilization of certain others is limited to specific amounts each year. Realization of those benefits is entirely dependent upon generating sufficient future taxable earnings in the specific tax jurisdictions before the carryforwards expire. 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 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 $1.2 million in fiscal 2005, $1.3 million in fiscal 2004, and $679,000 in fiscal 2003 related to software development projects. At October 31, 2005 we have an asset of $3.7 million for capitalized software development projects, a significant portion of which relates to projects currently in process 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 that require that critical terms of a hedging instrument are essentially the same as a hedged forecasted transaction. Another important element of our policy demands that formal documentation be maintained as required by the Statement of Financial Accounting Standards (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 hedge instruments in earnings. We routinely monitor significant estimates, assumptions, and judgments associated with derivative instruments, and compliance with formal documentation requirements.

Stock Compensation – We apply Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations in accounting for the plans, and, except for certain shares subject to variable plan accounting, no compensation expense has been recognized for stock options issued under the plans. For companies electing to continue the use of APB No. 25, SFAS No. 123R "Accounting for Stock-Based Compensation", requires pro forma disclosures determined through the use of an option-pricing model as if the provisions of SFAS No. 123R had been adopted.

We intend to adopt SFAS 123R on November 1, 2005 using the prospective method. We believe that the adoption of SFAS 123R will not have a material effect on the Consolidated Financial Statements.

Interest Rate Risk

We had no borrowings outstanding under our bank credit facilities at October 31, 2005 and have not borrowed from our bank credit facilities since February 2005. Our only debt at October 31, 2005 is a first mortgage loan with a fixed interest rate of 7 3/8%. As a result, a one percentage point (1%) increase in our variable borrowing interest rate would have had an immaterial impact on our fiscal 2005 results. Interest expense would have increased by approximately $25,000 in fiscal 2004 as a result of the same 1% increase in interest rates. Note 4 of the Consolidated Financial Statements sets forth the interest rates related to our current credit facilities.

Foreign Currency Exchange Risk

In fiscal 2005, approximately two thirds of our sales and service fees, including export sales, were derived from foreign markets. All of our computerized machine tools and computer control systems, as well as certain proprietary service parts, are sourced by our U.S.-based engineering and manufacturing division and re-invoiced to our foreign sales and service subsidiaries, primarily in their functional currencies.

Our products are sourced from foreign suppliers or built to our specifications by either our wholly owned subsidiary in Taiwan, or overseas contract manufacturers. 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, 2005 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: Contract Date	Contract Amount at Forward Rates in U.S. Dollars: October 31, 2005	Maturity Dates
Sale Contracts:					
Euro	23,650,000	$ 1.2976	30,688,240	28,645,047	Nov 2005-Oct 2006
Sterling	2,550,000	$ 1.8120	4,620,600	4,513,863	Nov 2005-Aug 2006
Purchase Contracts:					
New Taiwan Dollar	770,000,000	31.54*	24,413,443	23,295,292	Nov 2005-Oct 2006

*NT Dollars per U.S. Dollar

Forward contracts for the sale of foreign currencies as of October 31, 2005 which were entered into to protect against the effects of foreign currency fluctuations on receivables and payables denominated in foreign currencies were as follows:

Forward Contracts	Notional Amount in Foreign Currency	Weighted Avg. Forward Rate	Contract Amount at Forward Rates in U.S. Dollars: Contract Date	Contract Amount at Forward Rates in U.S. Dollars: October 31, 2005	Maturity Dates
Sale Contracts:					
Euro	6,692,237	$ 1.2054	8,066,822	8,042,396	Nov 2005-Dec 2005
Singapore Dollar	6,998,334	$ 0.5998	4,198,167	4,154,353	Nov 2005-Apr 2006
Sterling	613,635	$ 1.7827	1,093,927	1,086,008	Nov 2005-Dec 2005
Purchase Contracts:					
New Taiwan Dollar	254,000,000	33.17*	7,657,522	7,578,810	Nov 2005-Dec 2005

*NT Dollars per U.S. Dollar

HURCO COMPANIES, INC.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and changes in shareholders' equity present fairly, in all material respects, the financial position of Hurco Companies, Inc. and its subsidiaries at October 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 2005	2004	2003
		(Dollars in thousands, except per share amounts)	
Sales and service fees	$125,509	$ 99,572	$ 75,532
Cost of sales and service	82,951	69,274	54,710
Gross profit	42,558	30,298	20,822
Selling, general and administrative expenses	26,057	21,401	18,749
Restructuring expense (credit) and other expense, net (Note 15)	--	465	(124)
Operating income	16,501	8,432	2,197
Interest expense	355	468	658
Variable options expense	--	322	51
Earnings from equity investments	418	387	202
Other income (expense), net	(482)	(461)	(270)
Income before income taxes	16,082	7,568	1,420
Provision (benefit) for income taxes (Note 6)	(361)	1,299	958
Net income	$ 16,443	$ 6,269	$ 462

Earnings per common share – basic	$ 2.66	$ 1.08	$ 0.08
Weighted average common shares outstanding – basic	6,171	5,784	5,582
Earnings per common share – diluted	$ 2.60	$ 1.04	$ 0.08
Weighted average common shares outstanding – diluted	6,336	6,026	5,582

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

HURCO COMPANIES, INC.

CONSOLIDATED BALANCE SHEETS

ASSETS	As of October 31 2005	2004
	(Dollars in thousands, except per share amounts)	
Current assets:		
Cash and cash equivalents	$ 17,559	$ 8,249
Cash – restricted	--	277
Accounts receivable, less allowance for doubtful accounts of $842 in 2005 and $723 in 2004	20,100	17,337
Inventories	29,530	28,937
Deferred tax assets	3,043	--
Other	3,586	1,672
Total current assets	73,818	56,472
Property and equipment:		
Land	761	761
Building	7,205	7,205
Machinery and equipment	13,170	12,106
Leasehold improvements	1,102	676
	22,238	20,748
Less accumulated depreciation and amortization	(13,187)	(12,512)
	9,051	8,236
Deferred tax assets – long-term	1,346	--
Software development costs, less accumulated amortization	3,752	2,920
Investments and other assets	6,147	5,818
	$ 94,114	$ 73,446
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 17,051	$ 15,737
Accounts payable-related parties	2,087	2,624
Accrued expenses and other	9,879	9,697
Accrued warranty expenses	1,618	1,750
Current portion of long-term debt	126	317
Total current liabilities	30,761	30,125
Non-current liabilities:		
Long-term debt	4,010	4,283
Deferred credits and other	399	583
	4,409	4,866
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, 6,220,220 and 6,019,594 shares issued and outstanding in 2005 and 2004, respectively	622	602
Additional paid-in capital	48,701	46,778
Retained earnings (deficit)	13,001	(3,442)
Accumulated other comprehensive income (loss)	(3,380)	(5,483)
Total shareholders' equity	58,944	38,455
	$ 94,114	$ 73,446

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

HURCO COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended October 31 2005	2004	2003
	(Dollars in thousands)		
Cash flows from operating activities:			
Net income	$ 16,443	$ 6,269	$ 462
Adjustments to reconcile net income to			
Net cash provided by (used for) operating activities:			
Provision for doubtful accounts	119	286	421
Equity in income of affiliates	(418)	(387)	(202)
Depreciation and amortization	1,331	1,223	1,429
Restructuring and other charges	--	465	--
Tax benefit from exercise of stock options	1,146	--	--
Change in assets/liabilities			
(Increase) decrease in accounts receivable	(3,606)	(3,992)	1,348
(Increase) decrease in inventories	(660)	(4,947)	1,465
Increase (decrease) in accounts payable	(1,191)	8,623	(687)
Increase (decrease) in accrued expenses	2,653	(197)	(1,760)
(Increase) decrease in deferred tax asset	(4,389)	--	--
Other	549	(537)	(200)
Net cash provided by operating activities	11,977	6,806	2,276
Cash flows from investing activities:			
Proceeds from sale of property and equipment	--	26	14
Purchase of property and equipment	(1,879)	(762)	(536)
Software development costs	(1,161)	(1,290)	(679)
Change in restricted cash	277	345	(622)
Other proceeds (investments)	224	(53)	(25)
Net cash used for investing activities	(2,539)	(1,734)	(1,848)
Cash flows from financing activities:			
Advances on bank credit facilities	4,977	20,468	55,731
Repayments on bank credit facilities	(5,124)	(24,520)	(54,418)
Repayments of term debt	(200)	(538)	(1,211)
Repayment of first mortgage	(117)	(108)	(108)
Proceeds from exercise of common stock options	797	2,128	--
Purchase of common stock	--	--	(23)
Net cash provided by (used for) financing activities	333	(2,570)	(29)
Effect of exchange rate changes on cash	(461)	458	532
Net increase in cash	9,310	2,960	931
Cash and cash equivalents at beginning of year	8,249	5,289	4,358
Cash and cash equivalents at end of year	$ 17,559	$ 8,249	$ 5,289
Supplemental disclosures:			
Cash paid for:			
Interest	$ 331	$ 439	$ 595
Income taxes	$ 1,509	$ 286	$ 468

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

HURCO COMPANIES, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock				Accumulated Other	
	Shares Issued & Outstanding	Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Comprehensive Income (Loss)	Total
			(Dollars in thousands)			
Balances, October 31, 2002	5,583,158	$558	$44,717	$(10,173)	$(7,085)	$28,017
Net income	--	--	--	462	--	462
Translation of foreign currency financial statements	--	--	--	--	1,454	1,454
Unrealized loss of derivative instruments	--	--	--	--	(1,169)	(1,169)
Comprehensive income						747
Repurchase of common stock	(7,171)	(1)	(22)	--	--	(23)
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

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 our 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 $2.6 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.

Restricted Cash – Restricted cash results from hedging arrangements that require cash to be on deposit with an institution based on open positions.

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. Income and expenses are translated at the average exchange rates during the year. Cumulative foreign currency translation adjustments of $4.6 million are included in Accumulated Other Comprehensive Income in shareholders' equity. 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 forecast inter-company sales and forecast 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 Sheet at fair value in Other Current Assets and Accrued Expenses. Gains and losses resulting from changes in the fair value of these hedge contracts are deferred in Accumulated Other Comprehensive Income and recognized as an adjustment to cost of sales in the period that the sale 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, 2005, we had $1.2 million of gains related to cash flow hedges deferred in Accumulated Other Comprehensive Income. Of this amount, $1.0 million represents unrealized gains related to future cash flow hedge instruments that remain subject to currency fluctuation risk. These deferred gains will be recorded as an adjustment to Cost of Sales in the periods through October 31, 2006, in which the sale of the related hedged item is recognized, as described above. At October 31, 2004, we had $1.7 million of losses related to cash flow hedges deferred in Accumulated Other Comprehensive Income. Net losses on cash flow hedge contracts which we reclassified from Other Comprehensive Income to Cost of Sales in the years ended October 31, 2005, 2004 and 2003 were $747,000, $2.8 million and $1.4 million, respectively.

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 $476,000, $246,000, and $154,000 for the years ended October 31, 2005, 2004 and 2003, 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. 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	10
Shop and office equipment	5
Leasehold improvements	5

Total depreciation expense for the years ended October 31, 2005, 2004 and 2003 was $1.0 million, $932,000, and $1.0 million, respectively. Any impairment would be recognized based on an assessment of future operations (including cash flows) to insure that assets are appropriately valued.

HURCO COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 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.

Product Warranty – Expected future product warranty expense is recorded when the product is sold.

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 $2.4 million, $2.0 million, and $1.8 million, in fiscal 2005, 2004, and 2003, 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 $1,161,000 in 2005, $1,290,000 in 2004, and $679,000 in 2003 related to software development projects. Amortization expense was $329,000, $291,000 and $361,000 for the years ended October 31, 2005, 2004 and 2003, respectively. Accumulated amortization at October 31, 2005 and 2004 was $2.6 million and $2.3 million, respectively. Any impairment of the carrying value of the capitalized software development costs could be recognized based on an assessment of future operations (including cash flows) to insure 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
2006	$ 535
2007	760
2008	714
2009	714
2010	605

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, 2005, 2004 and 2003 was 165,000, 242,000, and zero 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. It also requires that the benefit of certain loss carryforwards be recorded as an asset and that a valuation allowance be established against the asset when it is "more likely than not" the benefit will not be realized.

Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates.

Stock Based Compensation – We apply Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations in accounting for the plans, and, except for certain shares subject to variable plan accounting, no compensation expense has been recognized for stock options issued under the plans. For companies electing to continue the use of APB No. 25, SFAS No. 123R "Accounting for Stock-Based Compensation", requires pro forma disclosures determined through the use of an option-pricing model as if the provisions of SFAS No. 123R had been adopted. If we had adopted the provisions of SFAS No. 123R, net income and earnings per share would have been as follows:

	2005	2004	2003
Net income (in thousands)	$ 16,420	$ 6,174	$ 265
Earnings per share:			
Basic	$ 2.66	$ 1.07	$ 0.05
Diluted	$ 2.59	$ 1.02	$ 0.05

We intend to adopt SFAS 123R on November 1, 2005 using the prospective method. We believe that the adoption of SFAS 123R will not have a material effect on the Consolidated Financial Statements.

Reclassifications – Certain reclassifications have been made to prior years' financial statements to conform to the presentation used in fiscal 2005.

2. BUSINESS OPERATIONS

Nature of Business – We design and produce computer control systems and 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, transportation 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.

HURCO COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

3. INVENTORIES

Inventories as of October 31, 2005 and 2004 are summarized below (in thousands):	2005	2004
Purchased parts and sub assemblies	$ 6,561	$ 6,888
Work-in-process	5,403	5,148
Finished goods	17,566	16,901
	$ 29,530	$ 28,937

4. DEBT AGREEMENTS

Long-term debt as of October 31, 2005 and 2004, consisted of (in thousands):	2005	2004
Domestic bank revolving credit facility	$ --	$ --
European bank credit facility	--	147
First Mortgage	4,136	4,253
Economic Development Revenue Bonds, Series 1990	--	200
	4,136	4,600
Less current portion	126	317
	$ 4,010	$ 4,283

As of October 31, 2005, long-term debt was payable as follows (in thousands):	
Fiscal 2006	$ 126
Fiscal 2007	136
Fiscal 2008	145
Fiscal 2009	3,729
Fiscal 2010	--
Thereafter	--
	$ 4,136

As of October 31, 2005 and 2004, we had $829,000 and $196,000, respectively, of outstanding letters of credit issued to non-U.S. suppliers for inventory purchase commitments. As of October 31, 2005, we had unutilized credit facilities of $10.7 million available for either direct borrowings or commercial letters of credit.

Domestic Bank Credit Facility – We had no borrowings outstanding under our domestic credit facility at October 31, 2005. Interest on the domestic bank credit facility was at rates ranging from 4.0% to 6.25% at October 31, 2005 and from 3.25% to 4.0% at October 31, 2004.

Effective October 26, 2004, we amended our $8 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, 2005 was 0.23. 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.

Promissory Note – On October 24, 2002, we issued a secured promissory note for $1,350,000 to the seller of patented technology that we purchased. The final installment on the note was paid in December 2003.

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 3/8% 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 Facilities – The terms and conditions of the October 2004 amendment also apply to our revolving credit and overdraft facility for our U.K. subsidiary.

On January 11, 2006, we renewed our 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% at January 11, 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, 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, 2005 was $4.1 million representing 6.6% of total capitalization, which aggregated $63.1 million, compared to $4.6 million, or 11% of total capitalization, at October 31, 2004. We were in compliance with all loan covenants and had unused credit availability of $10.7 million at October 31, 2005. 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 2006.

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 to the Consolidated Financial Statements. The U.S. Dollar equivalent notional amount of these contracts was $80.7 million at October 31, 2005. The net fair value of these derivative instruments recorded in Accrued Expenses at October 31, 2005 was $1.0 million. 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.

6. INCOME TAXES

Deferred income taxes reflect the effect of temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. Our total deferred tax assets and corresponding valuation allowance at October 31, 2005 and 2004, consisted of the following (in thousands):

	October 31	
	2005	2004
Tax effects of future tax deductible items related to:		
Current:		
Inter-company profit in inventory	$ 1,672	$ 1,426
Accrued inventory reserves	834	404
Accrued warranty expenses	164	124
Deferred compensation	151	245
Other accrued expenses	498	390
Total current deferred tax assets	3,319	2,589
Non-current:		
Goodwill	61	61
Total deferred tax assets	3,380	2,650
Tax effects of future taxable differences related to:		
Accelerated tax deduction and other tax over book deductions related to property, equipment and software	(1,699)	(1,377)
Other	--	(604)
Total deferred tax liabilities	(1,699)	(1,981)
Net tax effects of temporary differences	1,682	669
Tax effects of carryforward benefits:		
U.S. federal and state net operating loss carryforwards, expiring 2006-2023	312	3,592
Foreign tax benefit carryforwards, expiring 2005-2008	--	402
Foreign net operating loss carryforwards, with no expiration	1,544	1,301
U.S. federal general business tax credits, expiring 2005-2025	882	1,026
U.S. Alternative minimum tax credit with no expiration	190	--
Tax effects of carryforwards	2,928	6,321
Tax effects of temporary differences and carryforwards, net	4,610	6,990
Less valuation allowance	221	6,990
Net deferred tax asset	$ 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.

We operate in a highly cyclical industry and incurred significant operating losses in fiscal 2001 and 2002. At October 31, 2004, a $6,990,000 valuation allowance was maintained against our net deferred tax assets. This valuation allowance was maintained because we determined that it was more likely than not that all of the deferred tax assets might not be realized.

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. During the fourth quarter of fiscal 2005, after examining a number of factors, including historical results and near term earnings projections, we determined that it was more likely than not that we would realize all of our remaining domestic net deferred tax assets and a significant portion of our deferred tax assets related to certain foreign tax jurisdictions.

As a result of this analysis, 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 $2,342,000, which is net of approximately $1,146,000 recorded as additional paid-in-capital for the tax effects of the exercise by employees of stock options during both fiscal 2005 and 2004.

Income (loss) before income taxes (in thousands):

	Year Ended October 31		
	2005	2004	2003
Domestic	$ 9,834	$ 3,424	$ (875)
Foreign	6,248	4,144	2,295
	$ 16,082	$ 7,568	$ 1,420
The provision for income taxes consists of:			
Current:			
Federal	$ 3,457	$ --	$ --
State	279	11	--
Foreign	2,259	1,240	1,148
	5,995	1,251	1,148
Deferred:			
Federal	(4,685)	48	(190)
State	(553)	--	--
Foreign	(1,118)	--	--
	(6,356)	48	(190)
	$ (361)	$ 1,299	$ 958

Differences between the effective tax rate and U.S. federal income tax rate were (in thousands):			
Tax at U.S. statutory rate	$ 5,468	$ 2,649	$ 497
Effect of tax rates of international jurisdictions in excess (less than) of U.S. statutory rates	81	8	(130)
State income taxes	279	11	--
Effect of losses without current year benefit	--	--	591
Deferred tax asset valuation adjustment	(2,342)	--	--
Utilization of net operating loss carryforwards	(3,740)	(1,369)	--
Permanent items	(155)	--	--
Other	48	--	--
Provision (benefit) for income taxes	$ (361)	$ 1,299	$ 958

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.

HURCO COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 $243,800, $253,900 and $228,076 for the years ended October 31, 2005, 2004 and 2003, respectively.

We also have life insurance agreements with our executive officers. Beginning in fiscal 2003, the premiums were borrowed from the cash value of the policies and will be repaid from the policies' cash surrender values when the policies are terminated in accordance with the provisions of the agreements. In fiscal 2005, we purchased the insurance policies from the executive officers. The insurance premiums paid by the Company will be repaid from the cash surrender value of the policies when the policies are terminated.

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, 2005, options to purchase 207,600 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 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, 2005, options to purchase 7,800 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, 2005, 2004 and 2003 and the related activity for the year is as follows:

	Shares Under Option	Weighted Average Exercise Price Per Share
Balance October 31, 2002	830,160	$ 3.78
Granted	--	--
Cancelled	(8,000)	4.14
Expired	(33,500)	5.85
Exercised	--	--
Balance October 31, 2003	788,660	$ 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

Stock options outstanding and exercisable on October 31, 2005 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	151,500	$2.62	6.6
5.813 - 8.250	63,900	6.00	4.0
$ 2.125 - 8.250	215,400	$3.63	5.8
Exercisable			
$ 2.125 - 5.125	142,420	$2.65	--
5.813 - 8.250	63,900	6.00	--
$ 2.125 - 8.250	206,320	$3.69	--

We apply Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" (APB No. 25), and related interpretations in accounting for the plans, and, except for certain shares subject to variable plan accounting, no compensation expense has been recognized for stock options issued under the plans. For companies electing to continue the use of APB No. 25, SFAS No. 123 "Accounting for Stock-Based Compensation", requires pro forma disclosures determined through the use of an option-pricing model as if the provisions of SFAS No. 123 had been adopted.

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment", which is a revision to SFAS No. 123. SFAS 123R requires all share-based payments to employees, including stock options, to be expensed based on their fair values. We have disclosed the effect on net earnings and earnings per share under SFAS 123. SFAS 123R contains three methodologies for adoption: (1) adopt SFAS 123R on the effective date for interim periods thereafter, (2) adopt SFAS 123R on the effective date for interim periods thereafter and restate prior interim periods included in the fiscal year of adoption under the provisions of SFAS 123, or (3) adopt SFAS 123R on the effective date for interim periods thereafter and restate all prior interim periods under the provisions of SFAS 123. SFAS 123R must be adopted and in the first fiscal year beginning after June 15, 2005. We intend to adopt SFAS 123R on November 1, 2005 using the prospective method. We believe that the adoption of SFAS 123R will not have a material effect on the Consolidated Financial Statements.

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 and in fiscal 2003 of $51,000. As of October 31, 2005, all options subject to variable plan accounting have been exercised.

If we had adopted the provisions of SFAS No. 123, net income and earnings per share would have been as follows:	2005	2004	2003
Net income (in thousands)	$ 16,420	$ 6,174	$ 265
Earnings per share:			
Basic	$ 2.66	$ 1.07	$ 0.05
Diluted	$ 2.59	$ 1.02	$ 0.05

As of October 31, 2005, 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.

9. RELATED PARTY TRANSACTIONS

We own approximately 24% of one of our Taiwanese-based contract manufacturers. This investment of $975,000 is accounted for using the equity method and is included in Investments and Other Assets on the Consolidated Balance Sheet. Purchases of product from this contract manufacturer totaled $2.7 million, $4.4 million and $3.7 million for the years ended October 31, 2005, 2004 and 2003, respectively. Sales of product to this contract manufacturer were $117,000, $199,000 and $205,000 in fiscal 2005, 2004 and 2003 respectively. Trade payables to this contract manufacturer were $509,000 at October 31, 2005 and $115,000 at October 31, 2004. Trade receivables were $136,000 at October 31, 2005 and $62,000 at October 31, 2004.

HURCO COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of October 31, 2005, 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 manufactured under contract for sale exclusively to us. We are accounting for this investment using the equity method. The investment of $1.6 million at October 31, 2005 is included in Investments and Other Assets on the Consolidated Balance Sheet. Purchases of product from this supplier amounted to $7.7 million, $6.6 million and $4.8 million in 2005, 2004 and 2003, respectively. Sales of product to this supplier were $1.8 million, $1.9 million and $1.2 million for the years ended October 31, 2005, 2004 and 2003, respectively. Trade payables to HAL were $1.6 million and $2.5 million at October 31, 2005 and 2004, respectively. Trade receivables from HAL were $242,000 and $581,000 at October 31, 2005 and 2004, respectively.

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

(in thousands)	2005	2004	2003
Net Sales	$ 50,896	$ 23,469	$ 26,284
Gross Profit	8,947	7,780	4,409
Operating Income	2,676	2,210	564
Net Income	2,313	1,479	261
Current Assets	$ 21,553	$ 16,194	$ 17,162
Non-current Assets	1,824	2,031	2,015
Current Liabilities	14,857	17,215	13,549

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 European subsidiaries guarantee third party lease financing residuals in connection with the sale of certain machines in Europe. At October 31, 2005 there were 38 third party guarantees totaling approximately $1.6 million. A retention of title clause allows our German subsidiary to obtain the machine if the customer defaults on its lease. We believe that the proceeds obtained from liquidation of the machine would cover any payments required under 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):

	Warranty Reserve
Balance at October 31, 2004	$ 1,750
Provision for warranties during the period	1,709
Charges to the accrual	(1,778)
Impact of foreign currency translation	(63)
Balance at October 31, 2005	$ 1,618

12. OPERATING LEASES

We lease facilities, certain equipment and vehicles under operating leases that expire at various dates through 2010. Future payments required under operating leases as of October 31, 2005, are summarized as follows (in thousands):

2006	$ 1,543
2007	1,098
2008	617
2009	458
2010	291
Thereafter	194
Total	$ 4,201

Lease expense for the years ended October 31, 2005, 2004, and 2003 was $1.8 million, $1.5 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) (in thousands, except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005				
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	$ .50	$ .53	$ .46	$ 1.16
Income per common share – diluted	$ .48	$ .52	$ .45	$ 1.13

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2004				
Sales and service fees	$ 22,718	$ 24,255	$ 23,748	$ 28,851
Gross profit	6,531	7,413	7,313	9,041
Gross profit margin	28.7%	30.6%	30.8%	31.3%
Restructuring expense and other expense, net (Note 15)	--	--	--	465
Selling, general and administrative expenses	4,927	5,127	5,241	6,106
Operating income	1,604	2,286	2,072	2,470
Provision (benefit) for income taxes	366	388	405	140
Net income	669	1,737	1,582	2,281
Income per common share – basic	$ .12	$ .31	$ .27	$ .38
Income per common share – diluted	$ .12	$ .29	$ .25	$ .36

(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.

HURCO COMPANIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

Our computerized metal cutting machine tools are manufactured to our specifications by manufacturing contractors in Taiwan including our wholly owned subsidiary, Hurco Manufacturing Limited (HML). Our executive offices and principal design, engineering, and manufacturing management operations are headquartered in Indianapolis, Indiana. We sell our products through approximately 230 independent agents and distributors in approximately 50 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. During fiscal 2005, no customer accounted for more than 5% of our 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,		
	2005	2004	2003
Computerized Machine Tools	$ 107,313	$ 83,663	$ 61,385
Computer Control Systems and Software *	4,129	3,604	3,044
Service Parts	9,991	8,696	7,643
Service Fees	4,076	3,609	3,460
Total	$ 125,509	$ 99,572	$ 75,532

*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,		
	2005	2004	2003
United States	$ 40,666	$ 30,654	$ 22,829
Germany	36,039	31,206	22,111
United Kingdom	11,917	8,818	8,381
Other Europe	26,061	20,361	17,735
Total Europe	74,017	60,385	48,227
Asia and Other	10,826	8,533	4,476
Total Foreign	84,843	68,918	52,703
	$ 125,509	$ 99,572	$ 75,532

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

15. RESTRUCTURING EXPENSE AND OTHER EXPENSE, NET

During fiscal 2002, we discontinued several under-performing product lines, sold the related assets and discontinued a software development project to enable us to focus our resources and technology development on our core products, which consist primarily of general purpose computerized machine tools for the metal cutting industry (vertical machining centers) into which our proprietary Ultimax® software and computer control systems have been fully integrated. Included in restructuring expense and other expense, net in fiscal 2002 is a $1.1 million provision for potential expenditures related to a disputed claim in the United Kingdom, regarding a terminated facility lease (Note 10). The disputed facility lease claim was settled in fiscal 2003 and paid in the first quarter of fiscal 2004.

The severance accrual of $264,000 at October 31, 2002 represented costs related to employees to be paid in future periods. The severance provision represented 53 positions that have been eliminated or were to be eliminated in fiscal 2003. At October 31, 2002, 38 employees had been paid the full amount of their severance while the remaining 15 employees were paid at various times through the second quarter of fiscal 2003. In fiscal 2003, we paid the remaining severance and adjusted the foreign lease liability balance to the actual settlement amount.

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 Chief Financial Officer. Under the agreement, we will pay Mr. Wolf severance compensation totaling $465,000.

(in thousands)	Balance 10/31/02	Provision (Credit)	Charges to Accrual	Balance 10/31/03
Description				
Severance costs	$ 264	$ (43)	$ 221	$ --
Foreign lease termination liability	1,113	(81)	(157)	1,189
	$ 1,377	$ (124)	$ 64	$ 1,189

	Balance 10/31/03	Provision (Credit)	Charges to Accrual	Balance 10/31/04
Description				
Severance costs	$ --	$ 465	$ --	$ 465
Foreign lease termination liability	1,189	--	1,189	--
	$ 1,189	$ 465	$ 1,189	$ 465

	Balance 10/31/04	Provision (Credit)	Charges to Accrual	Balance 10/31/05
Description				
Severance costs	$ 465	$ --	$ 321	$ 144
	$ 465	$ --	$ 321	$ 144

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 a material effect on the Consolidated Financial Statements.

In December 2004, the FASB issued Statement No. 123R, "Share Based Payment", that requires companies to expense the value of employee stock options and similar awards for interim and annual periods beginning after June 15, 2005 and applies to all outstanding and unvested stock-based awards at a company's adoption date. We believe that the adoption of SFAS 123R will not have a material effect on the Consolidated Financial Statements.

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.
Richard T. Niner, General Partner, Wind River Associates (1)
O. Curtis Noel, Independent Business Consultant (3)
Charlie Rentschler, Securities Analyst (2)
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

Stephen J. Alesia
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 15, 2006 at 10 a.m. Eastern Time at Hurco's Corporate Offices, One Technology Way, Indianapolis, Indiana.

Transfer Agent

Computershare Investor Services, 250 Royall Street, Canton Massachusetts 02021

Legal Counsel

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

Independent Auditors

PricewaterhouseCoopers LLP, Indianapolis, Indiana

Investor Relations

Stephen J. Alesia, 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.

	2005		2004	
Fiscal Quarter Ended	**High**	**Low**	**High**	**Low**
January 31	$ 19.40	$ 12.65	$ 5.82	$ 2.52
April 30	$ 19.38	$ 10.50	$ 10.70	$ 4.25
July 31	$ 20.00	$ 10.25	$ 14.40	$ 7.83
October 31	$ 19.09	$ 13.81	$ 17.37	$ 6.68

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 218 holders of record of Hurco Common Stock as of January 13, 2006.

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, among others, changes in general economic and business conditions that affect market demand for machine tools and related computer control systems, software products, and replacement parts, changes in manufacturing markets, adverse currency movements, innovations by competitors, performance of our contract manufacturers, governmental actions and initiatives, including import and export restrictions and tariffs, and developments in the relations among the U.S., China and Taiwan.

Hurco Companies, Inc.

One Technology Way PO Box 68180 Indianapolis, IN 46268 800.634.2416 www.hurco.com