



1965

2005

# 40 Years of Progress

Rush Enterprises, Inc. 2005 Annual Report

### Forty Years of Progress

In 1965, the truck sales business was in its infancy, with many small dealers spread around the country in a fragmented market. Marvin Rush and two partners opened their first dealership that year in Houston, Texas, a city that is a major crossroads for east-west truck traffic. But what set Marvin apart was his vision: to build a network of dealerships in the Southern Belt that would sell, lease and service trucks as well. In 1967, Marvin made his first 100-unit fleet sale of Peterbilt trucks and started a leasing company and a finance and insurance division. Nine years later, Marvin bought out his partners, becoming the sole owner of the Company, Rush Enterprises.

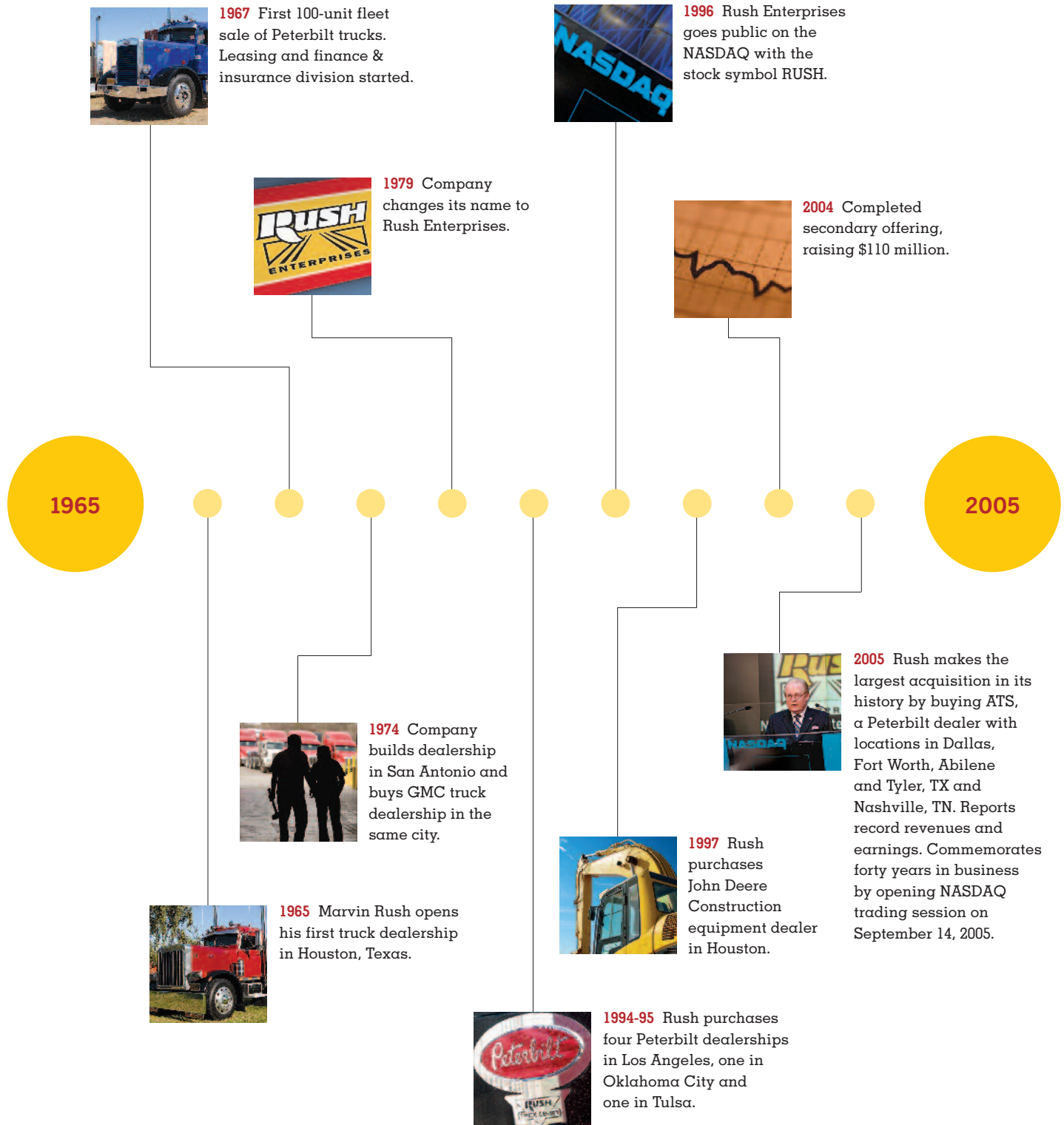


As the Company grew, it continued to acquire dealerships in the Southern Belt, becoming the largest truck dealership in the country. By 1996, the Company had reached a critical mass and the time was ripe for taking the company public. The Rush IPO was the first automotive or truck dealer to go public and was listed on the NASDAQ®, under the symbol RUSH.

Today, with more than 45 Rush Truck Centers in nine states and 2,600 employees, Rush has reached a milestone. In 2005, the company made its largest acquisition and reached revenues of \$1.9 billion. By any measure, the history of Rush has been a great success. The next chapter in the Rush saga is being written every day and promises to be even more dramatic than the accomplishments of the last forty years.



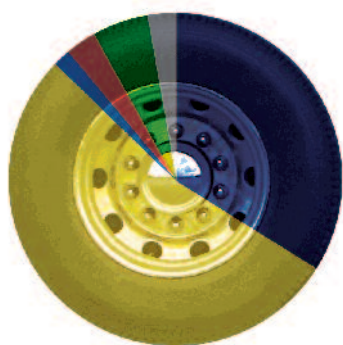
1965 Peterbilt 351A



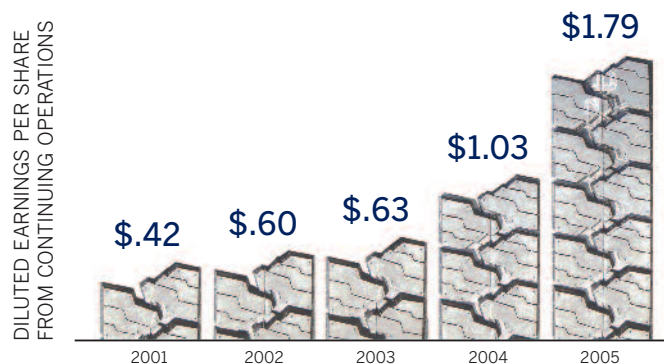
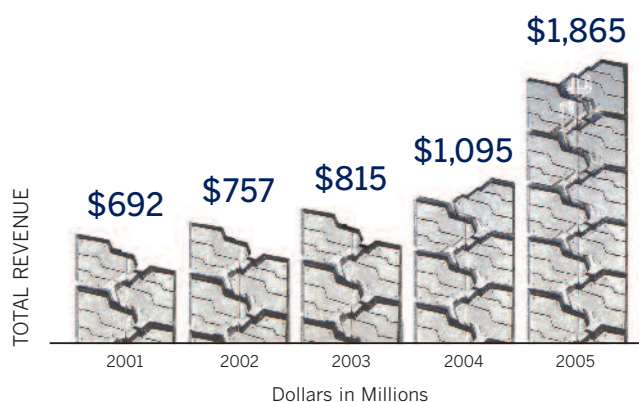


# Financial Highlights

<i>Dollars in thousands (except per share data)</i>	2005	2004	2003	2002	2001
Total revenues	<b>\$1,864,770</b>	\$1,094,979	\$815,332	\$757,147	\$691,513
Selling, general and administrative	<b>188,667</b>	141,947	124,207	111,721	101,832
Depreciation and amortization	<b>10,487</b>	9,119	8,929	8,594	9,176
Operating income from continuing operations	<b>83,538</b>	34,076	20,114	20,890	18,189
Interest expense, net	<b>12,895</b>	5,950	6,348	6,499	9,267
Income from continuing operations before income taxes	<b>71,138</b>	28,750	15,750	14,546	9,989
Provision for income taxes	<b>26,513</b>	11,574	6,300	5,818	3,996
Income from continuing operations	<b>44,625</b>	17,176	9,450	8,728	5,993
Earnings per common share – diluted	<b>\$1.79</b>	\$1.03	\$0.63	\$0.60	\$0.42
Diluted weighted average shares	<b>24,957</b>	16,607	15,024	14,461	14,166
Working capital	<b>\$126,137</b>	138,241	14,113	7,995	7,050
Total assets	<b>840,234</b>	565,933	366,878	345,110	338,811
Long-term debt	<b>133,152</b>	96,056	90,028	94,916	98,170
Shareholders' equity	<b>273,620</b>	222,807	88,706	79,695	81,439



PERCENTAGE of GROSS PROFITS



## About Rush Enterprises

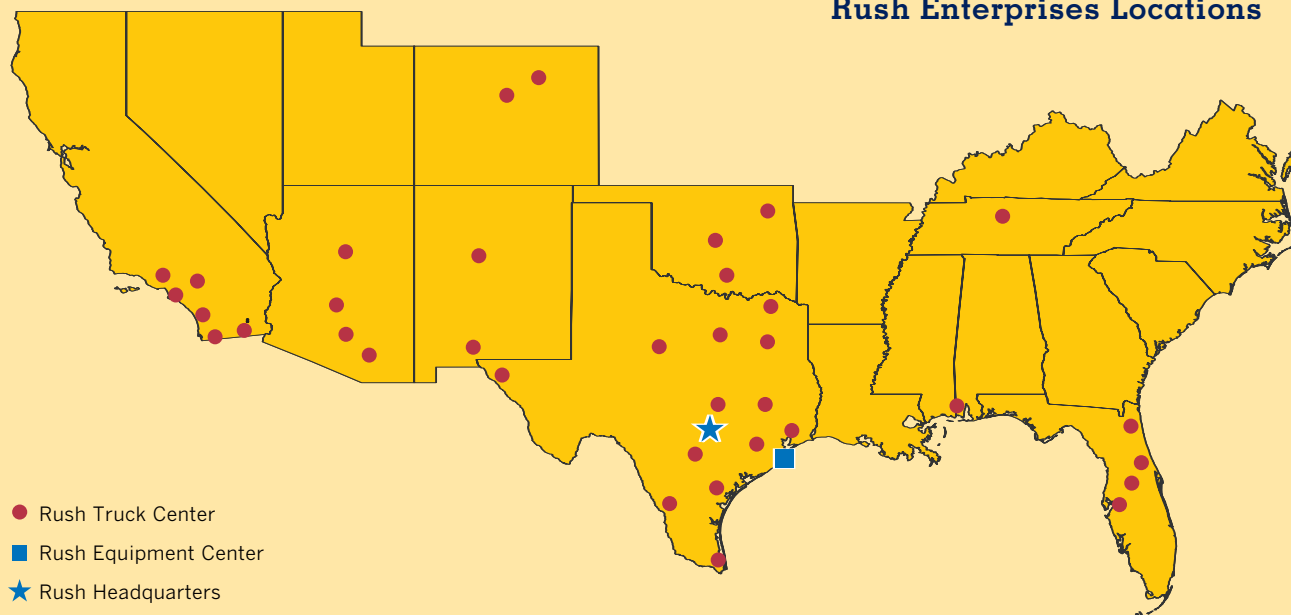
**Rush Enterprises (NASDAQ: RUSHA & RUSHB)** operates the largest network of Peterbilt heavy-duty truck dealerships in North America and a John Deere construction equipment dealership in Houston, Texas. Its current operations

include a network of dealerships located in Alabama, Arizona, California, Colorado, Florida, New Mexico, Oklahoma, Tennessee and Texas. These dealerships provide an integrated, one-stop source for the retail sale of new and used heavy-duty

and medium-duty trucks and construction equipment; aftermarket parts, service and body shop facilities; and a wide array of financial services, including the financing of truck and equipment sales, insurance products and leasing and rentals.



### Rush Enterprises Locations



## To Our Shareholders

**FORTY YEARS AGO**, I started this business and I can honestly say I never expected to accomplish this much. I had dreams of growing the business, but had a single location and was operating in a small, fragmented industry. Who would have predicted that we would grow to become what we are today? Since then, the industry has grown dramatically, and, most importantly, we have developed a group of people that are, bar none, the best in the business. Included in this annual report is a timeline that highlights some of our accomplishments, but realize that none of it could have happened without the loyal and dedicated people that have been with us for years. Our success is a tribute to their efforts.

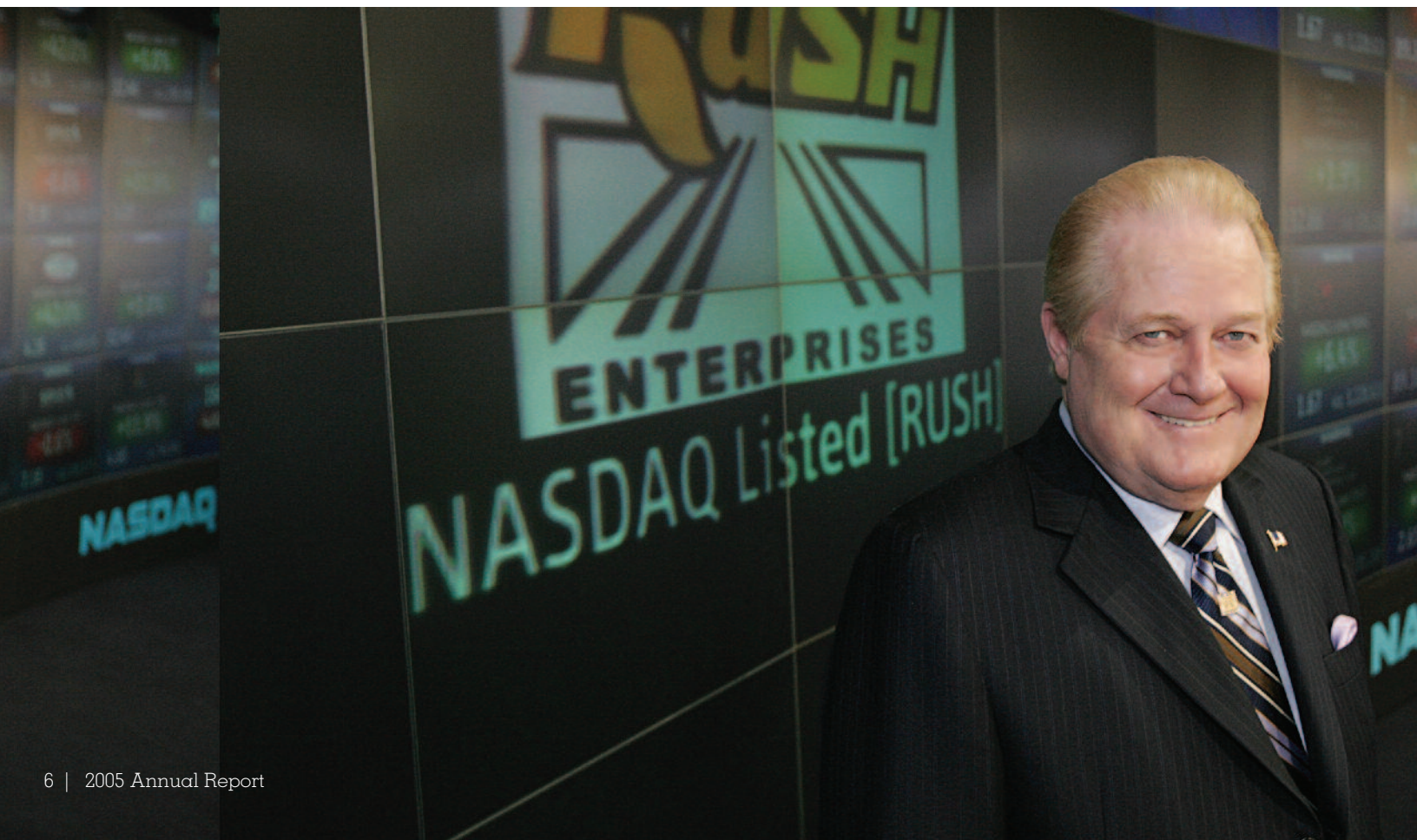
We now find ourselves at an interesting point in our evolution as an organization. We have accomplished so much, but I still believe that the best is yet to come. We are poised, through both human and equity

capital, to take advantage of the future. I'll share with you a few of my thoughts.

Right now the truck business is as strong as it has ever been. Beginning in the latter stages of 2003, the country experienced an economic recovery that, combined with the need to replace aging truck equipment, created an improving truck market. This recovery resulted in United States Class 8 truck sales increasing from about 145,000 units in each of the years ended 2001 through 2003, to over 255,000 units in 2005. The current forecast is for the industry to continue its high level of demand through 2009. As I write this letter, everyone is talking about how bad 2007 could be because of impending emission requirements that will undoubtedly cause a slowdown. Trucks will cost more and get less fuel economy. But there's more to the story. The 2010 emission requirements will result in greater price increases than were experienced in 2002 or 2007 and the fuel

economy is just as much an issue. Furthermore, the replacement time frame between the 2007 and 2010 emission changes will cause accelerated demand in the latter stages of 2007 through 2009. This is because the trucks that were purchased in 2004 through 2006 will be replaced in 2007 through 2010. The bottom line is that we expect 2007 demand to be about 170,000 to 180,000 units. As we have said before, we don't consider that to be a bad year.

How do we mitigate this downturn? I said it last year and I think it bears repeating, "Quality of Earnings." This term refers to a focus on the fundamental idea of creating incremental gross profit while holding the line on expenses. It translates into higher absorption rates. You may remember that the absorption rate is our ability to cover overhead expenses with the gross profit dollars derived from our parts, service and body shop business. Our absorption rate





will increase if we're successful. We have transformed this organization over the last several years into a service organization that sells trucks. This is vitally important as it does two things. First, it maximizes profits at the peak of the economic cycle. More truck-related gross profit falls to the bottom line when your parts and service gross profits cover expenses. Second, it helps you minimize the reduction in profit when the inevitable decline in truck sales occurs. I mention this because currently the question of the hour is what will happen to profits in 2007? We believe that we can soften the decline in earnings with our focus on absorption.

Unlike the large truck markets of the late 1990's where our absorption rate was under 80%, we have focused on both selling trucks and increasing our absorption rate. Our absorption rate increases will translate into higher profits.

This year was marked by the accomplishment of goals and the integration of our largest acquisition to date. We had a goal established at our 2003 management conference of selling 10,000 new Class 8 trucks and becoming 100% absorbed by 2006. I am proud to announce our team accomplished this task a year early by selling 10,111 new Class 8 trucks and achieving a 100.35% absorption rate. Now we have a goal of achieving a 110% absorption rate by 2008 and selling 13,000 new Class 8 trucks and 8,000 medium-duty trucks in 2009.

Not to forget our medium-duty efforts, this year we sold 2,807 medium-duty trucks and furthered our medium-duty presence by buying franchises in Orlando, Florida, Dallas, Texas, Texarkana, Texas and Fontana, California. We will continue to expand our medium-duty presence and are pleased with the progress we have made to date. One day soon we will

sell as many medium-duty trucks as we do Class 8's.

Our acquisition of American Truck Source expanded our presence in the major truck markets of Dallas, Texas and Nashville, Tennessee, as well as outlying stores in the Dallas area of responsibility. We are very pleased with the integration of these new stores and have undertaken expansion efforts in the Nashville and Ft. Worth stores. Other expansions are on the drawing board. Anytime you undertake such a large and complex acquisition, integration is a potential issue. This was the easiest and most successful integration we have undertaken. Our newest team members embraced the ownership change and enthusiastically adopted our business methods.

Earlier, I said we had both the human and equity capital to be successful. I'd like to take a moment and update you on the human capital side of our business. At our management conference in November, the primary focus was on people. I know it may sound strange, given that we're still a relatively small business, but we as an industry are always seeking human capital. Our challenge is to attract, develop and retain the best talent in the truck industry. The problem is our industry is small and most of our competitors are entrepreneurial owners. Our people must think like entrepreneurs while working for a public company. They must have the freedom of thought and action.

Our method for attracting, developing and retaining people is not revolutionary, but it is different than our competitors. As we have grown, our demand for great people has accelerated. We must evolve as an organization and enhance our methods. With this in mind, we focused on all three aspects of attract, develop and retain. As I knew they would, our managers came up with some great ideas that will assist in

this most important task. I look forward to their success.

Regarding equity capital, we are evaluating through formalized strategic planning our alternatives for the deployment of capital. We are fortunate to have a large cash position and strong cash flows for the next several years. The challenge will be to invest the cash in business ventures that will achieve an acceptable return. We are working on ideas and will not deviate from our core competency.

I am excited about the future of the organization I started forty years ago. It won't be long before I turn it over to capable people in the organization. Recently the Board of Directors and I decided to turn over the position of Chief Executive Officer to Rusty Rush, my son. While I will still be involved in the daily affairs of the business for now and Rusty will report to me, he will assume more of the executive stewardship role. Rusty has been working with me for over twenty-five years and has an understanding of the business and a view for the future that is unparalleled. He will build the business to levels I could never have imagined forty years ago.

Times are good in the truck business and we are maximizing our opportunities. Our people are improving the quality of earnings process to make us a stronger company able to sustain healthy operating margins in good times and bad. Our standard for constant improvement must never be compromised. I know our people; they won't stand for less.



**MARVIN RUSH**

*Chairman*

APRIL 6, 2006





With over 700 service and body shop bays nationwide, customers traveling the Southern Belt have minimized downtime and are back on the road even faster.



## Operations Review

### Forty Years of Progress

In many ways 2005 was a historical year for Rush, not only because it was our fortieth year in business, but also because it was our best growth year ever. New records were set in both revenue and earnings and new heights of productivity were reached in terms of acquisitions and store openings. The year began with the successful completion of the acquisition of American Truck Source, Inc. (ATS), a Peterbilt truck dealer with operations in Texas and Tennessee, the largest acquisition in Rush's history. This event seems particularly timely as it occurred in the Company's fortieth year of operation, establishing a new level of performance. As a result, in 2005 revenues reached a record \$1.9 billion as compared to \$1.1 billion in 2004, and net income jumped from \$16.9 million, or \$1.02 per diluted share, to a record \$44.6 million, or \$1.79 per diluted share in 2005.

The ATS acquisition not only expanded our geographical footprint, but it also expanded our service points for customers traveling the east-west routes in the Sunbelt States. This is particularly important because the presence of Rush Truck Centers along this route enables trucks to get back on the road in a matter of hours, in most cases.

Throughout the year, the Company continued to focus on expanding its presence in the Southeast. In June, Rush completed construction of a 41,000-square-foot facility on Interstate 10, the new home of its Mobile, Alabama dealership. As part of the efforts to take advantage of the large Nashville market, the Company relocated its Nashville dealership to a new 120,000-square-foot, state-of-the-art facility in Smyrna, doubling the size of the existing Nashville dealership.

In September, another milestone was reached as Rush commemorated its ninth year on NASDAQ by presiding over the opening bell. That event signifies the success of the Company in creating and enhancing shareholder value during this period.

### Enlarging the Rush Footprint

In 2003, the Company established goals of selling 10,000 new Class 8 trucks and achieving a 100% absorption rate in 2006. This year, Rush sold 10,111 new Class 8 trucks and recorded an absorption rate of 100.35%, achieving these goals one year ahead of schedule. In 2005 Rush sold 2,807 medium-duty trucks, a marked increase from last year's 1,766.

Part of Rush's growth strategy includes a major commitment to increase its medium-duty (Class 4 through Class 7 trucks) presence in its existing geographical footprint. Rush acquired GMC and Isuzu medium-duty truck dealerships in Orlando, Florida and Texarkana, Texas. The Company subsequently added heavy-and medium-duty Peterbilt trucks, parts and service to both locations and is operating the newly acquired dealerships as full-service Rush Truck Centers. We also purchased a GMC and UD medium-duty truck franchise in Dallas, Texas and have combined these franchises with our Peterbilt and Hino franchises at our existing medium-duty truck store in Dallas.

In October, Rush acquired GMC, Isuzu and Hino medium-duty truck franchises in Fontana, California. These newly acquired franchises are being operated from our existing Fontana medium-duty dealership, which also sells Peterbilt and UD medium-duty trucks.



Most medium-duty trucks service an area within a radius of 50 miles or less, creating an opportunity for Rush to grow its parts and service business in the area in which the truck is purchased. Medium-duty trucks are typically serviced at night, allowing Rush better utilization of its service bays during the night shift, thereby aiding in the goal of increasing its absorption rate.

The success of this strategy is evident in the dramatically increased sales of Class 5–7 trucks; and the Company projects sales of 4,000 or more in 2006.

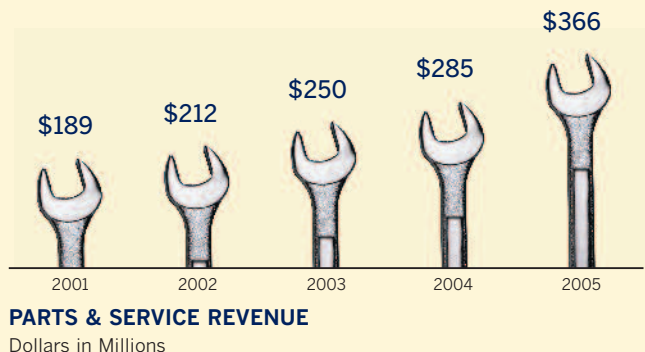
The Rush Equipment Center is an authorized John Deere construction equipment dealer that serves the Houston light- and medium-application construction equipment market. Rush operates the Rush Equipment Center on the same model as the Rush Truck Centers.

In 2005, the Rush Equipment Center reported sales of \$57.7 million, which included equipment sales and parts and service sales.

### Improving Quality of Earnings

A key measurement of Rush's operating efficiency at each Rush Truck Center is its absorption rate, calculated by dividing its gross profit from parts, service and body shop business by the fixed costs of all of a dealership's departments. A 100% absorption rate means that every dollar of gross profit on the sale of a truck, after sales commission and inventory carrying costs, goes to the bottom line.

Since the last large truck market of the late 1990s, we have increased our absorption rate from below 80% to just over 100%, a year earlier than projected. This improvement has greatly enhanced our "quality of earnings," which translates into widening EBIT margins.



Rush has targeted a rate of 110% by year end 2008. By continuing to increase our absorption rate, we will be positioned to soften the earnings impact that will result from fewer trucks being sold in 2007.

### The Power of the Rush Brand

The centerpiece of the Rush operating strategy is the one-stop center concept. At each location, customers may be able to do any of the following: purchase new or used trucks and related insurance products; finance, lease or rent trucks; purchase aftermarket parts and accessories; or have service performed. Rush's focus on providing value-added services, notably parts and service, helps to mitigate the effects of an inherently volatile truck sales market. By providing a number of services at locations throughout the southern United States, Rush inspires loyalty among its customers. This loyalty is evidenced by the fact that more than half of Rush's customers are repeat customers.

Rush employs a branding program for all its truck facilities, designating each as a "Rush Truck Center." Distinctive signage is utilized to promote name recognition and strong brand identity. Each Rush Truck Center has a centralized real-time system that is accessible by every other Rush Truck Center, allowing Rush to maintain the proper truck inventory levels and systemwide customer repair information.

A large number of Rush's new truck sales have traditionally been to fleet customers, which Rush defines as customers who purchase more than five trucks in any single 12-month period. To fleet customers, Rush's one-stop center concept and the size of Rush's dealer network are particularly attractive and provide Rush with a distinct competitive advantage.





Rush has re-located the Nashville dealership to a 120,000-square foot, state-of-the-art facility in Smyrna, making this the largest dealership in the Rush network.



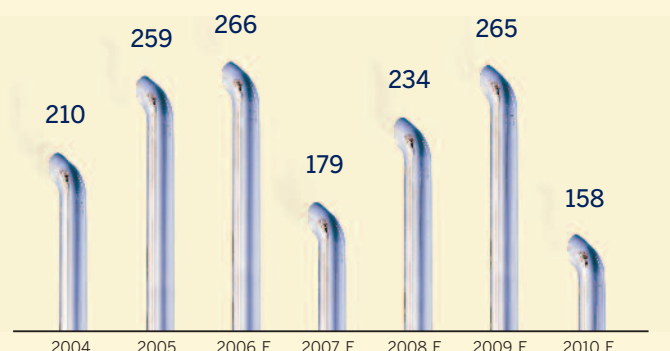




Rush inspires loyalty among its customers and they equate the truck in the sky with quality service and consistent pricing.



In addition to truck sales, Rush offers full-service truck leasing and rental, which provide a captive source for parts and service revenue because all of the trucks that Rush leases and rents must be serviced at a Rush Truck Center or a service center approved by Rush. Sales of parts and service carry substantially higher gross profit margins than truck sales and are less cyclical. Rush has more than 700 service and body shop bays throughout its network. Certain Rush Truck Centers service all makes of trucks and are designated warranty centers for Peterbilt trucks and other truck component manufacturers. Rush also offers third-party financing and insurance products at certain Rush Truck Centers.



#### U.S. CLASS 8 TRUCKS SALES

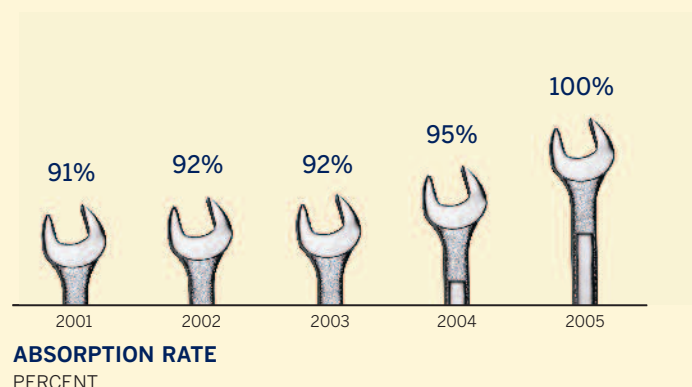
THOUSANDS of UNITS

E = A.C.T. Publications estimates

The truck dealership industry is highly fragmented, with many dealers owning just a single dealership. The industry is consolidating because of the demand for a broad network of service facilities, a trend toward outsourcing or maintenance by small- and medium-sized fleets and the increasing dominance of larger fleets. This consolidation trend will likely continue to accelerate, which will create additional opportunities for Rush to expand because of its competitive advantages and its breadth of offering to customers.

Moreover, the increasingly complex nature of trucks and components requires computerized controls and diagnostic systems, which necessitates a significant capital investment in equipment and training of personnel. Ever-evolving environmental standards also require sophisticated operating and testing equipment to ensure compliance.

Rush believes that more of its customers will lease or rent Class 8 trucks as fleets, particularly private fleets, and seek to establish



full-service leases or rental contracts, which provide for turnkey service including parts, maintenance, and potentially, fuel, fuel tax reporting and other services. Differentiation among truck dealers has become less dependent on pure price competition and is increasingly based on a dealer's ability to offer a wide variety of services to its clients. Rush's one-stop center concept and the size and geographic diversity of its dealer network provide it with a competitive advantage.

#### 2006 and Beyond

The truck market in 2006 should exceed 2005's near-record levels, but it is likely to be followed by a decrease in truck sales in the first half of 2007 because of the new emission standards that take effect on January 1, 2007. This will create greater demand in 2006 for trucks that will be grandfathered under the new regulations. Industry expectations are for the new engines to add \$6–\$8,000 to the cost of a truck and increase operating and maintenance costs as well.

By the second half of 2007, truck sales should rebound and be followed by strong markets in 2008 and 2009 due to the impending 2010 emission standards.

Looking ahead, expense management will remain a focus and contribute to widening operating income margins. Rush expects that all of its acquisitions will be accretive to earnings. The Company continues to strengthen its geographic footprint and add to its competitive strength through the "Geography of Performance" plan to enhance overall results, sell more heavy- and medium-duty trucks, leverage off its existing asset base and improve operating margins.

Now in its forty-first year of growth, Rush looks back at its history with pride and a strong sense of accomplishment. At the same time, the Company is optimistic about its future and is well prepared to meet the challenges to come.



## Financial Review

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## Selected Consolidated Financial and Operating Data

### Rush Enterprises, Inc. and Subsidiaries

The information below was derived from the audited consolidated financial statements included in this report and reports we have previously filed with the SEC. This information should be read together with those consolidated financial statements and the notes to those consolidated financial statements. These historical results are not necessarily indicative of the results to be expected in the future. The selected financial data presented below may not be comparable between periods in all material respects or indicative of the Company's future financial position or results of operations due primarily to acquisitions and discontinued operations which occurred during the periods presented. See Note 17 to the Company's Consolidated Financial Statements for a discussion of such acquisitions and Note 3 to the Company's Consolidated Financial Statements for a discussion of such discontinued operations. The selected financial data presented below should be read in conjunction with the Company's other financial information included elsewhere herein.

(in thousands, except per share amounts)

Year Ended December 31,	2005	2004	2003	2002	2001
<b>Summary of Income Statement Data</b>					
Revenues					
New and used truck sales	\$ 1,400,736	\$ 738,225	\$ 501,757	\$ 488,456	\$ 438,143
Parts and service	365,908	285,206	249,818	211,478	188,566
Construction equipment sales	41,692	32,305	28,263	24,324	31,666
Lease and rental	33,975	27,193	25,847	25,277	25,040
Finance and insurance	15,356	7,909	6,286	5,448	5,251
Other	7,103	4,141	3,361	2,164	2,847
Total revenues	1,864,770	1,094,979	815,332	757,147	691,513
Cost of products sold	1,582,078	909,837	662,082	615,942	562,316
Gross profit	282,692	185,142	153,250	141,205	129,197
Selling, general and administrative	188,667	141,947	124,207	111,721	101,832
Depreciation and amortization	10,487	9,119	8,929	8,594	9,176
Operating income from continuing operations	83,538	34,076	20,114	20,890	18,189
Interest expense, net	12,895	5,950	6,348	6,499	9,267
Gain on sale of assets	495	624	1,984	155	1,067
Income from continuing operations before income taxes	71,138	28,750	15,750	14,546	9,989
Provision for income taxes	26,513	11,574	6,300	5,818	3,996
Income from continuing operations	44,625	17,176	9,450	8,728	5,993
Income (loss) from discontinued operations, net	0	(260)	(621)	(10,472)	(2,731)
Net income	\$ 44,625	\$ 16,916	\$ 8,829	\$ (1,744)	\$ 3,262
<b>Earnings Per Share:</b>					
Earnings per Common Share – Basic					
Income from continuing operations	\$ 1.84	\$ 1.10	\$ 0.67	\$ 0.62	\$ 0.43
Net income (loss)	\$ 1.84	\$ 1.08	\$ 0.63	\$ (0.12)	\$ 0.23
Earnings per Common Share – Diluted					
Income from continuing operations	\$ 1.79	\$ 1.03	\$ 0.63	\$ 0.60	\$ 0.42
Net income (loss)	\$ 1.79	\$ 1.02	\$ 0.59	\$ (0.12)	\$ 0.23
Basic weighted average shares	24,202	15,684	14,042	14,004	14,004
Diluted weighted average shares and assumed conversions	24,957	16,607	15,024	14,461	14,166

Year Ended December 31,	2005	2004	2003	2002	2001
<b>Operating Data</b>					
Number of locations	48	39	38	41	44
Unit truck sales					
New trucks	12,918	7,140	4,535	4,717	4,245
Used trucks	3,677	2,716	2,421	2,111	1,907
Total unit trucks sales	16,595	9,856	6,956	6,828	6,152
Total finance contracts sold (in thousands)	\$ 451,807	\$ 259,898	\$ 165,137	\$ 144,134	\$ 149,906
Truck lease and rental units	1,798	1,427	1,397	1,363	1,403
(in thousands)					
Year Ended December 31,	2005	2004	2003	2002	2001
<b>Balance Sheet Data</b>					
Working capital	\$ 126,137	\$ 138,241	\$ 14,113	\$ 7,995	\$ 7,050
Inventories	338,212	189,792	137,423	115,333	84,155
Inventory included in assets held for sale	—	—	2,496	10,218	30,150
Fixed assets included in assets held for sale	—	—	6,328	6,744	13,821
Total assets	840,234	565,933	366,878	345,110	338,811
Floor plan financing	315,985	168,002	108,235	89,288	85,300
Line-of-credit borrowings	2,755	2,434	17,732	22,395	22,459
Long-term debt, including current portion	133,152	96,056	90,028	94,916	98,170
Capital lease obligations, including current portion	16,905	—	—	—	—
Shareholders' equity	273,620	222,807	88,706	79,695	81,439



# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Rush Enterprises, Inc. and Subsidiaries

### Acquisition of American Truck Source, Inc.

In January 2005, the Company acquired certain assets of ATS, including its Peterbilt truck dealerships in Texas and Tennessee, for a total purchase price of \$132.4 million. The acquisition provides the Company with rights to sell Peterbilt trucks and parts at new locations in Dallas, Fort Worth, Abilene and Tyler, Texas, and Nashville, Tennessee. The transaction was financed with cash of \$77.8 million, expansion of the Company's existing floor plan agreement for truck inventory of \$34.6 million, and the issuance of debt of approximately \$20.0 million to finance the purchase of real estate and certain vehicles used in ATS's leasing operations. Of the \$77.8 million paid in cash, \$21.9 million was for the purchase of a note receivable from the selling shareholders of ATS. This \$21.9 million was immediately repaid by the selling shareholders at closing, resulting in net cash used in the acquisition of \$55.9 million.

### General

The Company is a full-service, integrated retailer of premium transportation and construction equipment and related services. The Company's Rush Truck Centers sell heavy-duty trucks manufactured by Peterbilt Motors Company, a division of PACCAR, Inc. Certain Rush Truck Centers sell medium-duty trucks manufactured by Peterbilt, GMC, Hino, UD or Isuzu. The Company also operates a John Deere construction equipment dealership at its Rush Equipment Center in Houston, Texas. Through its strategically located network of Rush Truck Centers and its Rush Equipment Center, the Company provides one-stop service for the needs of its customers, including retail sales of new and used trucks and construction equipment, aftermarket parts sales, service and repair facilities, and financing, leasing and rental, and insurance services.

The Company's Rush Truck Centers are principally located in high-traffic areas throughout the southern United States. Since commencing operations as a Peterbilt heavy-duty truck dealer in 1966, the Company has grown to operate more than 40 Rush Truck Centers in Alabama, Arizona, California, Colorado, Florida, New Mexico, Oklahoma, Tennessee and Texas.

Our business strategy consists of providing our customers with competitively priced products supported with timely and reliable service through our integrated dealer network. We intend to continue to implement our business strategy, reinforce customer loyalty and remain a market leader by continuing to develop our Rush Truck Centers and Rush Equipment Center as we extend our geographic focus through strategic acquisitions of new locations and expansions of our existing facilities.

**Rush Truck Centers.** Since commencing operations as a Peterbilt heavy-duty truck dealer over 39 years ago, we have grown to operate 35 full-service Rush Truck Centers, two Rush Truck Centers that offer parts and service, and two Rush Truck Centers that only sell parts. Our Rush Truck Centers are located in Alabama, Arizona, California, Colorado, Florida, New Mexico, Oklahoma, Tennessee and Texas. Our full-service Rush Truck Centers sell new Peterbilt Class 8 trucks and provide parts and service, including body shop service at certain locations, to owners of Class 8 trucks. Our full-service Rush Truck Centers also sell Peterbilt medium-duty trucks and medium-duty trucks manufactured by GMC, Hino, UD, or Isuzu, depending upon the location of the Rush Truck Center, and provide parts and service, including body shop service at certain locations, to owners of medium-duty trucks. Our Rush Truck Centers are strategically located to serve customers traveling from California to Florida across the southern U.S. and to take advantage of ever increasing cross border traffic between the United States and Mexico resulting from implementation of NAFTA.

**Rush Equipment Center.** Our Rush Equipment Center in Houston, Texas, provides a full line of construction equipment, including John Deere backhoe loaders, hydraulic excavators, crawler dozers and four-wheel drive loaders.

**Leasing and Rental Services.** Through certain of our Rush Truck Centers and four stand-alone Rush Truck Leasing stores, we provide a broad line of product selections for lease or rent, including Class 6, Class 7 and Class 8 trucks, heavy-duty cranes and refuse haulers. Our lease and rental fleets are offered on a daily, monthly or long-term basis.

**Financial and Insurance Services.** Through our dealerships we offer third party financing to assist customers in purchasing new and used trucks and construction equipment. Additionally, we sell a complete line of property and casualty insurance, including collision and liability insurance on trucks, cargo insurance and credit life insurance.

**Perfection Equipment.** Our Perfection Equipment subsidiary operates out of two locations in Oklahoma City. Perfection Equipment offers installation of equipment, equipment repair, parts installation, and paint and body repair. Perfection carries over 120 lines of truck and industrial parts and over 100 lines of equipment. Perfection Equipment specializes in up-fitting trucks used by oilfield service providers and other specialized service providers.

**World Wide Tires.** We operate World Wide Tires stores in three locations. World Wide Tires primarily sells tires for use on Class 8 trucks.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Rush Enterprises, Inc. and Subsidiaries

#### Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based on the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these consolidated financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates. The Company believes the following accounting policies, which are also described in Note 2 of Notes to Consolidated Financial Statements, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

**Inventories.** Inventories are stated at the lower of cost or market value. Cost is determined by specific identification for new and used truck and construction equipment inventory and by the first-in, first-out method for tires, parts and accessories. An allowance is provided when it is anticipated that cost will exceed net realizable value.

**Other Assets.** Other assets consist primarily of goodwill related to acquisitions and other intangible assets. As stated in Note 2 of Notes to Consolidated Financial Statements, Financial Accounting Standards Board Statement No. 142 ("SFAS 142") provides that goodwill and other intangible assets that have indefinite useful lives will not be amortized, but instead must be tested at least annually for impairment, and intangible assets that have finite useful lives should continue to be amortized over their useful lives. SFAS 142 also provides specific guidance for testing goodwill and other nonamortized intangible assets for impairment. SFAS 142 requires management to make certain estimates and assumptions in order to allocate goodwill to reporting units and to determine the fair value of a reporting unit's net assets and liabilities, including, among other things, an assessment of market condition, projected cash flows, interest rates and growth rates, which could significantly impact the reported value of goodwill and other intangible assets. SFAS 142 requires, in lieu of amortization, an annual impairment review of goodwill. The Company did not record an impairment charge related to the goodwill for its continuing operations as a result of its December 31, 2005 impairment review.

**Revenue Recognition Policies.** Income on the sale of a vehicle or a piece of construction equipment is recognized when the customer executes a purchase contract with us, the unit has been delivered to the customer and there are no significant uncertain-

ties related to financing or collectibility. Lease and rental income is recognized over the period of the related lease or rental agreement. Parts and service revenue is earned at the time the Company sells the parts to its customers or at the time the Company completes the service work order related to service provided to the customer's unit. Payments received on prepaid maintenance plans are deferred as a component of accrued expenses and recognized as income when the maintenance is performed.

**Finance and Insurance Revenue Recognition.** Finance income related to the sale of a unit is recognized when the finance contract is sold to a finance company. During 2003, 2004 and 2005, finance contracts were not retained by the Company for any significant length of time because finance contracts are generally sold to finance companies concurrent with the sale of the related unit. The majority of finance contracts are sold without recourse against the Company. A majority of the Company's liability related to finance contracts sold with recourse is generally limited to 5% to 20% of the outstanding amount of each note initiated on behalf of the finance company. However, in 2003 the Company instituted a finance program that accepts 100% liability, with some restrictions, for the outstanding amount of each note initiated on behalf of the finance company. In order for a contract to be accepted into this finance program, a customer must meet strict credit requirements or maintain a significant equity position in the truck being financed; consequently, approximately 1% of the Company's portfolio balance related to finance contracts sold by the Company are under this 100% liability finance program and the Company does not expect to finance a significant percentage of its truck sales under this 100% liability finance program in the future. The Company provides for an allowance for repossession losses and early repayment penalties that it may be liable for under finance contracts sold without recourse.

As part of the acquisition of certain assets of ATS, the Company assumed contingent liabilities to finance companies for notes that ATS initiated on behalf of such finance companies related to the sale of trucks. ATS's portfolio to which the contingent liability relates is made up of contracts sold with and without recourse, and the Company expects a majority of the portfolio to be liquidated by January 1, 2008. The Company has provided a specific allowance for repossession losses and early repayment penalties related to ATS's portfolio.

The Company arranges financing for customers through various financial institutions and receives a commission from the lender equal to either the difference between the interest rates charged to customers over the predetermined interest rates set

by the financing institution or a commission for the placement of contracts. The Company also receives commissions from the sale of various insurance products and extended service contracts to customers. Revenue is recognized by the Company upon the sale of such finance and insurance contracts to the finance and insurance companies net of a provision for estimated repossession losses and interest charge backs. The Company is not the obligor under any of these contracts. In the case of finance contracts, a customer may prepay, or fail to pay, thereby terminating the contract. If the customer terminates a retail finance contract or insurance contract prior to scheduled maturity, a portion of the commissions previously paid to the Company may be charged back to the Company depending on the terms of the relevant contracts. The estimate of ultimate charge back exposure is based on the Company's historical charge back expense arising from similar contracts, including the impact of refinance and default rates on retail finance contracts and cancellation rates on insurance contracts. The actual amount of historical charge backs has not been significantly different from the Company's estimates.

**Insurance Accruals.** The Company is partially self-insured for medical, workers compensation, and property and casualty insurance and calculates a reserve for those claims that have been incurred but not reported and for the remaining portion of those claims that have been reported. The Company uses information provided by third-party administrators to determine the reasonableness of the calculations they perform.

**Accounting for Income Taxes.** Significant management judgment is required to determine the provisions for income taxes and to determine whether deferred income taxes will be realized in full or in part. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. When it is more likely than not that all or some portion of specific deferred income tax assets will not be realized, a valuation allowance must be established for the amount of deferred income tax assets that are determined not to be realizable. The Company recorded a valuation allowance related to deferred income taxes in certain states. Accordingly, the facts and financial circumstances impacting the state deferred income tax assets are reviewed quarterly and management's judgment is applied to determine the amount of valuation allowance required in any given period.

Additionally, despite the Company's belief that its tax return positions are consistent with applicable tax law, management believes that certain positions may be challenged by taxing

authorities. Settlement of any challenge can result in no change, a complete disallowance, or some partial adjustment reached through negotiations. Significant judgment is required in evaluating the Company's tax contingencies. The Company's tax contingencies are adjusted in light of changing facts and circumstances. The Company's income tax expense includes the impact of reserve provisions and changes to reserves that it considers appropriate, as well as related interest. Unfavorable settlement of any particular issue would require use of the Company's cash. Favorable resolution would be recognized as a reduction to income tax expense at the time of resolution.

#### Key Performance Indicator

**Absorption Rate.** The management of the Company uses several performance metrics to evaluate the performance of its dealerships. The Company considers its "absorption rate" to be of critical importance. Absorption rate is calculated by dividing the gross profit from the parts, service and body shop departments by the overhead expenses of all of a dealership's departments, except for the selling expenses of the new and used truck departments and carrying costs of new and used truck inventory. When 100% absorption is achieved, then gross profit from the sale of a truck, after sales commissions and inventory carrying costs, directly impacts operating profit. In 1999, the Company's absorption rate was approximately 80%. The Company has made a concerted effort to increase its absorption rate since then. Management believes that maintaining an absorption rate in excess of 100% is critical to the Company's ability to generate consistent earnings in a cyclical business. The Company achieved a 100.4% absorption rate in 2005.



# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Rush Enterprises, Inc. and Subsidiaries

### Results of Operations

The following discussion and analysis includes the Company's historical results of operations for 2003, 2004 and 2005. The following table sets forth for the years indicated certain financial data as a percentage of total revenues:

Year Ended December 31,	2005	2004	2003
New and used truck sales	75.1%	67.4%	61.5%
Parts and service	19.6	26.0	30.6
Construction equipment sales	2.3	3.0	3.5
Lease and rental	1.8	2.5	3.2
Finance and insurance	0.8	0.7	0.8
Other	0.4	0.4	0.4
Total revenues	100.0	100.0	100.0
Cost of products sold	84.8	83.1	81.2
Gross profit	15.2	16.9	18.8
Selling, general and administrative	10.1	13.0	15.2
Depreciation and amortization	0.6	0.8	1.1
Operating income from continuing operations	4.5	3.1	2.5
Interest expense, net	0.7	0.6	0.8
Gain on sale of assets	0.0	0.1	0.2
Income before income taxes from continuing operations	3.8	2.6	1.9
Income taxes	1.4	1.1	0.8
Income from continuing operations	2.4	1.5	1.1
(Loss) from discontinued operations, net of taxes	0.0	0.0	(0.1)
Net income	2.4%	1.5%	1.0%

### Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

**Revenues** Revenues increased \$769.8 million, or 70.3%, from \$1,095.0 million in 2004 to \$1,864.8 million in 2005. Sales of new and used trucks increased \$662.5 million, or 89.7%, from \$738.2 million in 2004 to \$1,400.7 million in 2005.

Unit sales of new Class 8 trucks increased 88.1%, from 5,374 units in 2004 to 10,111 units in 2005 due to increasing demand and the ATS acquisition. The increase in Class 8 unit sales is being driven by the industry's need to replace aging equipment after U.S. truck sales lagged behind the normal replacement cycle during 2001, 2002, and 2003. The Company's average sales price per Class 8 truck increased from \$101,200 in 2004 to \$106,300 in 2005. This price increase is primarily attributable to an increase in the manufacturing costs. Based on estimates from A.C.T. Research, the Company believes that the sales of Class 8 trucks in the United States will increase from approximately 259,000 units in 2005 to approximately 266,000 units in 2006. In 2005, the Company retained a 3.9% share of the U.S. Class 8

truck sales market. Based on internal expansion and communication with our customers, the Company expects to increase this share to approximately 4.1% in 2006, which would result in sale of approximately 11,000 Class 8 trucks based on retail sales of 266,000 units as estimated by A.C.T. Research. Industry expectations are for Class 8 truck sales to decline in 2007 primarily due to new diesel emissions laws, which are expected to increase the cost and reduce the fuel efficiency of diesel engines built on or after January 1, 2007. Some industry experts believe that the drop-off of truck sales in 2007 will begin to recover in the second half of 2007. A.C.T. Research currently estimates U.S. Class 8 retail sales to total approximately 179,000 units in 2007.

Unit sales of new medium-duty trucks increased 58.9%, from 1,766 units in 2004 to 2,807 units in 2005. In 2004, the Company continued its concerted effort to improve its medium-duty truck sales by adding experienced medium-duty sales personnel and introducing new medium-duty franchises at some of our Rush Truck Centers to complement the existing medium-duty lines sold at such dealerships. During the last half of 2005, the Company made acquisitions of medium-duty truck franchises in

Dallas and Texarkana, Texas, Orlando, Florida and Fontana, California. Overall, new medium-duty truck sales revenue increased \$64.5 million in 2005 compared to 2004. In 2006, the Company expects to continue to add medium-duty franchises to certain dealerships and to increase medium-duty sales and market share compared to 2005. The Company expects to sell approximately 4,000 medium-duty trucks in 2006. A.C.T. Research currently expects demand for class 5, 6, and 7 medium-duty trucks to remain flat in 2006 and decrease approximately 7.5% in 2007.

Unit sales of used trucks increased 35.4%, from 2,716 units in 2004 to 3,677 units in 2005. Used truck average revenue per unit increased by 22.3%. Historically, used truck demand is consistent with new truck demand. The Company expects used truck demand to remain high; however, our ability to sell used trucks is ultimately dependent upon our ability to acquire used trucks for resale.

Parts and service sales increased \$80.7 million, or 28.3%, from \$285.2 million in 2004 to \$365.9 million in 2005. The parts and service sales increase in 2005 was due to business development activities combined with price increases for parts and labor and acquisitions throughout the year. The Company expects parts and service revenue to increase by approximately 12.0% in 2006.

Sales of new and used construction equipment increased \$9.4 million, or 29.1%, from \$32.3 million in 2004 to \$41.7 million in 2005. Currently, the construction equipment sales increase is primarily attributable to the improved market conditions in Houston, Texas and the need to replace aging equipment. Approximately 2,700 units of construction equipment were put into use in our area of responsibility in 2005, and the construction equipment industry expects to sell approximately 2,840 units of new construction equipment in the Houston area in 2006. John Deere's market share in the Houston area construction equipment market increased from 16.3% in 2004 to 19.9% in 2005. The Company believes it can increase John Deere's market share, in the Houston area, to approximately 25% in 2006. Because the Company operates only one construction equipment location, new and used construction equipment revenue can fluctuate significantly from quarter to quarter depending on the mix of product sold and the timing of deliveries.

Lease and rental revenues increased 25.0%, from \$27.2 million in 2004 to \$34.0 million in 2005. The increase in truck lease and rental revenue was due to the increase in our customer base during 2005. The Company expects lease and rental revenue to increase approximately 17.0% during 2006 compared to 2005 in part due to the acquisition of units in the lease and rental fleet

during the fourth quarter of 2005.

Finance and insurance revenues increased 94.9%, from \$7.9 million in 2004 to \$15.4 million in 2005. Finance and insurance revenues typically increase as sales of new and used trucks increase. Finance and insurance revenues have minimal direct costs and, therefore, contribute a disproportionate share of operating profits.

Other income increased \$3.0 million, or 73.2%, from \$4.1 million in 2004 to \$7.1 million in 2005. The increase in other income revenue is primarily related to the gain on sale realized on trucks from the lease and rental fleet and commissions earned from John Deere for direct manufacturer sales into our area of responsibility. Other income also consists of document fees related to truck sales and purchase discounts.

**Gross Profit** Gross profit increased \$97.6 million, or 52.7%, from \$185.1 million in 2004 to \$282.7 million in 2005. Gross profit as a percentage of sales decreased from 16.9% in 2004 to 15.2% in 2005. This decrease is primarily a result of a change in our product mix. Truck sales, a lower margin revenue item, increased as a percentage of total revenue from 67.4% in 2004 to 75.1% in 2005. Parts and service revenue, a higher margin revenue item, decreased as a percentage of total revenue from 26.0% in 2004 to 19.6% in 2005.

Gross margins on Class 8 truck sales decreased from 7.0% in 2004 to 6.7% in 2005. This decrease in gross margin is primarily a result of an increase in truck sales to large fleet customers in 2005 compared to 2004. Large fleet sales typically result in lower margins than small fleet sales and sales to owner operators. Manufacturers' incentives for Class 8 trucks accounted for 27.0% of the gross margin in 2004 and 23.7% in 2005. Historically, manufacturers' incentives have varied depending on market conditions and demand for Class 8 trucks. The Company expects 2006 margins to approximate those achieved in 2005. Each year the Company evaluates its reserve for new truck valuation losses. The Company did not record a loss provision in 2004 or 2005.

Gross margins on medium-duty truck sales remained constant at 6.2% in 2004 and 2005. Manufacturers' incentives for medium duty trucks accounted for 3.8% of the gross margin in 2004 and 2005. We expect sales of lower margin Class 4 through 6 models to continue to grow as a percentage of the total medium-duty sales mix which will slightly decrease margins.

Gross margins on used truck sales decreased from 9.8% in 2004 to 9.2% in 2005. Margins on used trucks will vary depending on the mix of used trucks that are acquired from either

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### **Rush Enterprises, Inc. and Subsidiaries**

owner-operators or fleet owners at trade-in. Used trucks acquired as trade-ins from fleet owners normally result in lower margins when the truck is sold. The current challenge for the used truck business is procuring a sufficient quantity of quality used trucks for resale at an acceptable price, in a market where demand is exceeding supply. Each year the Company evaluates its reserve for used truck valuation losses. The Company recorded a \$150,000 loss provision to the Company's reserve for used truck valuation in 2005 and recognized a \$350,000 loss provision during 2004. In 2006, the Company expects to maintain the margins achieved in 2005.

Gross margins from the Company's parts, service and body shop operations increased from 37.9% in 2004 to 41.1% in 2005. Gross profit dollars for the parts, service and body shop departments increased from \$108.0 million in 2004 to \$150.5 million in 2005. The Company expects 2006 gross margins on parts, service and body shop revenue to approximate those achieved in 2005.

Gross margins on new and used construction equipment sales decreased from 13.0% in 2004 to 12.4% in 2005. The decrease was attributable to a change in the mix of products sold during 2005. The Company expects 2006 gross margins on new and used construction equipment sales to be consistent with those achieved in 2005 and overall gross profit growth on new and used construction equipment sales to be directly correlated to sales growth.

Gross profit generated from lease and rental sales decreased from 27.4% in 2004 to 23.9% in 2005. The decrease in gross margin from lease and rental sales is primarily due to the increase in interest rates and the increase in the cost of new trucks for use in the lease and rental fleet. The Company expects to maintain gross margins from lease and rental sales of approximately 22.0% to 24.0% for 2006. The Company's policy is to depreciate its lease and rental fleet using the shortest depreciable life established by generally accepted accounting principles. This policy results in the Company realizing small gross margins while the unit is in service and a corresponding larger gain on sale when the unit is sold at the end of the lease term.

The increase in finance and insurance revenues and other income, as described above, has minimal direct cost and, therefore, contributes a disproportionate share of gross profit. The Company expects gross profit from finance and insurance sales and other income in 2006 to be directly related to truck revenue.

**Selling, General and Administrative Expenses** Selling, General and Administrative ("SG&A") expenses increased \$46.8 million,

or 33.0%, from \$141.9 million in 2004 to \$188.7 million in 2005. The increase in SG&A is attributable in part to increased commissions resulting from increased truck sales and the current year acquisitions. SG&A expenses as a percentage of sales decreased from 13.0% in 2004 to 10.1% in 2005. SG&A expenses as a percentage of sales have historically ranged from 10.0% to 16.0%. The Company expects SG&A expenses as a percentage of sales to remain low while the demand for trucks remains high. The Company estimates that the implementation of Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)") will increase our SG&A expenses by approximately \$2.1 million in 2006. The Company's management continually monitors SG&A expenses.

**Interest Expense, Net** Net interest expense increased \$6.9 million, or 115.0%, from \$6.0 million in 2004 to \$12.9 million in 2005. Net interest expense increased as a result of increased floor plan interest rates, increased truck inventory and floor plan debt due to increased demand for trucks and the increased levels of indebtedness associated with the real estate acquired from ATS and other real estate financings. Based on increased truck inventory and floor plan debt, the Company expects net interest expense to increase to approximately \$17.5 million in 2006.

**Income From Continuing Operations Before Income Taxes** Income from continuing operations before income taxes increased by \$42.3 million, or 146.9%, from \$28.8 million in 2004 to \$71.1 million in 2005, as a result of the factors described above. Industry experts predict an increase in Class 8 truck sales for 2006. The Company believes that income from continuing operations in 2006 will increase compared to 2005 based on the expectations discussed above.

**Income Taxes From Continuing Operations** Income taxes from continuing operations increased \$14.9 million, or 128.4%, from \$11.6 million in 2004 to \$26.5 million in 2005. The Company has provided for taxes at a 37.27% effective rate in 2005 and expects the effective tax rate to be approximately 37.25% in 2006.



## Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

**Revenues** Revenues increased \$279.6 million, or 34.3%, from \$815.3 million in 2003 to \$1.1 billion in 2004. Sales of new and used trucks increased \$236.4 million, or 47.1%, from \$501.8 million in 2003 to \$738.2 million in 2004.

Unit sales of new Class 8 trucks increased 47.8%, from 3,636 units in 2003 to 5,374 units in 2004. The increase in Class 8 units sales was driven by the industry's need to replace aging equipment after three consecutive years of U.S. truck sales lagging behind the normal replacement cycle. The Company's average sales price per Class 8 truck remained relatively flat from 2003 to 2004 at \$101,200.

Unit sales of new medium-duty trucks increased 96.4%, from 899 units in 2003 to 1,766 units in 2004. In 2004, the Company continued its concerted effort to improve its medium-duty truck sales by adding experienced medium-duty sales personnel, and introducing new Class 4 through 6 medium-duty franchises at some of our Rush Truck Centers to complement the previously existing Peterbilt medium-duty line, which consists primarily of Class 7 trucks. Class 4 through 6 unit truck sales accounted for 55% of the Company's medium-duty unit sales in 2004 compared to 44% in 2003. The average sales price for Class 4 through 6 models during 2004 was \$40,500 compared to \$68,200 for the Class 7 Peterbilt medium-duty model. The increase in the percentage of Class 4 through 6 trucks sold by the Company in 2004 resulted in a 2.6% decrease in our average medium-duty truck sales price in 2004 compared to 2003. Overall, new medium-duty truck sales revenue increased \$44.6 million in 2004 compared to 2003.

Unit sales of used trucks increased 12.2%, from 2,421 units in 2003 to 2,716 units in 2004. Used truck average revenue per unit increased by 7.0%. Historically, used truck demand is consistent with new truck demand.

Parts and service sales increased \$35.4 million, or 14.2%, from \$249.8 million in 2003 to \$285.2 million in 2004. Same store parts and service sales increased \$37.9 million, or 15.5%, in 2004 compared to 2003. The increase in parts and service sales was due to a combination of new business development, price increases for parts and labor, extension of our business hours and expansion of capacity made possible by the addition of service bays and technicians to certain locations.

Sales of new and used construction equipment increased \$4.0 million, or 14.1%, from \$28.3 million in 2003 to \$32.3 million in

2004. This increase was primarily due to a change in product mix and price increases. According to John Deere, the Company's market share in the Houston area construction equipment market was 16.7% in 2004 compared to 19.1% in 2003. In 2004, we focused on increasing our margins, which had an adverse effect on our market share. According to data compiled by John Deere, approximately 2,200 units of construction equipment were put into use in our area of responsibility in 2004 compared to 1,678 in 2003.

Lease and rental revenues increased 5.4%, from \$25.8 million in 2003 to \$27.2 million in 2004. The increase in truck lease and rental revenue was due to the increase in our customer base during 2004.

Finance and insurance revenues increased 25.4%, from \$6.3 million in 2003 to \$7.9 million in 2004. This increase was directly related to the increase in new and used truck revenue.

Other income increased \$0.8 million, or 23.5%, from \$3.4 million in 2003 to \$4.2 million in 2004. Other income revenue was primarily related to the gain on sale realized on trucks from the lease and rental fleet, commissions earned from John Deere for direct manufacturer sales into our area of responsibility, document fees related to truck sales and purchase discounts. The increase in other income during 2004 was primarily related to gains realized from the sales of trucks that were previously used in the Company's leasing operations.

**Gross Profit** Gross profit increased \$31.8 million, or 20.7%, from \$153.3 million in 2003 to \$185.1 million in 2004. Gross profit as a percentage of sales decreased from 18.8% in 2003 to 16.9% in 2004. This decrease was primarily a result of a change in our product mix. Truck sales, a lower margin revenue item, increased as a percentage of total revenue from 61.5% in 2003 to 67.4% in 2004. Parts and service revenue, a higher margin revenue item, decreased as a percentage of total revenue from 30.6% in 2003 to 26.0% in 2004.

Gross margins on Class 8 truck sales decreased from 7.4% in 2003 to 7.0% in 2004. Manufacturers' incentives for Class 8 trucks accounted for 35.8% of the gross margin in 2003 and 27.0% in 2004. The Company recorded a \$0.3 million loss provision to increase the Company's reserve for new truck inventory valuation in 2003 and did not record a loss provision in 2004.

Gross margins on medium-duty truck sales increased from 5.8% in 2003 to 6.2% in 2004. Manufacturers' incentives for medium duty trucks accounted for 3.9% of the gross margin in 2003 and 3.8% in 2004.

Gross margins on used truck sales increased from 6.2% in

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Rush Enterprises, Inc. and Subsidiaries

2003 to 9.8% in 2004. During 2003, the Company experienced lower than normal margins on used trucks sales because the Company was required to wholesale a large number of trade-in units from new fleet customers. The Company did not purchase as many used trucks from first time new truck fleet customers in 2004, which resulted in increased gross margins on used truck sales compared to 2003. The Company recorded a \$350,000 loss provision to the Company's reserve for used truck valuation losses in 2004 compared to a \$1.0 million loss provision recognized during 2003.

Gross margins from the Company's parts, service and body shop operations decreased from 39.4% in 2003 to 37.9% in 2004. The decrease in gross margins was primarily due to parts sales becoming a larger percentage of the Company's overall parts and service revenues. Historically, gross margins on parts sales are approximately 60% lower than gross margins on service sales. Additionally, the Company increased preventative maintenance services that are provided at lower margins than traditional repair work, and selectively provided discounted labor rates to garner additional sales at certain locations. Gross profit dollars for the parts, service and body shop departments increased from \$98.5 million in 2003 to \$108.0 million in 2004.

Gross margins on new and used construction equipment sales increased from 9.9% in 2003 to 13.0% in 2004. The increase was attributable to price increases and a change in the types of products sold during 2004.

Gross profit generated from lease and rental sales increased from 25.9% in 2003 to 27.4% in 2004.

**Selling, General and Administrative Expenses** Selling, General and Administrative ("SG&A") expenses increased \$17.7 million, or 14.3%, from \$124.2 million in 2003 to \$141.9 million in 2004. Same store SG&A expenses increased \$18.8 million, or 15.1%, from 2003 to 2004. This increase was primarily due to increased salary expense and increased commissions corresponding to the increase in gross profit. SG&A expenses as a percentage of sales decreased from 15.2% in 2003 to 13.0% in 2004.

**Interest Expense, Net** Net interest expense decreased \$0.3 million, or 4.7%, from \$6.3 million in 2003 to \$6.0 million in 2004. Net interest expense decreased primarily as the result of the increase in interest income earned on the net proceeds of our public offering of Class A Common Stock, which closed in November 2004.

**Gain on Sale of Assets** Gain on sale of assets decreased \$1.4 million, from \$2.0 million in 2003 to \$0.6 million in 2004. The gain in 2004 was primarily related to the replacement of fixed assets used in the operation of the business. The gain recognized in 2003 was primarily related to the sale of the assets of Rush Truck Centers of Louisiana, Inc.

**Income From Continuing Operations Before Income Taxes** Income from continuing operations before income taxes increased by \$13.0 million, or 82.3%, from \$15.8 million in 2003 to \$28.8 million in 2004, as a result of the factors described above.

**Income Taxes From Continuing Operations** Income taxes from continuing operations increased \$5.3 million, or 84.1%, from \$6.3 million in 2003 to \$11.6 million in 2004.

**Loss From Discontinued Operations, Net of Income Taxes** Loss from discontinued operations, net of income taxes, decreased from a loss of \$0.6 million in 2003 to a loss of \$0.3 million in 2004. The loss recorded during 2003 represented the net operating results of D&D and included costs of \$983,000 related to the liquidation of the Hockley, Texas store. The loss recorded during 2004 included net operating profit of D&D of \$0.3 million, a net charge of \$0.2 million related to the valuation of the Hockley, Texas real estate and a \$0.4 million income tax adjustment. The Company sold all assets related to its discontinued operations during 2004.

**Liquidity and Capital Resources** The Company's short-term cash needs are primarily for working capital, including inventory requirements, expansion of existing facilities and acquisitions of new facilities. These short-term cash needs have historically been financed with retention of profits and borrowings under credit facilities available to the Company.

At December 31, 2005, the Company had working capital of approximately \$126.1 million, including \$133.1 million in cash, \$63.5 million in accounts receivable, \$338.2 million in inventories, \$1.8 million in prepaid expenses and other, and \$3.9 million in deferred tax assets, offset by \$316.0 million outstanding under floor plan notes payable, \$18.8 million in current maturities of long-term debt, \$2.3 million in current maturities of capital lease obligations, \$2.8 million in advances outstanding under lines of credit, \$23.3 million of trade accounts payable and \$51.2 million in accrued expenses. The Company may request working capital advances in the minimum amount of \$100,000 from GE Capital, its primary truck lender. However, such working capital advances

may not cause the total indebtedness owed GE Capital to exceed an amount equal to the wholesale advances made against the then current inventory less any payment reductions then due. There were no working capital advances outstanding under this agreement at December 31, 2005. The Company has three separate secured lines of credit that provide for an aggregate maximum borrowing of \$16.7 million. Advances outstanding under these secured lines of credit in aggregate were \$2.8 million, with an additional \$5.4 million pledged to secure various letters of credit related to self-insurance products, leaving \$8.5 million available for future borrowings as of December 31, 2005.

The Company has no material commitments for capital expenditures as of December 31, 2005. However, the Company will continue to purchase vehicles that are necessary to operate its lease and rental division. Furthermore, management will continue to authorize capital expenditures for new buildings and expansion of dealership facilities based on market opportunities.

During 2005, operating activities resulted in net cash used in operations of \$52.2 million. Cash provided by operations was primarily due to income from continuing operations of \$44.6 million coupled with provisions for depreciation and amortization of \$21.0 million, an increase in provisions for deferred income tax of \$1.3 million, an increase of \$3.1 million in the tax benefit realized from exercise of employee stock options and an increase of accounts payable and accrued expenses of \$14.9 million, which was offset by increases in inventories of \$102.3 million, an increase in accounts receivable and other current assets of \$33.1 million and a gain on sale of property plant and equipment of \$1.7 million.

During 2005, the Company used \$123.5 million in investing activities. This consisted of purchases of property and equipment of \$65.8 million and business acquisitions of \$66.0 million which were offset by proceeds from the sale of property and equipment of \$8.5 million. Property and equipment purchases are primarily related to the purchase of additional units for the rental and leasing operations for \$46.2 million during 2005. The Company expects to purchase more trucks for its leasing operations in 2006 based on expected increases in customer demand. The Company expects to make capital expenditures for recurring items such as computers, shop equipment and vehicles of approximately \$8.0 million in 2006.

Net cash provided by financing activities in 2005 amounted to \$150.6 million. Net cash provided by financing activities primarily consisted of an increase in notes payable of \$52.1 million, an increase in capital lease obligations of \$18.4 million, issuance of shares related to the exercise of employee stock options and purchases under the employee stock purchase plan of \$3.2 million

and net draws of floor plan notes payable of \$113.3 million, offset by principal payments on notes payable and lines of credit of \$36.5 million. The proceeds from notes payable are primarily related to the increase in the lease and rental fleet, real estate financing and debt acquired as part of the ATS acquisition.

During 2004, operating activities resulted in net cash used in operations of \$5.6 million. Cash provided by operations was primarily due to income from continuing operations of \$17.2 million coupled with provisions for depreciation and amortization of \$15.9 million, an increase in provisions for deferred income tax of \$4.1 million, an increase of \$3.4 million in the tax benefit realized from exercise of employee stock options and an increase of accounts payable and accrued expenses of \$11.2 million, which was offset by increases in inventories of \$49.7 million, an increase in accounts receivable of \$5.8 million and a gain on sale of property plant and equipment of \$1.8 million.

During 2004, the Company used \$34.8 million in investing activities. This consisted of purchases of property and equipment of \$44.6 million, business acquisitions of \$3.5 million and an increase in other assets of \$0.9 million, which were offset by proceeds from the sale of property and equipment of \$14.1 million. Property and equipment purchases are partially related to the purchase of 201 additional units for the leasing operations for \$18.5 million during 2004. Approximately \$7.1 million of property and equipment expenditures was for the replacement of capital equipment and \$7.1 million was for the replacement of the corporate aircraft. Additionally, the Company acquired building, land and leasehold improvements of \$11.9 million.

Net cash provided by financing activities in 2004 amounted to \$164.3 million. Net cash provided by financing activities primarily consisted of proceeds from the issuance of shares in the November 2004 public offering and exercises of employee stock options totaling \$113.8 million, an increase in notes payable of \$40.5 million and net draws of floor plan notes payable of \$59.8 million, offset by principal payments on notes payable of \$34.4 million and net payments on lines of credit of \$15.3 million. The proceeds from notes payable are primarily related to the increase in the lease and rental fleet and real estate financing. \$76.9 million of the proceeds from the stock offering were used in January 2005 to purchase certain assets of ATS.

The Company arranges financing for customers through various financial institutions including GE Capital and PACCAR Financial. The Company financed approximately \$425.8 million of new and used truck sales in 2005. The Company receives a commission from the lender equal to either the difference between the interest rates charged to customers over the predetermined



## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Rush Enterprises, Inc. and Subsidiaries

interest rates set by the financing institution or a commission for the placement of contracts. A majority of finance contracts are sold without recourse to the Company. A majority of the Company's liability related to finance contracts sold with recourse is generally limited to 5% to 20% of the outstanding amount of each note initiated on behalf of the finance company. However, in 2003 the Company instituted a finance program that accepts 100% liability, with some restrictions, for the outstanding amount of each note initiated on behalf of the finance company. In order for a contract to be accepted into this finance program, a customer must meet strict credit requirements or maintain a significant equity position in the truck being financed; consequently, approximately 1% of the Company's portfolio balance related to finance contracts sold by the Company are under this 100% liability finance program and the Company does not expect to finance a significant percentage of its truck sales under this 100% liability finance program in the future. The Company provides an allowance for repossession losses and early repayment penalties that it may be liable for under finance contracts sold without recourse.

In addition, through The CIT Group, Inc., CitiCapital, John Deere Credit and others, the Company arranged customer financing for approximately \$26.0 million of our new and used construction equipment sales in 2005. Generally, construction equipment financings are memorialized through the use of installment or lease contracts, which are secured by the construction equipment financed, and generally require a down payment up to 10% of the value of the financed piece of construction equipment, with the remaining balance being financed over a three- to five-year period. The Company experiences no repossession loss on construction equipment financings because such financings are sold to third parties without recourse.

Substantially all of the Company's truck purchases are made on terms requiring payment within 15 days or less from the date the trucks are invoiced from the factory. On September 20, 2005, the Company entered into a three-year floor plan financing agreement with GE Capital. Interest under the floor plan financing agreement is payable monthly at a rate equal to LIBOR plus 1.68%. The Company finances substantially all of the purchase price of its new truck inventory, and the loan value of its used truck inventory under the floor plan financing agreement with GE Capital, under which GE Capital pays the manufacturer directly with respect to new trucks. The Company makes monthly interest payments to GE Capital on the amount financed, but is not required to commence loan principal repayments on any vehicle until such vehicle has been floor planned for 12 months or is sold.

The agreement allows for prepayments and working capital advances with monthly adjustments to the interest due on outstanding advances. On December 31, 2005, the Company had approximately \$302.8 million outstanding under its floor plan financing agreement with GE Capital.

Substantially all of the Company's new construction equipment purchases are financed by John Deere and CitiCapital. The Company finances substantially all of the purchase price of its new construction equipment inventory under its floor plan facilities. The agreement with John Deere provides an interest-free financing period after which time the amount financed is required to be paid in full. When construction equipment is sold prior to the expiration of the interest free finance period, the Company is required to repay the principal within approximately ten days of the sale. If the construction equipment financed by John Deere is not sold within the interest free finance period, it is transferred to the CitiCapital floor plan arrangement. The Company makes principal payments for sold inventory to CitiCapital on the 15th day of each month. Used and rental construction equipment is financed to a maximum of book value under a floor plan arrangement with CitiCapital. The Company makes monthly interest payments on the amount financed and is required to commence loan principal repayments on rental construction equipment as book value reduces. Principal payments for sold used construction equipment are made no later than the 15th day of each month following the sale. The loans are collateralized by a lien on the construction equipment. The Company's floor plan agreements limit the aggregate amount of borrowings based on the book value of new and used construction equipment units. As of December 31, 2005, the Company's floor plan arrangement with CitiCapital permits the financing of up to \$10.5 million in construction equipment. On December 31, 2005, the Company had \$3.1 million outstanding under its floor plan financing arrangements with John Deere and \$10.1 million outstanding under its floor plan financing arrangement with CitiCapital.

**Cyclicality** The Company's business is dependent on a number of factors relating to general economic conditions, including fuel prices, interest rate fluctuations, economic recessions, environmental and other government regulations and customer business cycles. Unit sales of new trucks have historically been subject to substantial cyclical variation based on these general economic conditions. According to A.C.T. Research, industry-wide domestic retail sales of Class 8 trucks in 2005 totaled approximately 259,000 units. A.C.T. Research currently forecasts U.S. heavy-duty new truck sales to increase to approximately 266,000 units

in 2006 and decrease to 179,000 units in 2007. Through geographic expansion, concentration on higher margin parts and service operations and diversification of its customer base, the Company believes it can reduce the negative impact on the Company's earnings of adverse general economic conditions or cyclical trends affecting the heavy-duty truck industry.

**Effects of Inflation** The Company believes that the relatively moderate rates of inflation over the last few years have not had a significant impact on revenues or profitability. The Company does not expect inflation to have any near-term material effects on the sale of its products and services.

**Off-Balance Sheet Arrangements** The Company does not have off-balance sheet arrangements as of December 31, 2005.

**Contractual Obligations** The Company has certain contractual obligations that will impact its short and long-term liquidity. At December 31, 2005, such obligations were as follows:

Contractual Obligations (in thousands)	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt obligations <sup>(1)</sup>	\$ 133,152	\$ 18,807	\$ 41,826	\$ 55,165	\$ 17,354
Capital lease obligations <sup>(2)</sup>	16,905	2,277	5,351	5,636	3,641
Operating lease obligations <sup>(2)</sup>	39,887	8,831	13,180	8,140	9,736
Interest expense on fixed rate debt <sup>(3)</sup>	22,840	6,994	10,537	4,951	358
Interest expense on variable rate debt <sup>(3)</sup>	3,409	760	1,380	1,041	228
<b>Total</b>	<b>\$ 216,193</b>	<b>\$ 37,669</b>	<b>\$ 72,274</b>	<b>\$ 74,933</b>	<b>\$ 31,317</b>

<sup>(1)</sup> Refer to Note 9 of Notes to Consolidated Financial Statements.

<sup>(2)</sup> Refer to Note 12 of Notes to Consolidated Financial Statements.

<sup>(3)</sup> In computing interest expense, the Company used its weighted average interest rate outstanding on fixed rate debt to estimate its interest expense on fixed rate debt. The Company used its weighted average variable rate outstanding on variable rate debt and added 0.25 percent per year to estimate its interest expense on variable rate debt.

### Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the risk of loss that may impact the financial position, results of operations, or cash flows of the Company due to adverse changes in financial market prices, including interest rate risk, and other relevant market rate or price risks.

The Company is exposed to some market risk through interest rates related to our floor plan borrowing arrangements, variable rate debt and discount rates related to finance sales. Floor plan borrowings are based on the LIBOR rate of interest and are used to meet working capital needs. As of December 31, 2005, the Company had floor plan borrowings of approximately \$316.0 million. Assuming an increase in the LIBOR rate of interest of 100 basis points, interest expense could increase by approximately \$3.2 million. The interest rate variability on all other debt would not have a material adverse effect on the Company's financial position. The Company provides all customer financing opportunities to various finance providers. The Company receives all finance charges in excess of a negotiated discount rate from the finance providers in the month following the date of the financing. The negotiated discount rate is variable, thus subject to interest rate fluctuations. This interest rate risk is mitigated by the Company's ability to pass discount rate increases to customers through higher financing rates.

The Company is also exposed to some market risk through interest rates related to the investment of our current cash and cash equivalents of \$133.1 million at December 31, 2005. These funds are generally invested in highly liquid money market accounts, government-sponsored enterprises and corporate bonds that do not expose the Company to a loss of principal. As such instruments mature and the funds are reinvested, we are exposed to changes in market interest rates. This risk is mitigated by management's ongoing evaluation of the best investment rates available for current and noncurrent high quality investments. If market interest rates were to increase or decrease immediately and uniformly by 100 basis points, the Company's interest income could correspondingly increase or decrease by approximately \$1.3 million. We have not used derivative financial instruments in our investment portfolio.



## Report of Independent Registered Public Accounting Firm

### **Rush Enterprises, Inc. and Subsidiaries**

#### **To the Board of Directors and Shareholders of Rush Enterprises, Inc.:**

We have audited the accompanying consolidated balance sheets of Rush Enterprises, Inc. (a Texas corporation) and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Rush Enterprises, Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Rush Enterprises, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2006 expressed an unqualified opinion thereon.

ERNST & YOUNG LLP  
San Antonio, Texas  
February 24, 2006

## Consolidated Balance Sheets

### Rush Enterprises, Inc. and Subsidiaries

	December 31, 2004	December 31, 2005
(In thousands, Except Shares and Per Share Amounts)		
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$158,175	\$ 133,069
Accounts receivable	30,296	63,473
Inventories	189,792	338,212
Prepaid expenses and other	1,418	1,829
Deferred income taxes	1,544	3,856
Total current assets	381,225	540,439
Property and equipment, net	138,953	196,161
Other assets, net	45,327	103,634
Total assets	\$565,505	\$ 840,234
<b>Liabilities and Shareholders' Equity</b>		
Current Liabilities:		
Floor plan notes payable	\$168,002	\$ 315,985
Current maturities of long-term debt	16,083	18,807
Current maturities of capital lease obligations	—	2,277
Advances outstanding under lines of credit	2,434	2,755
Trade accounts payable	16,970	23,327
Accrued expenses	39,495	51,151
Total current liabilities	242,984	414,302
Long-term debt, net of current maturities	79,973	114,345
Capital lease obligations, net of current maturities	—	14,628
Deferred income taxes, net	19,741	23,339
Shareholders' equity:		
Preferred stock, par value \$.01 per share; 1,000,000 shares authorized; 0 shares outstanding in 2004 and 2005	—	—
Common stock, par value \$.01 per share; 40,000,000 class A shares and 10,000,000 class B shares authorized; 16,342,320 class A shares and 7,554,656 class B shares outstanding in 2004; 16,770,060 class A shares and 7,895,863 class B shares outstanding in 2005	239	247
Additional paid-in capital	156,423	162,603
Retained earnings	66,145	110,770
Total shareholders' equity	222,807	273,620
Total liabilities and shareholders' equity	\$565,505	\$ 840,234

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





# Consolidated Statements of Operations

Rush Enterprises, Inc. and Subsidiaries

(In Thousands, Except Per Share Amounts)

For The Years Ended December 31,	2003	2004	2005
<b>Revenues:</b>			
New and used truck sales	\$ 501,757	\$ 738,225	\$ 1,400,736
Parts and service	249,818	285,206	365,908
Construction equipment sales	28,263	32,305	41,692
Lease and rental	25,847	27,193	33,975
Finance and insurance	6,286	7,909	15,356
Other	3,361	4,141	7,103
Total revenues	815,332	1,094,979	1,864,770
<b>Cost Of Products Sold:</b>			
New and used truck sales	466,396	684,724	1,304,290
Parts and service	151,373	177,250	215,419
Construction equipment sales	25,158	28,114	36,509
Lease and rental	19,155	19,749	25,860
Total cost of products sold	662,082	909,837	1,582,078
Gross Profit	153,250	185,142	282,692
Selling, General And Administrative	124,207	141,947	188,667
Depreciation And Amortization	8,929	9,119	10,487
Operating Income	20,114	34,076	83,538
<b>Interest Income (Expense):</b>			
Interest Income	290	782	2,508
Interest Expense	(6,638)	(6,732)	(15,403)
Total Interest Expense, net	(6,348)	(5,950)	(12,895)
Gain On Sale Of Assets	1,984	624	495
Income From Continuing Operations Before Income Taxes	15,750	28,750	71,138
Provision For Income Taxes	6,300	11,574	26,513
Income From Continuing Operations	9,450	17,176	44,625
Loss From Discontinued Operations, net	(621)	(260)	—
Net Income	\$ 8,829	\$ 16,916	\$ 44,625
<b>Earnings Per Share:</b>			
Earnings Per Common Share – Basic			
Income from continuing operations	\$ 0.67	\$ 1.10	\$ 1.84
Net income	\$ 0.63	\$ 1.08	\$ 1.84
Earnings Per Common Share – Diluted			
Income from continuing operations	\$ 0.63	\$ 1.03	\$ 1.79
Net income	\$ 0.59	\$ 1.02	\$ 1.79

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

## Consolidated Statements of Shareholder's Equity

### Rush Enterprises, Inc. and Subsidiaries

	Common Stock		\$0.01	Additional	
	Shares Issued and Outstanding		Par	Paid-In	Retained
(In Thousands)	Class A	Class B	Value	Capital	Earnings
Balance, December 31, 2002	7,002	7,002	\$ 140	\$ 39,155	\$ 40,400
Exercise of employee stock options	19	19	—	182	
Net income	—	—	—	—	8,829
Balance, December 31, 2003	7,021	7,021	140	39,337	49,229
Exercise of employee stock options (including tax benefit of \$3,364)	571	534	11	7,976	
Issuance of class A common stock	8,750	—	88	109,110	
Net income	—	—	—	—	16,916
Balance, December 31, 2004	16,342	7,555	239	156,423	66,145
Exercise of employee stock options (including tax benefit of \$3,076)	398	341	8	5,912	
Employee stock purchase plan	30	—	—	339	
Issuance costs of class A common stock	—	—	—	(71)	
Net income	—	—	—	—	44,625
Balance, December 31, 2005	16,770	7,896	\$ 247	\$ 162,603	\$ 110,770

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

## Consolidated Statements of Cash Flows

### Rush Enterprises, Inc. and Subsidiaries

(In Thousands)	2003	2004	2005
<b>Cash Flows from Operating Activities:</b>			
Income from continuing operations	\$ 9,450	\$ 17,176	\$ 44,625
Adjustments to reconcile net income to net cash provided by (used in) operating activities, net of acquisitions—			
(Loss) from discontinued operations	(621)	(260)	—
Depreciation and amortization	15,542	15,923	21,010
Gain on sale of property and equipment	(1,444)	(1,801)	(1,669)
Provision for deferred income tax expense	3,703	4,149	1,286
Tax benefit realized from exercise of stock options	—	3,364	3,076
Net charges related to discontinued operations	—	400	—
Change in accounts receivable, net	1,043	(5,804)	(32,844)
Change in inventories	(13,154)	(49,692)	(102,308)
Change in prepaid expenses and other, net	642	(296)	(230)
Change in trade accounts payable	1,088	800	6,357
Change in accrued expenses	82	10,399	8,537
Net cash provided by (used in) operating activities	16,331	(5,642)	(52,160)
<b>Cash Flows from Investing Activities:</b>			
Acquisition of property and equipment	(18,772)	(44,566)	(65,801)
Proceeds from the sale of property and equipment	7,521	14,129	8,457
Business acquisitions	(5,547)	(3,500)	(66,026)
Change in other assets	(33)	(897)	(139)
Net cash used in investing activities	(16,831)	(34,834)	(123,509)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from long-term debt	19,230	40,463	52,099
Proceeds from capital lease obligations	—	—	18,416
Payments on long-term debt	(24,118)	(34,435)	(34,979)
Payments on capital lease obligations	—	—	(1,511)
Draws on floor plan notes payable, net	19,590	59,767	113,345
(Payments) borrowings on lines of credit, net	(4,663)	(15,298)	321
Issuance of shares relating to employee stock options and employee stock purchase plan	182	4,623	3,183
Issuance of 8,750,000 shares relating to the public offering, net of the related expenses	—	109,198	(71)
Debt issuance costs	(95)	(56)	(240)
Net cash provided by financing activities	10,126	164,262	150,563
Net increase (decrease) in cash and cash equivalents	9,626	123,786	(25,106)
Cash and cash equivalents, beginning of year	24,763	34,389	158,175
Cash and cash equivalents, end of year	\$ 34,389	\$ 158,175	\$ 133,069
<b>Supplemental Disclosure of Cash Flow Information:</b>			
Cash paid during the year for interest	\$ 7,086	\$ 7,807	\$ 12,020
Income taxes	\$ 1,487	\$ 4,788	\$ 21,703

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

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

### NOTE 1. ORGANIZATION AND OPERATIONS:

Rush Enterprises, Inc. (the "Company") was incorporated in June 1996 under the laws of the State of Texas. The Company, founded in 1965, now operates a Truck segment and a Construction Equipment segment. The Truck segment operates a regional network of Rush Truck Centers. Rush Truck Centers primarily sell trucks manufactured by Peterbilt. Certain Rush Truck Centers sell medium-duty trucks manufactured by Peterbilt, GMC, Hino, UD or Isuzu. Through its strategically located network of Rush Truck Centers, the Company provides one-stop service for the needs of its customers, including retail sales of new and used trucks, aftermarket parts sales, service and repair facilities and financing, leasing and rental, and insurance services. The Company's truck centers are located in areas on or near major highways in Alabama, Arizona, California, Colorado, Florida, New Mexico, Oklahoma, Tennessee and Texas. The Construction Equipment segment, formed during 1997, operates a John Deere equipment center in Houston, Texas. Dealership operations include the retail sale of new and used construction equipment, aftermarket parts and service facilities, equipment rentals and the financing of new and used equipment (see Note 19).

In October 2005, the Company purchased certain assets of TEC of California, Inc., which consisted of GMC, Isuzu and Hino medium-duty franchises. The newly acquired lines were added to the Company's existing medium-duty truck store in Fontana, California. The transaction was valued at approximately \$3.4 million, with the purchase price paid in cash.

In September 2005, the Company purchased certain assets of Hayes Leasing Company, Inc., which consisted of GMC and UD medium-duty franchises. The newly acquired lines were added to its existing medium-duty truck store in Dallas, Texas. The transaction was valued at approximately \$3.4 million, with the purchase price paid in cash.

In September 2005, the Company purchased certain assets of Barrett Trucks, LLC, which consisted of a GMC and Isuzu medium-duty dealership in Texarkana, Texas. The Company added Peterbilt trucks to the dealership and is operating the facility as a full-service Rush Truck Center offering heavy-duty and medium-duty trucks, parts and service. The transaction was valued at approximately \$626,000, with the purchase price paid in cash.

In July 2005, the Company purchased certain assets of Fountain Motor Co., Inc., which consisted of a GMC and Isuzu medium-duty dealership in Orlando, Florida. The Company added Peterbilt trucks and UD products to the dealership and is operating the facility as a full-service Rush Truck Center offering heavy-duty and medium-duty trucks, parts and service. The transaction

was valued at approximately \$2.8 million, with the purchase price paid in cash.

In January 2005, the Company acquired certain assets of American Truck Source, Inc., including its Peterbilt truck dealerships in Texas and Tennessee, for a total purchase price of \$132.4 million. The acquisition provides the Company with rights to sell Peterbilt trucks and parts at new locations in Dallas, Fort Worth, Abilene and Tyler, Texas; and Nashville, Tennessee. The transaction was financed with cash of \$77.8 million, expansion of the Company's existing floor plan agreement for truck inventory of \$34.6 million, and the issuance of debt of approximately \$20.0 million to finance the purchase of real estate and certain vehicles used in ATS's leasing operations. Of the \$77.8 million paid in cash, \$21.9 million was for the purchase of a note receivable from the selling shareholders of ATS. This \$21.9 million was immediately repaid by the selling shareholders at closing, resulting in net cash used in the acquisition of \$55.9 million.

In April 2003, the Company purchased substantially all of the assets of Peterbilt of Mobile, Inc., a Peterbilt dealership in Mobile, Alabama. The transaction was valued at approximately \$1.4 million, with the purchase price paid in cash.

In February 2003, the Company acquired the common stock of Orange County Truck and Trailers, Inc. ("Orange County"), a Peterbilt dealer in central Florida. The acquisition provided the Company with the right to sell Peterbilt trucks and parts from three new locations in central Florida, including Orlando, Haines City, and Tampa. The transaction was valued at approximately \$5.4 million, with the purchase price paid in cash.

As part of the Company's corporate reorganization in connection with its initial public offering ("Offering") in June 1996, the Company acquired, as a wholly owned subsidiary, a managing general agent (the "MGA") to manage all of the operations of Associated Acceptance, Inc. ("AA"). W. Marvin Rush, the sole shareholder of AA, is prohibited from the sale or transfer of the capital stock of AA under the MGA agreement, except as designated by the Company. Therefore, the financial position and operations of AA have been included as part of the Company's consolidated financial position and results of operations for all periods presented.

Effective at the close of business on July 9, 2002 (the "Record Date"), pursuant to action taken by the shareholders at the Annual Meeting of the Company held July 9, 2002, and described in the Proxy Statement dated May 15, 2002, the Board of Directors of the Company reclassified the outstanding common stock, \$0.01 par value per share (the "Old Common Stock"), as Class B Common Stock, \$0.01 par value per share (the "Class B



## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

Common Stock”), and declared a stock dividend of one share of a new Class A Common Stock, \$.01 par value per share (the “Class A Common Stock”), for each share of Class B Common Stock held by shareholders of record on the Record Date. Each share of Class A Common Stock ranks substantially equal to each share of Class B Common Stock with respect to receipt of any dividends or distributions declared on shares of common stock and the right to receive proceeds on liquidation or dissolution of the Company after payment of the Company’s indebtedness and liquidation preference payments to holders of preferred shares. However, holders of Class A Common Stock have 1/20th of one vote per share on all matters requiring a shareholder vote, while holders of Class B Common Stock have one vote per share on all matters requiring a shareholder vote. The Company’s stock trades on The NASDAQ National Market® under the symbols RUSHA and RUSHB. Prior to the reclassification and stock dividend, the Company had 7,002,044 shares of Old Common Stock outstanding. Additionally, all stock option information in Note 13 has been adjusted to reflect the above transaction for all periods presented. The adjustment caused each option outstanding prior to July 9, 2002 to become an option to purchase Class A Common Stock and an option to purchase Class B Common Stock, each with an exercise price of 50% of the exercise price of the option originally granted.

### NOTE 2. SIGNIFICANT ACCOUNTING POLICIES:

#### Principles of Consolidation

The consolidated financial statements presented herein include the account of Rush Enterprises, Inc. together with our consolidated subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation. Certain reclassifications of amount related to prior years have been made to conform with the 2005 presentation.

#### Estimates in Financial Statements

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

#### Inventories

Inventories are stated at the lower of cost or market value. Cost

is determined by specific identification for new and used truck and construction equipment inventory and by the first-in, first-out method for tires, parts and accessories. An allowance is provided when it is anticipated that cost will exceed net realizable value.

#### Property and Equipment

Property and equipment are stated at cost and depreciated over their estimated useful lives. Leasehold improvements are amortized over the useful life of the improvement, or the term of the lease, whichever is shorter. Provision for depreciation of property and equipment is calculated primarily on a straight-line basis. The Company capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest, when incurred, is added to the cost of underlying assets and is amortized over the estimated useful life of such assets. The Company did not incur any capitalized interest related to major capital projects in the periods presented. The cost, accumulated depreciation and amortization and estimated useful lives are summarized as follows:

(in thousands)	2004	2005	Estimated Life (Years)
Land	\$ 19,696	\$ 23,744	—
Buildings and improvements	47,679	62,362	31 - 39
Leasehold improvements	9,375	10,512	4 - 35
Machinery and shop equipment	17,059	22,765	5 - 15
Furniture and fixtures	17,393	23,459	3 - 7
Transportation equipment	21,501	24,159	2 - 15
Leasing vehicles	59,810	98,962	4 - 8
Construction in progress	5,792	895	
Accumulated depreciation and amortization	(59,352)	(70,697)	
<b>Total</b>	<b>\$ 138,953</b>	<b>\$ 196,161</b>	

As of December 31, 2005, the Company had \$16.7 million (net of accumulated depreciation of \$1.4 million) in leasing vehicles under various capital leases included in property and equipment. The charge to income resulting from amortization of these assets recorded under capital leases is included with depreciation expense.

#### Allowance for Doubtful Receivables and Repossession Losses

The Company provides an allowance for doubtful receivables and repossession losses after considering historical loss experience and other factors that might affect the collection of accounts receivable and the ability of customers to meet their obligations on finance contracts sold by the Company.

### Other Assets

Other assets consist primarily of goodwill related to acquisitions of approximately \$43.6 million as of December 31, 2004 and \$100.7 million as of December 31, 2005. During 2004 and 2005, the Company acquired goodwill related to acquisitions of \$1.1 million and \$57.1 million, respectively. Other assets also include notes receivable of \$1.8 million at December 31, 2005. The Company recognizes interest income on notes receivable monthly as earned. Accumulated amortization of other assets at December 31, 2004 was approximately \$4.7 million. At December 31, 2005, accumulated amortization of other assets was approximately \$4.5 million. The Company annually assesses the appropriateness of the asset valuations of other assets and the related amortization period as applicable.

Goodwill represents the excess purchase price over the fair value of net assets acquired. The Company applies the provisions of Financial Accounting Standards Board ("FASB") Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), in our accounting for goodwill. SFAS 142 requires that goodwill and other intangible assets that have indefinite lives not be amortized but instead be tested at least annually by reporting unit for impairment, or more frequently when events or changes in circumstances indicate that the asset might be impaired. For indefinite lived intangible assets, impairment is tested by comparing the carrying value of the asset to the fair value of the reporting unit to which they are assigned. Goodwill was tested for impairment at December 31, 2005 and no impairment write down was required. However, the Company is exposed to the possibility that changes in market conditions could result in significant impairment charges in the future, thus resulting in a potential increase in earnings volatility.

### Income Taxes

Income taxes are accounted for under the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). SFAS 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in a company's financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the differences between the financial statement and tax bases of assets and liabilities using currently enacted tax rates in effect for the years in which the differences are expected to reverse.

### Revenue Recognition Policies

Income on the sale of a vehicle or a piece of construction equipment

(each a "unit") is recognized when the seller and customer execute a purchase contract, delivery has occurred and there are no significant uncertainties related to financing or collectibility. Finance income related to the sale of a unit is recognized over the period of the respective finance contract, based on the effective interest rate method, if the finance contract is retained by the Company. During 2003, 2004 and 2005, no finance contracts were retained for any significant length of time by the Company but were generally sold, with limited recourse, to certain finance companies concurrent with the sale of the related unit. Gain or loss is recognized by the Company upon the sale of such finance contracts to the finance companies, net of a provision for estimated repossession losses and early repayment penalties. Lease and rental income is recognized over the period of the related lease or rental agreement. Parts and services revenue is earned at the time the Company sells the parts to its customers or at the time the Company completes the service work order related to service provided to the customer's unit. Payments received on prepaid maintenance plans are deferred as a component of accrued expenses and recognized as income when the maintenance is performed.

### Cost of Sales

For the Company's new and used truck and construction equipment operations and its parts operations, cost of sales consists primarily of the Company's actual purchase price, less manufacturer's incentives, for new and used trucks and construction equipment and parts. For the Company's service and body shop operations, technician labor cost is the primary component of cost of sales. For the Company's rental and leasing operations, cost of sales consists primarily of depreciation, rent and interest expense on the lease and rental fleet owned and leased by the Company, and the maintenance cost of the lease and rental fleet. There are no costs of sales associated with the Company's finance and insurance revenue or other revenue.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of incentive-based compensation for sales, finance and general management personnel, salaries for administrative personnel and expenses for rent, marketing, insurance, utilities, shipping and handling costs and other general operating purposes.

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

### Stock Options

In October 1995, Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), was issued. SFAS 123 defines a fair value based method of accounting for employee stock options or similar equity instruments and encourages all entities to adopt that method of accounting for all of their employee stock compensation plans. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period of the award, which is usually the vesting period. However, SFAS 123 also allows entities to continue to measure compensation costs for employee stock compensation plans using the intrinsic value method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Because the Company elected to continue to follow APB 25, SFAS 123 requires disclosure of pro forma net income and earnings per share as if the new fair value accounting method were adopted.

If the Company had adopted the fair value accounting method under SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

(in thousands, except per share amounts)	2003	2004	2005
<b>Income from continuing operations</b>			
As reported	\$ 9,450	\$ 17,176	\$ 44,625
Stock based employee costs, net of tax effects	845	979	1,053
Pro forma	8,605	16,197	43,572
<b>Basic earnings per share –</b>			
As reported	\$ 0.67	\$ 1.10	\$ 1.84
Pro forma	0.61	1.03	1.80
<b>Diluted earnings per share –</b>			
As reported	\$ 0.63	\$ 1.03	\$ 1.79
Pro forma	0.57	0.98	1.75
<b>Net income</b>			
As reported	\$ 8,829	\$ 16,916	\$ 44,625
Stock based employee costs, net of tax effects	845	979	1,053
Pro forma	7,984	15,937	43,572
<b>Basic earnings per share –</b>			
As reported	\$ 0.63	\$ 1.08	\$ 1.84
Pro forma	0.57	1.02	1.80
<b>Diluted earnings per share –</b>			
As reported	\$ 0.59	\$ 1.02	\$ 1.79
Pro forma	0.53	0.96	1.75

The fair value for options granted during the three fiscal years ended December 31, 2003, 2004 and 2005, respectively, was estimated using a Black-Scholes option pricing model with the following valuation assumptions:

	2003	2004	2005
Expected stock volatility	.433 - .471	.299 - .499	.225 - .345
Expected dividend yield	–	–	–
Risk-free interest rate	3.65% - 4.2%	3.14% - 3.84%	4.0% - 4.13%
Expected life (years)	7	7	7

The Company is required to adopt the provisions of Statement of Accounting Standards No. 123, "Share-Based Payment (Revised 2004)" ("SFAS 123R") on January 1, 2006. Among other things, SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the date of the grant.

### Advertising Costs

Advertising costs are expensed as incurred. Advertising and marketing expense related to operations was \$1.4 million for fiscal year 2003, \$1.5 million for fiscal year 2004, and \$2.5 million for fiscal year 2005. Advertising and marketing expense is included in selling, general and administrative expense.

### Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash and other money market instruments. The Company considers all highly liquid investments with an original maturity of ninety days or less to be cash equivalents.

### Recent Accounting Pronouncements

SFAS 123R establishes standards for the accounting for transactions in which an entity (i) exchanges its equity instruments for goods or services, or (ii) incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of the equity instruments. SFAS 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the measurement date, which is generally the date of the grant. SFAS 123R was to be effective for the Company on July 1, 2005; however, the required implementation date was delayed until January 1, 2006. The Company will transition to fair-value based accounting for stock-



based compensation using a modified version of prospective application ("modified prospective application"). Under modified prospective application, as it is applicable to the Company, SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (generally referring to non-vested awards) that are outstanding as of January 1, 2006 must be recognized as the remaining requisite service is rendered during the period of and/or the periods after the adoption of SFAS 123R. The attribution of compensation cost for those earlier awards will be based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures required for companies that did not adopt the fair value accounting method for stock-based employee compensation.

Based on the stock-based compensation awards outstanding as of December 31, 2005 for which the requisite service is not expected to be fully rendered prior to January 1, 2006, the Company expects to recognize total pre-tax compensation cost of approximately \$1.2 million beginning in 2006, in accordance with the accounting requirements of SFAS 123R. Future levels of compensation cost recognized related to stock-based compensation awards (including the aforementioned expected costs during the period of adoption) may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards before and after the adoption SFAS 123R.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption of SFAS 123(R). While the Company cannot accurately estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions were \$0 in 2003, \$3.4 million in 2004 and \$3.1 million in 2005.

### NOTE 3. DISCONTINUED OPERATIONS

On November 12, 2002, the Company announced that it would sell its Michigan John Deere construction equipment stores as a result of continuing deterioration in the Michigan construction equipment market and its location in regards to the Company's other operations and its plans for future expansion. The sale of the Michigan construction equipment stores was substantially

complete at December 31, 2002. Prior to the sale, the Michigan construction equipment stores were part of the Company's Construction Equipment segment. The Construction Equipment segment has been restated for all periods presented to exclude the Michigan stores.

On November 12, 2002 the Company decided to discontinue its Retail segment, which operated three farm and ranch retail stores in Seguin, Hockley and Denton, Texas. The Company decided that the Retail segment did not fit into its long-term plans of growing its core heavy-duty truck and construction equipment businesses. The Denton store was closed in December 2002; the Hockley store began liquidating inventory during November 2002 and completed the liquidation on March 9, 2003. The Company sold the Seguin store and the Hockley real estate in the fourth quarter of 2004. As a result of these actions, the Retail segment will no longer be reported as a separate business segment.

The results of operations of these businesses have been classified as discontinued operations in the Company's consolidated statements of income for all periods presented. Net sales and income (loss) before income taxes related to the discontinued businesses were as follows:

(in thousands)	2003	2004	2005
<b>Michigan Construction Equipment Stores</b>			
Net Sales	\$ 251	\$ –	\$ –
Earnings (loss) before income taxes:			
Results of operations from discontinued operations	–	–	–
Charges related to discontinued operations	–	–	–
(Loss) before income taxes	–	–	–
Income tax benefit (expense)	–	–	–
Net (loss) from discontinued operations	\$ –	\$ –	\$ –

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

(in thousands)	2003	2004	2005
<b>Retail Segment Stores (D&amp;D)</b>			
Net Sales	\$ 17,298	\$ 11,746	\$ -
Earnings (loss) before income taxes:			
Results of operations from discontinued operations	(1,035)	209	-
Charges related to discontinued operations	-	(58)	-
Income (Loss) before income taxes	(1,035)	151	-
Income tax benefit (expense)	414	(411)	-
<b>Net (loss) from discontinued operations</b>	<b>\$ (621)</b>	<b>\$ (260)</b>	<b>\$ -</b>

The 2004 D&D charges related to discontinued operations include a \$0.4 million charge for the disposal of the real estate in Hockley, Texas and a \$0.3 million gain on the sale of the Seguin real estate, inventory and other assets. The \$0.4 million income tax expense is primarily related to tax expense recorded to establish a reserve for the estimated unusable portion of D&D's stated net operating loss carry forward. There was no activity related to these discontinued operations in 2005.

### NOTE 4. SUPPLIER AND CUSTOMER CONCENTRATION:

#### Major Suppliers and Dealership Agreements

The Company has entered into dealership agreements with various companies ("Manufacturers"). These agreements are nonexclusive agreements that allow the Company to stock, sell at retail and service trucks, equipment and products of the Manufacturers in the Company's defined market. The agreements allow the Company to use the Manufacturers' names, trade symbols and intellectual property and expire as follows:

Distributor	Expiration Dates
Peterbilt	March 2006 through January 2008
General Motors Corporation	October 2010
Isuzu	Indefinite
Hino	December 2006 through March 2007
UD	June 2006 through September 2008
John Deere	Indefinite

These agreements, as well as agreements with various other Manufacturers, impose a number of restrictions and obligations on the Company, including restrictions on a change in control of the Company and the maintenance of certain required levels of working capital. Violation of these restrictions could result in the loss of the Company's right to purchase the Manufacturers' products and

use the Manufacturers' trademarks. As of December 31, 2005, the Company's management believed it was in compliance with all the restrictions and obligations of its dealership agreements.

The Company purchases its new Peterbilt vehicles and most of its parts from PACCAR, the maker of Peterbilt trucks and parts, at prevailing prices charged to all franchised dealers. Sales of new Peterbilt trucks accounted for 95% of the Company's new vehicle sales for the year ended December 31, 2003. Sales of new Peterbilt trucks accounted for 93% of the Company's new vehicle sales for the years ended December 31, 2004 and 2005.

The Company purchases most of its new construction equipment and parts from John Deere at prevailing prices charged to all franchised dealers. Sales of new John Deere equipment accounted for 93% of the Company's new equipment sales for the year ended December 31, 2003. Sales of new John Deere equipment accounted for 94% of the Company's new equipment sales for the year ended December 31, 2004. Sales of new John Deere equipment accounted for 92% of the Company's new equipment sales for the year ended December 31, 2005.

#### Primary Lenders

The Company purchases its new and used truck and construction equipment inventories with the assistance of floor plan financing programs offered by various financial institutions and John Deere. The financial institution the Company uses for truck inventory purchases allows for requests of working capital advances in the minimum amount of \$100,000. However, such working capital advances may not cause the total indebtedness owed to the financial institution to exceed an amount equal to the wholesale advances made against the then current inventory less any payment reductions then due.

The floor plan agreement with one of the financial institutions used for construction equipment purchases expires in February 2007. Additional floor plan financing is provided by John Deere pursuant to the Company's equipment dealership agreement. These agreements provide that the occurrence of certain events will be considered events of default. There were no known events of default as of December 31, 2005. In the event that the Company's financing becomes insufficient, or its relationship with the current primary lenders terminates, the Company would need to obtain similar financing from other sources. Management believes it can obtain additional floor plan financing or alternative financing if necessary.

The Company's debt agreements include certain restrictive covenants. The Company was in compliance with these and all debt covenants as of December 31, 2005.

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

### Concentrations of Credit Risks

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with what it considers to be quality financial institutions. As of December 31, 2005, the Company had deposits in excess of federal insurance protection totaling approximately \$140.7 million.

The Company controls credit risk through credit approvals and by selling a majority of its trade receivables without recourse. Concentrations of credit risk with respect to trade receivables are reduced because a large number of geographically diverse customers make up the Company's customer base, thus spreading the trade credit risk. A majority of the Company's business, however, is concentrated in the United States heavy-duty trucking and construction equipment markets and related aftermarkets. The Company controls credit risk through credit approvals and by selling certain trade receivables without recourse. After the Company enters into a finance contract, the Company generally sells the contracts to a third party. These finance contracts are sold both with and without recourse. A majority of the Company's finance contracts are sold without recourse. The Company provides an allowance for doubtful receivables and a reserve for repossession losses related to finance contracts sold. Historically, the Company's allowance and reserve have covered future losses.

### 5. ACCOUNTS RECEIVABLE:

The Company's accounts receivable, net, consisted of the following:

	December 31,	
(in thousands)	2004	2005
Trade accounts receivable from sale of vehicles and construction equipment	\$ 16,002	\$ 46,293
Other trade receivables	6,161	4,184
Warranty claims	3,017	3,745
Other accounts receivable	5,466	9,524
Less allowance for doubtful receivables	(350)	(273)
<b>Total</b>	<b>\$ 30,296</b>	<b>\$ 63,473</b>

For the years ended December 31, 2003, 2004 and 2005, the Company had no significant related-party sales.

### NOTE 6. INVENTORIES:

The Company's inventories consisted of the following:

	December 31,	
(in thousands)	2004	2005
New vehicles	\$ 120,733	\$ 242,469
Used vehicles	17,995	21,010
Construction equipment - new	7,800	12,919
Construction equipment - used	1,010	587
Parts and accessories	41,897	59,339
Other	1,833	3,486
Less allowance	(1,476)	(1,598)
<b>Total</b>	<b>\$ 189,792</b>	<b>\$ 338,212</b>

The Company recognized \$350,000 of pretax used vehicle inventory valuation loss during 2004 and a \$150,000 used vehicle inventory valuation loss during 2005.



# Notes to Consolidated Financial Statements

Rush Enterprises, Inc. and Subsidiaries

## NOTE 7. VALUATION ACCOUNTS:

Valuation and allowance accounts include the following:

	Balance Beginning of Year	Net Charged to Costs and Expenses	Acquisitions	Net Write-Offs	Balance End of Year
<b>2005</b>					
Reserve for warranty receivable	350	147		(224)	273
Reserve for parts inventory	1,126	1,201	234	(1,114)	1,447
Reserve for truck inventory	350	150		(350)	150
<b>2004</b>					
Reserve for warranty receivable	450	569		(669)	350
Reserve for parts inventory	415	1,029		(318)	1,126
Reserve for truck inventory	608	(194)		(64)	350
<b>2003</b>					
Reserve for warranty receivable	450	72		(72)	450
Reserve for parts inventory	476	126		(187)	415
Reserve for truck inventory	500	1,252		(1,144)	608

### Allowance for Doubtful Receivables

The Company provides an allowance for uncollectible warranty receivables. The Company evaluates the collectibility of its warranty claims receivable based on a combination of factors, including aging and correspondence with the applicable manufacturer. Management reviews the warranty claims receivable aging and adjusts the allowance based on historical experience. The Company records charge-offs related to warranty receivables on an as-needed basis. The Company sells a majority of its customer accounts receivable to a third party that is responsible for qualifying the customer for credit at the point of sale. All credit risk is assumed by the third party; therefore, the Company provides no allowance for customer accounts receivable.

### Inventory

The Company provides a reserve for obsolete and slow moving parts. The reserve is reviewed and, if necessary, adjustments are made on a quarterly basis. The Company relies on historical information to support its reserve. Once the inventory is written down, the Company does not adjust the reserve balance until the inventory is sold.

The valuation for new and used truck inventory is based on specific identification. A detail of new and used truck inventory is reviewed and, if necessary, adjustments to the value of specific units are made on a quarterly basis.

## NOTE 8. FLOOR PLAN NOTES PAYABLE AND LINES OF CREDIT:

### Floor Plan Notes Payable

Floor plan notes are financing agreements to facilitate the Company's purchase of new and used trucks and construction equipment. These notes are collateralized by the inventory purchased and accounts receivable arising from the sale thereof. The Company's floor plan notes have interest rates based on the prime rate or LIBOR, as defined in the agreements. The interest rates applicable to these agreements ranged from approximately 5.97% to 8.75% as of December 31, 2005. Amounts borrowed under these agreements are due when the related truck or construction equipment inventory (collateral) is sold and the sales proceeds are collected by the Company, or in the case of construction equipment rentals, when the carrying value of the equipment is reduced. These agreements may be modified, suspended or terminated by the lender as described in Note 4.

The Company finances substantially all of the purchase price of its new truck inventory, and the loan value of its used truck inventory under a floor plan financing agreement with GE Capital, under which GE Capital pays the manufacturer directly with respect to new trucks. The Company's floor plan agreement with GE Capital expires in September 2008. On December 31, 2005, the Company had approximately \$302.8 million outstanding under its floor plan financing agreement with GE Capital.

The Company's floor plan agreement with CitiCapital is based on the book value of the Company's construction equipment inventory. As of December 31, 2005, the aggregate amount of borrowing capacity with this lender was \$10.5 million, with

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

approximately \$10.1 million outstanding. Additional amounts are available under the Company's John Deere dealership agreement. At December 31, 2005, approximately \$3.1 million was outstanding pursuant to the John Deere dealership agreement.

Amounts of collateral as of December 31, 2004 and 2005 were as follows:

	December 31,	
(in thousands)	2004	2005
Inventories, new and used trucks and construction equipment at cost based on specific identification	\$ 147,538	\$ 276,985
Truck and construction equipment sale related accounts receivable	16,002	46,293
Cash held for floor plan payment related to receipts from truck sales	10,262	—
<b>Total</b>	<b>\$ 173,802</b>	<b>\$ 323,278</b>
<b>Floor plan notes payable</b>	<b>\$ 168,002</b>	<b>\$ 315,985</b>

### Lines of Credit

The Company may request working capital advances in the minimum amount of \$100,000 from GE Capital, its primary truck lender. However, such working capital advances may not cause the total indebtedness owed GE Capital to exceed an amount equal to the wholesale advances made against the then current inventory less any payment reductions then due. There were no working capital advances outstanding under this agreement at December 31, 2005. The Company has three separate secured lines of credit that provide for an aggregate maximum borrowing of \$16.7 million. Advances outstanding under these secured lines of credit in aggregate were \$2.8 million, with an additional \$5.4 million pledged to secure various letters of credit related to self-insurance products, leaving \$8.5 million available for future borrowings as of December 31, 2005.

### NOTE 9. LONG-TERM DEBT:

Long-term debt was comprised of the following (in thousands):

	December 31,	
(in thousands)	2004	2005
Variable interest rate term notes	\$ 15,859	\$ 12,375
Fixed interest rate term notes	80,197	120,777
<b>Total debt</b>	<b>96,056</b>	<b>133,152</b>
Less-Current maturities	(16,083)	(18,807)
<b>Total</b>	<b>\$ 79,973</b>	<b>\$ 114,345</b>

As of December 31, 2005, debt maturities were as follows:

(in thousands)	
2006	\$ 18,807
2007	18,883
2008	22,943
2009	24,004
2010	31,161
Thereafter	17,354
<b>Total</b>	<b>\$ 133,152</b>

The interest rates on the Company's variable interest rate notes are based on LIBOR and the prime rate on December 31, 2005. Interest rates on the notes ranged from approximately 6.17% to 7.25% on December 31, 2005. Payments on the notes range from \$4,067 to \$58,333 per month, plus interest. Maturities of these notes range from March 2006 to March 2014.

The Company's fixed interest rate notes are primarily with financial institutions and had interest rates that range from approximately 3.83% to 9.68% on December 31, 2005. Payments on the notes range from \$219 to \$59,027 per month, plus interest. Maturities of these notes range from January 2006 to January 2016.

The proceeds from the issuance of the notes were used primarily to acquire land, buildings and improvements, transportation equipment and leasing vehicles. The notes are secured by the assets acquired with the proceeds of such notes.

### NOTE 10. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS:

The following methods and assumptions were used to estimate the fair value of each class of financial instrument held by the Company:

**Current assets and current liabilities** The carrying value approximates fair value due to the short maturity of these items.

**Long-term debt** The fair value of the Company's long-term debt is based on secondary market indicators. Since the Company's debt is not quoted, estimates are based on each obligation's characteristics, including remaining maturities, interest rate, credit rating, collateral, amortization schedule and liquidity. The carrying amount approximates fair value.

## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

#### NOTE 11. DEFINED CONTRIBUTION PLAN:

The Company has a defined contribution plan (the "Rush Plan"), which is available to all Company employees and the employees of certain affiliates. Each employee who has completed 90 days of continuous service is entitled to enter the Rush Plan on the first day of the following month. Participating employees may contribute from 1% to 50% of total gross compensation. However, certain higher paid employees are limited to a maximum contribution of 15% of total gross compensation. For the first 10% of an employee's contribution, the Company, at its discretion, may contribute an amount equal to 25% of the employees' contributions for those employees with less than five years of service and an amount equal to 50% of the employees' contributions for those employees with more than five years of service. During the year ended December 31, 2003, the Company incurred expenses of approximately \$1.6 million related to the Rush Plan. During the year ended December 31, 2004, the Company incurred expenses of approximately \$1.8 million related to the Rush Plan. During the year ended December 31, 2005, the Company incurred expenses of approximately \$2.6 million related to the Rush Plan.

The Company currently does not provide any postretirement benefits nor does it provide any post employment benefits.

#### NOTE 12. LEASES:

##### Vehicle Leases

The Company leases vehicles primarily over periods ranging from one to ten years under operating lease and capital lease arrangements. These vehicles are subleased by the Company to customers under various agreements. Future minimum sublease rentals to be received by the Company under non-cancelable subleases for operating leases are \$27.4 million and for capital leases are \$16.4 million. Generally, the Company is required to incur all operating costs and pay a minimum rental and an excess mileage charge based on maximum mileage over the term of the lease. The Company guarantees the residual value of vehicles under operating lease and capital lease arrangements. At December 31, 2005, the Company guaranteed vehicle residual values of \$7.2 million under operating lease arrangements and \$5.2 million under capital lease arrangements. Historically, the Company purchases these vehicles at the end of the lease term and recognizes a gain on the sale of the vehicle. The residual values are not reflected in the future minimum lease payments for operating leases. Vehicle lease expenses for the year ended December 31, 2003 were approximately \$5.3 million. Vehicle lease expenses for the year ended December 31, 2004 were

approximately \$6.0 million. Vehicle lease expenses for the year ended December 31, 2005 were approximately \$5.5 million.

Future minimum lease payments under capital and non-cancelable vehicle leases as of December 31, 2005, are as follows:

(in thousands)	Capital Leases	Operating Leases
2006	\$ 3,643	\$ 4,768
2007	4,026	4,117
2008	3,394	3,537
2009	3,520	2,625
2010	2,464	1,712
Thereafter	4,062	1,856
Total minimum lease payments	\$ 21,109	\$ 18,615
Less amount representing interest	(4,204)	
Present value of net minimum capital lease payments	16,905	
Less current portion	(2,277)	
Obligations under capital leases less current portion	\$ 14,628	

##### Customer Vehicle Leases

A division of the Company leases both owned and leased vehicles to customers primarily over periods of one to ten years under operating lease arrangements. These leases require a minimum rental payment and a contingent rental payment based on mileage. Rental income during the year ended December 31, 2003 consisted of minimum rental payments of approximately \$13.7 million and contingent rental payments of \$3.0 million. Rental income during the year ended December 31, 2004 consisted of minimum rental payments of approximately \$15.4 million and contingent rental payments of \$2.9 million. Rental income during the year ended December 31, 2005 consisted of minimum rental payments of approximately \$20.6 million and contingent rentals payments of approximately \$3.5 million. Minimum lease payments to be received for non-cancelable leases and subleases in effect at December 31, 2005, are as follows:

(in thousands)	
2006	\$ 22,649
2007	19,433
2008	16,335
2009	12,589
2010	8,405
Thereafter	6,724
Total	\$ 86,135

## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

As of December 31, 2004, the Company had \$39.4 million (net of accumulated depreciation of \$20.4 million) of leasing vehicles included in property and equipment. As of December 31, 2005, the Company had \$75.8 million (net of accumulated depreciation of \$23.2 million) of leasing vehicles included in property and equipment.

#### Other Leases - Land and Buildings

The Company leases various assets under operating leases with expiration dates ranging from April 2006 through December 2026. Monthly rental payments range from approximately \$785 per month to \$47,595 per month. Rental expense for the year ended December 31, 2003 was \$2.2 million. Rental expense for the year ended December 31, 2004 was \$2.6 million. Rental expense for the year ended December 31, 2005 was \$3.2 million. Future minimum lease payments under non-cancelable leases at December 31, 2005, are as follows (in thousands):

2006	\$ 4,063
2007	3,034
2008	2,492
2009	2,200
2010	1,603
Thereafter	7,880
<b>Total</b>	<b>\$21,272</b>

#### NOTE 13. STOCK OPTIONS AND STOCK PLANS:

In April 1996, the Board of Directors and shareholders adopted the Rush Enterprises, Inc. Long-Term Incentive Plan (the "Incentive Plan"). The Incentive Plan provides for the grant of stock options (which may be nonqualified stock options or incentive stock options for tax purposes), stock appreciation rights issued independent of or in tandem with such options ("SARs"), restricted stock awards and performance awards.

The aggregate number of shares of common stock subject to stock options or SARs that may be granted to any one participant in any year under the Incentive Plan is 100,000 shares of Class A Common Stock and 100,000 shares of Class B Common Stock. The Company has 2,600,000 shares of Class A Common Stock and 1,400,000 shares of Class B Common Stock reserved for issuance upon exercise of any awards granted under the Company's Incentive Plan.

On April 8, 1996, the Board of Directors of the Company declared a dividend of one common share purchase right (a "Right") for each share of common stock outstanding. Each Right

entitles the registered holder to purchase from the Company one share of Class B Common Stock at a price of \$35.00 per share (the "Purchase Price"). The Rights are not exercisable until the distribution date, as defined in the Rights Agreement. The Rights will expire on April 7, 2006 (the "Final Expiration Date"), unless the Final Expiration Date is extended or unless the Rights are earlier redeemed or exchanged by the Company.

In March 2003, the Company granted options under the Incentive Plan to purchase an aggregate of 380,000 shares of Class A Common Stock and 93,000 shares of Class B Common Stock. In March 2004 and June 2004, the Company granted options under the Incentive Plan to purchase an aggregate of 187,850 shares of Class A Common Stock and 43,500 shares of Class B Common Stock. In March 2005, the Company granted options under the Incentive Plan to purchase an aggregate of 288,325 shares of Class A Common Stock. Each option vests in three equal annual installments beginning on the third anniversary of the grant date.

The Board of Directors and shareholders adopted the Rush Enterprises, Inc. 1997 Non-Employee Director Stock Option Plan (the "Director Plan"), reserving 600,000 shares of Class A Common Stock and 180,000 shares of Class B Common Stock for issuance upon exercise of any awards granted under the Plan. The Director Plan is designed to attract and retain highly qualified non-employee directors. Prior to July 9, 2002, under the terms of the Director Plan, each non-employee director received options to purchase 10,000 shares of the Old Common Stock on the date the Director Plan was adopted or upon their respective date of appointment and an additional option to purchase 10,000 shares of the Old Common Stock each year they are elected by the shareholders to serve on the Board of Directors, all of which vest immediately and expire ten years from the grant date. The exercise price of the options was equal to closing price, as reported by The Nasdaq National Market®, of the Company's Old Common Stock on the grant date. On July 9, 2002, each option to purchase Old Common Stock became an option to purchase Class A Common Stock and an option to purchase Class B Common Stock. Each of the new options became exercisable at one-half of the original option's exercise price. Subsequent to July 9, 2002, each non-employee director received options to purchase 20,000 shares of the Company's Class A Common Stock upon their respective date of appointment and each year they are elected by the shareholders to serve on the Board of Directors. During the year ended December 31, 2003, 60,000 options of Class A Common Stock were granted under the terms of the Director Plan. During the year ended December 31, 2004,



# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

80,000 options of Class A Common Stock were granted under the terms of the Director Plan. During the year ended December 31, 2005, 80,000 options of Class A Common Stock were granted under the terms of the Director Plan.

In 2004, the Company implemented an Employee Stock Purchase Plan ("ESPP") that allows eligible employees to contribute up to 10% of their base earnings toward the semi-annual purchase of the Company's Class A Common Stock. The employee's purchase price is 85% of the lesser of the closing price of the Class A Common Stock on the first business day or the last business day of the semi-annual offering period, as reported by The Nasdaq National Market®. Employees may pur-

chase shares having a fair market value of up to \$25,000 (measured as of the first day of each semi-annual offering period) for each calendar year. No compensation expense is recorded in connection with the plan. The total number of shares issuable under the plan is 600,000. No shares were issued under the plan during fiscal 2004 and 30,009 shares of Class A Common Stock were issued during fiscal 2005. Of the 2,507 employees eligible to participate, 193 were participants in the plan as of December 31, 2005.

A summary of the Company's stock option activity and related information for the years ended December 31, 2003, 2004 and 2005 follows:

	2003		2004		2005	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	2,452,730	\$ 3.82	2,927,282	\$ 3.80	2,096,782	\$ 4.80
Granted	533,000	3.80	311,350	11.92	368,325	15.41
Exercised	(46,248)	5.14	(1,104,672)	4.18	(738,938)	3.85
Forfeited	(12,200)	3.47	(37,178)	3.78	(6,350)	5.58
Outstanding, end of year	2,927,282	\$ 3.80	2,096,782	\$ 4.80	1,719,819	\$ 7.48
Exercisable, end of year	1,158,718	\$ 4.62	610,385	\$ 5.25	353,868	\$ 7.65
Weighted average fair value of options granted during the year		\$ 1.95		\$ 6.05		\$ 6.53

The following table summarizes the information about the Company's options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$2.07 - \$2.25	195,274	5.2	\$ 2.07	76,020	\$ 2.09
\$3.50 - \$4.32	812,105	6.7	\$ 3.60	81,833	\$ 3.53
\$4.85 - \$5.75	36,015	5.4	\$ 5.20	36,015	\$ 5.20
\$11.15 - \$12.96	308,100	8.3	\$ 11.92	80,000	\$ 11.77
\$14.16 - \$15.76	368,325	9.2	\$ 15.41	80,000	\$ 14.16
	1,719,819			353,868	

**NOTE 14. EARNINGS PER SHARE:**

Earnings per share for all periods reflects the adoption of Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128"), which established standards for computing and presenting earnings per share ("EPS") for entities with publicly held common stock or potential common stock. This statement requires dual presentation of basic and diluted EPS on the face of the income statement for all entities with complex capital structures. Basic EPS were computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS differs from basic EPS due to the assumed conversions of potentially dilutive options and warrants that were outstanding during the period. The Company's Class A and Class B Common Stock have equal claims on earnings of the Company. The following is a reconciliation of the numerators and the denominators of the basic and diluted per share computations for net income.

	2003	2004	2005
Numerator-			
Numerator for basic and diluted earnings per share –			
Net income available to common shareholders	\$ 8,829,000	\$ 16,916,000	\$ 44,625,000
Denominator –			
Denominator for basic earnings per share, weighted average shares	14,042,304	15,683,763	24,202,008
Effect of dilutive securities –			
Stock options	981,933	923,406	754,565
Denominator for diluted earnings per share, adjusted weighted average shares and assumed conversions	15,024,237	16,607,169	24,956,573
Basic earnings per common share	\$ 0.63	\$ 1.08	\$ 1.84
Diluted earnings per common share and common share equivalents	\$ 0.59	\$ 1.02	\$ 1.79

Options to purchase shares of common stock that were outstanding for the years ended December 31, 2003, 2004 and 2005 that were not included in the computation of diluted earnings per share because the exercise prices were greater than the average market prices of the common shares are as follows:

	2003	2004	2005
Options	188,305	10,000	288,325
Total antidilutive securities	188,305	10,000	288,325

**NOTE 15. INCOME TAXES:****Provision for Income Taxes**

The tax provisions for the years ended December 31, 2003, 2004 and 2005 are summarized as follows:

(in thousands)	2003	2004	2005
Current provision-			
Federal	\$ 2,029	\$ 6,805	\$ 23,349
State	341	864	1,878
	2,370	7,669	25,227
Deferred provision-			
Federal	3,189	3,911	950
State	327	405	336
	3,516	4,316	1,286
Provision for income taxes	\$ 5,886	\$ 11,985	\$ 26,513

The following summarizes the tax effect of significant cumulative temporary differences that are included in the net deferred income tax liability as of December 31, 2004 and 2005:

(in thousands)	2004	2005
Differences in depreciation and amortization	\$ 20,154	\$ 28,199
Deferred tax asset related to state net operating loss carry forwards (net of a valuation allowance of \$491,000 at December 31, 2004 and \$541,000 at December 31, 2005)	(428)	(81)
Deferred tax asset related to capital lease obligations, non-current	–	(4,742)
Deferred tax asset related to capital lease obligations, current	–	(1,581)
Accruals and reserves not deducted for tax purposes until paid	(1,544)	(2,194)
Other, net	15	(118)
Total	\$ 18,197	\$ 19,483

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

The Company's various state net operating loss carry forwards expire from 2006 through 2020.

A reconciliation of taxes based on the federal statutory rates and the provisions for income taxes for the years ended December 31, 2003, 2004 and 2005, are summarized as follows:

(in thousands)	2003	2004	2005
<b>Income taxes at the federal</b>			
statutory rate	\$ 5,150	\$10,116	<b>\$ 24,898</b>
State income taxes,			
net of federal benefit	587	891	<b>1,439</b>
Tax effect of permanent differences	—	454	<b>(77)</b>
State tax valuation allowance	—	491	<b>50</b>
Other, net	149	33	<b>203</b>
<b>Provision for income taxes</b>	<b>\$ 5,886</b>	<b>\$11,985</b>	<b>\$ 26,513</b>

Following is a summary of the Company's income tax provision for the years ended December 31, 2003, 2004 and 2005:

(in thousands)	2003	2004	2005
<b>Income tax expense on</b>			
continuing operations	\$6,300	\$11,574	<b>\$26,513</b>
<b>Income tax expense (benefit)</b>			
from discontinued operations	(414)	411	—
<b>Provision for income taxes</b>	<b>\$5,886</b>	<b>\$11,985</b>	<b>\$ 26,513</b>

As of December 31, 2005, the Company had provided for tax contingencies of approximately \$1.1 million.

### NOTE 16. COMMITMENTS AND CONTINGENCIES:

The Company is contingently liable to finance companies for certain notes initiated on behalf of such finance companies related to the sale of trucks and construction equipment. The majority of finance contracts are sold without recourse against the Company. A majority of the Company's liability related to finance contracts sold with recourse is generally limited to 5% to 20% of the outstanding amount of each note initiated on behalf of the finance company. However, in 2003 the Company instituted a finance program that accepts 100% liability, with some restrictions, for the outstanding amount of each note initiated on behalf of the finance company. In order for a contract to be accepted into this finance program, a customer must meet strict credit requirements or maintain a significant equity position in the truck being financed; consequently, approximately 1% of the Company's portfolio balance related to finance contracts sold by the Company

are under this 100% liability finance program and the Company does not expect to finance a significant percentage of its truck sales under this 100% liability finance program in the future. The Company provides for an allowance for repossession losses and early repayment penalties that it may be liable for under finance contracts sold without recourse.

Finance contracts initiated and sold were \$165.1 million during the year ended December 31, 2003, \$259.9 million during the year ended December 31, 2004 and \$451.8 million during the year ended December 31, 2005.

The Company is involved in various claims and legal actions arising in the ordinary course of business. The Company believes it is unlikely that the final outcome of any of the claims or proceedings to which the Company is a party would have a material adverse effect on the Company's financial position or results of operations; however, due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on the Company's results of operations for the fiscal period in which such resolution occurred.

### NOTE 17. ACQUISITIONS:

As previously discussed, in January 2005, the Company acquired certain assets of ATS, including its Peterbilt truck dealerships in Texas and Tennessee, for a total purchase price of \$132.4 million. The acquisition provides the Company with rights to sell Peterbilt trucks and parts at new locations in Dallas, Fort Worth, Abilene and Tyler, Texas; and Nashville, Tennessee. The transaction was financed with cash of \$77.8 million, expansion of the Company's existing floor plan agreement for truck inventory of \$34.6 million, and the issuance of debt of approximately \$20.0 million to finance the purchase of real estate and certain vehicles used in ATS's leasing operations. Of the \$77.8 million paid in cash, \$21.9 million was for the purchase of a note receivable from the selling shareholders of ATS. This \$21.9 million was immediately repaid by the selling shareholders at closing, resulting in net cash used in the acquisition of \$55.9 million.

# Notes to Consolidated Financial Statements

## Rush Enterprises, Inc. and Subsidiaries

The ATS acquisition has been accounted for as a purchase. The purchase price has been allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 38,664
Notes & leases receivable	23,211
Other assets	104
Property and equipment, net	20,790
Accrued expenses	(3,070)
Goodwill	52,667
<b>Total</b>	<b>\$ 132,366</b>

The goodwill acquired in the ATS acquisition is included in the "other assets" line item of the Rush Enterprises, Inc. and Subsidiaries Consolidated Balance Sheet for the period ended December 31, 2005. All of the goodwill acquired in the ATS acquisition will be amortized over 15 years for tax purposes.

The following unaudited pro forma summary presents information as if the ATS acquisition had taken place at the beginning of 2003. The pro forma information is provided for informational purposes only. It is based on historical information and does not necessarily reflect the actual results that would have occurred nor is it necessarily indicative of future results of operations of the Company. The following summary is for the years ended December 31, 2003 and 2004 (unaudited):

(in thousands, except per share amounts)	2003	2004
<b>Revenues</b>	<b>\$ 1,015,119</b>	<b>\$ 1,438,609</b>
<b>Income from continuing operations after</b>		
pro forma provision for income taxes	\$ 13,462	\$ 24,571
<b>Basic income from continuing</b>		
operations per share	\$ 0.59	\$ 1.04
<b>Diluted income from continuing</b>		
operations per share	\$ 0.57	\$ 1.01

In July 2005, the Company purchased certain assets of Fountain Motor Co., Inc., which consisted of a GMC and Isuzu medium-duty dealership in Orlando, Florida. The Company added Peterbilt trucks and UD products to the new dealership and is operating the facility as a full-service Rush Truck Center offering heavy-duty and medium-duty trucks, parts and service. The transaction was valued at approximately \$2.8 million, with the purchase price paid in cash.

The Fountain Motor Co., Inc. acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of the acquisition. The purchase price was allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 1,341
Property and equipment	20
Other assets	2
Accrued expenses	(24)
Goodwill	1,455
<b>Total</b>	<b>\$ 2,794</b>

All of the goodwill acquired in the Fountain Motor Co., Inc. acquisition will be amortized over 15 years for tax purposes.

In September 2005, the Company purchased certain assets of Barrett Trucks, LLC, which consisted of a GMC and Isuzu medium-duty dealership in Texarkana, Texas. The Company added Peterbilt trucks to the dealership and is operating the facility as a full-service Rush Truck Center offering heavy-duty and medium-duty trucks, parts and service. The transaction was valued at approximately \$626,000, with the purchase price paid in cash.

The Barrett Trucks LLC acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of the acquisition. The purchase price was allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 375
Property and equipment	42
Accrued expenses	(16)
Goodwill	225
<b>Total</b>	<b>\$ 626</b>

All of the goodwill acquired in the Barrett Trucks LLC acquisition will be amortized over 15 years for tax purposes.

In September 2005, the Company purchased certain assets of Hayes Leasing Company, Inc., which consisted of GMC and UD medium-duty franchises. The newly acquired lines were added to its existing medium-duty truck store in Dallas, Texas. The transaction was valued at approximately \$3.4 million, with the purchase price paid in cash.



## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

The Hayes Leasing Company, Inc. acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of the acquisition. The purchase price was allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 2,058
Property and equipment	31
Prepaid expenses	13
Goodwill	1,260
<b>Total</b>	<b>\$ 3,362</b>

All of the goodwill acquired in the Hayes Leasing Company, Inc. acquisition will be amortized over 15 years for tax purposes.

In October 2005, the Company purchased certain assets of TEC of California, Inc., which consisted of GMC, Isuzu and Hino medium-duty franchises. The newly acquired lines were added to its existing medium-duty truck store in Fontana, California. The transaction was valued at approximately \$3.4 million, with the purchase price paid in cash.

The TEC of California, Inc. acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of the acquisition. The purchase price was allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 1,847
Property and equipment	11
Accrued expenses	(9)
Goodwill	1,517
<b>Total</b>	<b>\$ 3,366</b>

All of the goodwill acquired in the TEC of California, Inc. acquisition will be amortized over 15 years for tax purposes.

In February 2003, the Company acquired the common stock of Orange County Truck and Trailer, Inc. ("Orange County"), a Peterbilt dealer in central Florida. The acquisition provided the Company with the right to sell Peterbilt trucks and parts from three locations in central Florida, including Orlando, Haines City and Tampa. The transaction was valued at approximately \$5.4 million, with the purchase price paid in cash.

The Orange County acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of acquisition.

The purchase price was allocated based on the fair values of the assets and liabilities at the date of the acquisition as follows:

(in thousands)	
Cash	\$ 1,270
Inventories	5,172
Accounts receivable & other assets	2,518
Property and equipment, net	568
Accounts payable & accrued expenses	(5,734)
Notes payable	(1,832)
Goodwill	3,421
<b>Total</b>	<b>\$ 5,383</b>

As the Orange County acquisition was a stock purchase, the goodwill is not deductible for tax purposes.

In April 2003, the Company purchased substantially all of the assets of Peterbilt of Mobile, Inc., a Peterbilt dealer in Mobile, Alabama.

The Peterbilt of Mobile, Inc. acquisition was accounted for as a purchase; operations of the business acquired are included in the accompanying consolidated financial statements from the date of the acquisition. The purchase price was allocated based on the fair values of the assets at the date of acquisition as follows:

(in thousands)	
Inventories	\$ 448
Property and equipment	126
Goodwill	860
<b>Total</b>	<b>\$ 1,434</b>

All of the goodwill acquired in the Peterbilt of Mobile, Inc. acquisition will be amortized over 15 years for tax purposes.

## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

#### NOTE 18. UNAUDITED QUARTERLY FINANCIAL DATA:

(In thousands, except per share amounts.)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2004</b>				
Revenues	\$ 229,884	\$ 267,179	\$ 296,904	\$ 301,012
Gross Profit	41,319	45,502	49,788	48,533
Operating income from continuing operations	4,529	8,229	10,957	10,361
Income from continuing operations before income taxes	3,504	6,807	9,548	8,891
Income from continuing operations	2,102	4,084	5,729	5,261
Gain (loss) from discontinued operations, net	53	44	(240)	(117)
Net income	\$ 2,155	\$ 4,128	\$ 5,489	\$ 5,144
Earning per share: Basic				
Income from continuing operations	\$ 0.15	\$ 0.28	\$ 0.38	\$ 0.28
Net income	\$ 0.15	\$ 0.28	\$ 0.36	\$ 0.27
Earning per share: Diluted				
Income from continuing operations	\$ 0.14	\$ 0.26	\$ 0.36	\$ 0.27
Net income	\$ 0.14	\$ 0.26	\$ 0.35	\$ 0.26
<b>2005</b>				
Revenues	\$ 402,043	\$ 461,817	\$ 485,427	\$ 515,483
Gross Profit	60,947	71,750	76,359	73,636
Operating income from continuing operations	14,926	21,462	23,897	23,253
Income from continuing operations before income taxes	12,495	18,267	20,635	19,741
Income from continuing operations	7,684	11,235	13,154	12,552
Net income	\$ 7,684	\$ 11,235	\$ 13,154	\$ 12,552
Earning per share: Basic				
Income from continuing operations	\$ 0.32	\$ 0.47	\$ 0.54	\$ 0.51
Net income	\$ 0.32	\$ 0.47	\$ 0.54	\$ 0.51
Earning per share: Diluted				
Income from continuing operations	\$ 0.31	\$ 0.45	\$ 0.53	\$ 0.50
Net income	\$ 0.31	\$ 0.45	\$ 0.53	\$ 0.50

## Notes to Consolidated Financial Statements

### Rush Enterprises, Inc. and Subsidiaries

#### **NOTE 19. SEGMENTS:**

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). This statement requires that public business enterprises report certain information about operating segments in complete sets of financial statements of the enterprise and in condensed financial statements of interim periods issued to shareholders. It also requires that public business enterprises report certain information about their products and services, the geographic areas in which they operate, and their major customers.

As previously mentioned, in November 2002 the Company announced its decision to discontinue its D&D operations. In connection with this decision, financial information related to D&D in 2003 and 2004 is no longer presented as a separate operating segment. Since the disposal of D&D was completed in 2004, there is no related financial activity in 2005.

The Company currently has two reportable business segments: the Truck segment and the Construction Equipment segment. The truck segment operates a regional network of truck centers

that provide an integrated one-stop source for the trucking needs of its customers, including retail sales of new and used heavy-duty and medium-duty trucks; aftermarket parts, service and body shop facilities; and a wide array of financial services, including the financing of new and used truck purchases, insurance products and truck leasing and rentals. The Construction Equipment segment operates a full-service John Deere dealership that serves the Houston, Texas area. Dealership operations include the retail sale of new and used construction equipment, aftermarket parts and service facilities, equipment rentals, and the financing of new and used construction equipment.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on income before income taxes not including extraordinary items.

The Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices. There were no material intersegment sales during the years ended December 31, 2003, 2004 and 2005.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business unit requires different technology and marketing strategies. Business units were maintained through expansion and acquisitions. Assets held for sale and goodwill related to discontinued operations are included in the Truck segment for the year ended December 31, 2003. The following table contains summarized information about reportable segment profit or loss and segment assets for the years ended December 31, 2003, 2004 and 2005:

(in thousands)	Truck Segment	Construction Equipment Segment	All Other	Totals
<b>2003</b>				
Revenues from external customers	\$ 765,565	\$ 41,422	\$ 8,345	\$ 815,332
Interest income	290	—	—	290
Interest expense	6,121	382	135	6,638
Depreciation and amortization	8,347	226	356	8,929
Segment income from continuing operations before income tax	14,291	1,228	231	15,750
Segment assets	341,037	15,873	9,968	366,878
Goodwill	38,431	4,075	114	42,620
Expenditures for segment assets	19,511	619	1,045	21,175
<b>2004</b>				
Revenues from external customers	\$ 1,039,758	\$ 46,154	\$ 9,067	\$ 1,094,979
Interest income	782	—	—	782
Interest expense	6,164	407	161	6,732
Depreciation and amortization	8,507	311	301	9,119
Segment income from continuing operations before income tax	26,606	2,094	50	28,750
Segment assets	534,504	18,863	12,138	565,505
Goodwill	39,406	4,075	111	43,592
Expenditures for segment assets	52,784	153	1,003	53,940
<b>2005</b>				
Revenues from external customers	\$ 1,793,485	\$ 57,731	\$ 13,554	\$ 1,864,770
Interest income	2,508	—	—	2,508
Interest expense	14,640	586	177	15,403
Depreciation and amortization	9,894	291	302	10,487
Segment income from continuing operations before income tax	64,921	4,566	1,651	71,138
Segment assets	801,917	24,080	14,237	840,234
Goodwill	96,539	4,075	111	100,725
Expenditures for segment assets	64,592	392	817	65,801

Revenues from segments below the quantitative thresholds are attributable to three operating segments of the Company. Those segments include a tire company, an insurance company and a hunting lease operation. None of those segments has ever met any of the quantitative thresholds for determining reportable segments.



## Stock Trading, Price Ranges and Dividends

### Rush Enterprises, Inc. and Subsidiaries

Our common stock trades on The NASDAQ National Market® under the symbols RUSHA and RUSHB.

The following table sets forth the high and low sales prices for the Class A Common Stock and Class B Common Stock for the fiscal periods indicated and as quoted on The NASDAQ National Market®.

Fiscal 2005:	High	Low
<b>Class A Common Stock</b>		
First Quarter	\$ 16.65	\$ 14.00
Second Quarter	\$ 16.58	\$ 12.84
Third Quarter	\$ 16.82	\$ 13.25
Fourth Quarter	\$ 15.87	\$ 13.95
<b>Class B Common Stock</b>		
First Quarter	\$ 17.45	\$ 14.91
Second Quarter	\$ 16.89	\$ 12.85
Third Quarter	\$ 16.64	\$ 13.25
Fourth Quarter	\$ 15.16	\$ 13.70
<b>Fiscal 2004:</b>	<b>High</b>	<b>Low</b>
<b>Class A Common Stock</b>		
First Quarter	\$ 12.30	\$ 9.04
Second Quarter	\$ 13.79	\$ 10.77
Third Quarter	\$ 14.08	\$ 10.00
Fourth Quarter	\$ 16.50	\$ 10.27
<b>Class B Common Stock</b>		
First Quarter	\$ 12.40	\$ 9.06
Second Quarter	\$ 14.05	\$ 10.61
Third Quarter	\$ 14.00	\$ 11.05
Fourth Quarter	\$ 17.72	\$ 11.27

As of March 3, 2006, there were approximately 53 record holders of the Class A Common Stock and approximately 58 record holders of the Class B Common Stock and approximately 3,460 beneficial holders of the Class A Common Stock and approximately 670 beneficial holders of the Class B Common Stock.

The Board of Directors intends to retain any earnings of the Company to support operations and to finance expansion and does not intend to pay cash dividends in the foreseeable future. Any future determination as to the payment of dividends will be at the discretion of the Board of Directors of the Company and will depend on the Company's financial condition, results of operations, capital requirements and such other factors as the Board of Directors deems relevant.

### NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain statements contained in this Annual Report (or otherwise made by the Company or on the Company's behalf from time to time in other reports, filings with the Securities and Exchange Commission, news releases, conferences, website postings or otherwise) that are not statements of historical fact constitute "forward-looking statements" within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act of 1934, as amended, notwithstanding that such statements are not specifically identified. Forward-looking statements include statements about the Company's financial position, business strategy and plans and objectives of management of the Company for future operations. These forward-looking statements reflect the best judgments of the Company about the future events and trends based on the beliefs of the Company's management as well as assumptions made by and information currently available to the Company's management. Use of the words "may," "should," "continue," "plan," "potential," "anticipate," "believe," "estimate," "expect" and "intend" and words or phrases of similar import, as they relate to the Company or its subsidiaries or Company management, are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements reflect the current view of the Company with respect to future events and are subject to risks and uncertainties that could cause actual results to differ materially from those in such statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those set forth under Item 1A—Risk Factors in our Form 10K for the year ended December 31, 2005, as well as future growth rates and margins for certain of our products and services, future demand for our products and services, competitive factors, general economic conditions, cyclicalities, economic conditions in the new and used truck and equipment markets, customer relations, relationships with vendors, the interest rate environment, governmental regulation and supervision, seasonality, distribution networks, product introductions and acceptance, technological change, changes in industry practices, onetime events and other factors described herein and in the Company's quarterly and other reports filed with the Securities and Exchange Commission (collectively, "cautionary statements"). Although the Company believes that its expectations are reasonable, it can give no assurance that such expectations will prove to be correct. Based upon changing conditions, should any one or more of these risks or uncertainties materialize, or should any underlying assumptions prove incorrect, actual results may vary materially from those described in any forward-looking statements. All subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the applicable cautionary statements. The Company does not intend to update these forward-looking statements.

## Corporate and Shareholder Information

### Rush Enterprises, Inc. and Subsidiaries

#### Board of Directors

**W. Marvin Rush**

*Chairman*

**W.M. "Rusty" Rush**

*President and Chief Executive Officer*

**Thomas A. Akin**

*Partner*

*Akin, Doherty, Klein and Feuge, P.C.*

**Ronald J. Krause**

*Former President and*

*Chief Operating Officer*

*Associates Corporation of North America*

**Harold D. Marshall**

*Former President and Chief Operating Officer*

*Associates First Capital Corporation*

**John D. Rock**

*Former Vice President of General Motors*

*and General Manager – Oldsmobile*

*Division*

#### Board Committees

**Audit Committee**

*Thomas A. Akin\**

*Ronald J. Krause*

*Harold D. Marshall*

**Compensation Committee**

*Harold D. Marshall\**

*Thomas A. Akin*

*Ronald J. Krause*

*John D. Rock*

**Nominating & Governance Committee**

*John D. Rock\**

*Ronald J. Krause*

*Harold D. Marshall*

\* Committee Chair

#### Executive Officers Rush Enterprises, Inc.

**W. Marvin Rush**

*Chairman*

**W.M. "Rusty" Rush**

*President and Chief Executive Officer*

**Martin A. Naegelin, Jr.**

*Senior Vice President,*

*Chief Financial Officer*

*and Treasurer*

**Daryl J. Gorup**

*Senior Vice President*

*Dealership Operations*

**Richard D. Hall**

*Vice President, Insurance*

**Scott Anderson**

*Senior Vice President*

*Finance and Insurance*

**J.M. "Spike" Lowe, Jr.**

*Senior Vice President*

*Corporate Development*

**David C. Orf**

*Senior Vice President*

*Marketing, Fleets and*

*Specialized Equipment*

**James E. Thor**

*Senior Vice President*

*Retail Sales*

**Derrek Weaver**

*Chief Compliance Officer,*

*Vice President of Legal Affairs*

*and Secretary*

#### Shareholder Information

**Executive Offices**

Rush Enterprises, Inc.

P.O. Box 34630

San Antonio, TX 78265

(830) 626-5200

**Independent Public Accountants**

Ernst & Young LLP

San Antonio, TX

**Corporate and Securities Counsel**

Fulbright & Jaworski L.L.P.

San Antonio, TX

**Annual Meeting**

The annual meeting of shareholders of the

Company will be held at 10:00 A.M. CDT

on May 16, 2006, at The Plaza Club,

Frost National Bank Building, 21st Floor

100 W. Houston Street

San Antonio, TX 78205

**Availability of 10-K Report**

Adam Friedman

Adam Friedman Associates LLC

11 East 44th Street, Fifth Floor

New York, NY 10017

(212) 981-2529 ext. 18

**Shares Listed**

Rush Enterprises, Inc.'s common stock

trades on the NASDAQ National Market®

under the symbols RUSHA and RUSHB.

**Website**

[www.rushenterprises.com](http://www.rushenterprises.com)

## Forward-Looking Statements

Certain statements in this Annual Report are "Forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Important factors that could cause actual results to differ materially from those in the forward-looking statements are described in the forward-looking statements section on page 50.



**Rush Enterprises, Inc.**

555 IH 35 South, Suite 500 New Braunfels, TX 78130  
(830) 626-5200 [www.rushenterprises.com](http://www.rushenterprises.com)