

PROGRESS SOFTWARE CORP /MA

Form 10-K/A

December 19, 2006

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K/A**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the Fiscal Year Ended November 30, 2005**

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**Commission File Number: 0-19417  
PROGRESS SOFTWARE CORPORATION  
(Exact name of registrant as specified in its charter)**

**MASSACHUSETTS**  
*(State or other jurisdiction of incorporation or  
organization)*

**04-2746201**  
*(I.R.S. Employer Identification No.)*

**14 Oak Park  
Bedford, Massachusetts 01730**  
*(Address of principal executive offices)*

**Telephone Number: (781) 280-4000**

**Securities registered pursuant to Section 12(b) of the Act:**  
**None**

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

**Common Stock \$.01 par value**

*Title of each class*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of May 31, 2005 (the last business day of the registrant's most recently completed second fiscal quarter), the aggregate market value of voting stock held by non-affiliates of the registrant was approximately \$966,000,000.

As of January 31, 2006, there were 40,406,000 common shares outstanding.

**Documents Incorporated by Reference**

Portions of the definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006 are incorporated by reference into Part III.

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**Table of Contents**

**Explanatory Note    Restatement of Consolidated Financial Statements**

We are amending our Annual Report on Form 10-K (the Original Filing) for the year ended November 30, 2005 to restate our consolidated financial statements for the years ended November 30, 2005, 2004 and 2003 and the related disclosures appearing in Item 8 of this Form 10-K/A. This Form 10-K/A also includes the restatement of Item 6, Selected Financial Data as of and for the years ended November 30, 2005, 2004, 2003, 2002 and 2001. Item 6 also includes certain supplementary selected financial data for the years November 30, 2000, 1999 and 1998, and additional information for the years ended November 30, 1997 and 1996.

On August 29, 2006, the Audit Committee of our Board of Directors concluded that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements, and that our consolidated financial statements, including the reports of our independent registered public accounting firm thereon, and our earnings releases and similar communications for the year ended November 30, 1996 and subsequent periods, should no longer be relied upon.

On November 28, 2006, our Board of Directors concluded that our consolidated financial statements for the three months ended February 28, 2006 and each of the years during the three year period ended November 30, 2005, as well as the selected financial data for the years ended November 30, 2002 and 2001 (as well as for certain prior periods not included in these financial statements) should be restated to record additional non-cash stock-based compensation expense, and related tax effects, resulting from stock options granted during fiscal years 1996 to 2005 that were incorrectly accounted for under accounting principles generally accepted in the United States of America (GAAP). This decision was based on the determination that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements.

Our decision to restate our financial statements was based on the facts obtained by an internal investigation into our stock option accounting. This investigation was initiated voluntarily by our Board of Directors in May 2006 as a result of media and analysts' reports regarding stock option grant practices of numerous companies, including Progress Software, as well as investor inquiries. The investigation was conducted initially under the direction of the Audit Committee of the Board of Directors, which included an independent director who also served on the Compensation Committee of our Board of Directors. In September 2006, our Board of Directors created a Special Committee (the Special Committee) of the Board of Directors, consisting only of independent directors who had never served on the Compensation Committee of our Board of Directors, to continue the investigation. The investigation was jointly conducted by our outside legal counsel and by special legal counsel retained by the Special Committee, which counsel had no prior relationship with us or our management.

In our restated financial statements, we recorded additional stock-based compensation charges of \$29.2 million for the years ended November 30, 1996 through November 30, 2005. As a result of the errors in determining measurement dates, we also recorded payroll withholding tax-related adjustments for certain options formerly classified as Incentive Stock Option (ISO) grants under Internal Revenue Service regulations. We recorded estimated payroll withholding tax liabilities of \$2.4 million for the years ended November 30, 2003 through November 30, 2005 in connection with the disqualification of such ISO tax treatment. The stock-based compensation charges, including the aforementioned withholding tax adjustments and income tax expense adjustments, decreased net income by \$22.0 million for the fiscal years ended November 30, 1996 through November 30, 2005.

All of the charges relating to revised measurement dates arose from incorrect measurement dates for stock option grants made from December 1995 through July 2005. During the second half of fiscal 2005, which was prior to the inception of the investigation, we had revised our stock option grant practices, as described in more detail in

Management's Discussion and Analysis of Financial Condition and Results of Operations - Restatement of Consolidated Financial Statements. The Special Committee concluded, based on its review of the facts and circumstances surrounding our option grant practices, including the retrospective selection of grant dates, that management knew that relevant accounting rules required us to record stock-based compensation charges when we made below fair market value option grants, but did not apply those rules correctly or assure that they were being applied correctly and therefore failed to record necessary accounting charges. The Special Committee further concluded that there was no evidence to indicate that the practices that caused errors related to stock option grant

measurement dates and stock-based compensation resulted from willful misconduct.

**Table of Contents**

We also restated our balance sheets to reclassify auction rate securities to short-term investments from cash and equivalents and the related purchases and sales of such securities in the statements of cash flows.

We have not amended and we do not intend to amend any of our other previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q, except for our Form 10-Q for the three months ended February 28, 2006, for the periods affected by the restatements or adjustments, except as described above. As we have previously announced, the consolidated financial statements and related financial information contained in such previously filed reports, including the reports of our independent registered public accounting firm thereon, and our earnings releases and similar communications for fiscal 1996 and subsequent periods, should no longer be relied upon. All the information in this Form 10-K/A is as of November 30, 2005 and does not reflect any subsequent information or events other than the restatement discussed in Note 14 and related matters discussed in Note 13 of the Consolidated Financial Statements appearing in this Form 10-K/A. Specifically, we are not reconfirming, updating or otherwise endorsing as of the date hereof any financial guidance for fiscal 2006, including our previous projections of revenue, income from operations, effective tax rates or other results of operations, or other forward-looking information restated in this report. For the convenience of the reader, this Form 10-K/A sets forth the Original Filing in its entirety. However, the following items have been amended solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby as a result of the restatement:

Part I Item 1 Business (amended solely to restate certain financial data included therein);

Part I Item 3 Legal Proceedings;

Part II Item 6 Selected Financial Data;

Part II Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations;

Part II Item 8 Financial Statements and Supplementary Data;

Part II Item 9A Controls and Procedures;

Part IV Item 15 Exhibits and Financial Statement Schedules

In accordance with applicable SEC rules, this Form 10-K/A includes updated certifications from our Chief Executive Officer and Chief Financial Officer as Exhibits 31.1, 31.2, and 32.1.

**PROGRESS SOFTWARE CORPORATION**  
**FORM 10-K/A**  
**FOR THE FISCAL YEAR ENDED NOVEMBER 30, 2005**  
**INDEX**

**PART I**

|  |    |
|--|----|
| <u>Item 1. Business</u>  | 5  |
| <u>Item 1A. Risk Factors</u>                                       | 14 |
| <u>Item 1B. Unresolved Staff Comments</u>                          | 18 |
| <u>Item 2. Properties</u>  | 18 |
| <u>Item 3. Legal Proceedings</u>                                   | 18 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 19 |

**PART II**

|   |    |
|---|----|
| <u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 19 |
| <u>Item 6. Selected Financial Data</u>  | 20 |
| <u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 22 |
| <u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>  | 35 |
| <u>Item 8. Financial Statements and Supplementary Data</u>  | 37 |
| <u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>                         | 74 |
| <u>Item 9A. Controls and Procedures</u>   | 74 |
| <u>Item 9B. Other Information</u>   | 78 |

**PART III**

|  |    |
|--|----|
| <u>Item 10. Directors and Executive Officers of the Registrant</u>   | 78 |
| <u>Item 11. Executive Compensation</u>   | 78 |
| <u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 78 |
| <u>Item 13. Certain Relationships and Related Transactions</u>   | 79 |
| <u>Item 14. Principal Accounting Fees and Services</u>   | 79 |

**PART IV**

|   |    |
|---|----|
| <u>Item 15. Exhibits and Financial Statement Schedules</u>      | 79 |
| <u>Signatures</u>   | 83 |
| <u>EX-23.1 Consent of Deloitte &amp; Touche LLP</u>             |    |
| <u>EX-31.1 Section 302 Certification of C.E.O.</u>              |    |
| <u>EX-31.2 Section 302 Certification of C.F.O.</u>              |    |
| <u>EX-32.1 Section 906 Certification of C.E.O. &amp; C.F.O.</u> |    |

**Table of Contents**

**PART I**

**CAUTIONARY STATEMENTS**

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This Form 10-K/A, and other information provided by us or statements made by our directors, officers or employees from time to time, may contain forward-looking statements and information, which involve risks and uncertainties. Actual future results may differ materially. Statements indicating that we expect, estimate, believe, are planning or plan to are forward-looking, as are other statements concerning future financial results, product offerings or other events that have not yet occurred. There are several important factors that could cause actual results or events to differ materially from those anticipated by the forward-looking statements. Such factors include those described in Item 1A of this Form 10-K/A under the heading Risk Factors. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized. We also cannot assure you that we have identified all possible issues which we might face. We undertake no obligation to update any forward-looking statements that we make.

**Item 1. Business**

**Overview**

Progress Software Corporation develops, markets and distributes application infrastructure software to simplify and accelerate the development, deployment, integration and management of business applications software. Our mission is to deliver superior software products and services that empower partners and customers to dramatically improve their development, deployment, integration and management of quality applications worldwide. We seek to achieve our mission by providing a robust set of software platforms, tools and services that enable the highly distributed deployment of responsive applications across internal networks, the Internet and occasionally-connected users and simplify the connectivity and integration of applications and data across the enterprise and between enterprises. More than half of our worldwide revenue is realized through relationships with indirect channel partners, principally application partners and original equipment manufacturers (OEMs). Application partners are independent software vendors that develop and market applications utilizing our technology and resell our products in conjunction with sales of their own products that incorporate our technology. These application partners sell business applications in diverse markets such as manufacturing, distribution, financial services, retail and health care. OEMs are companies that embed our products into their software products or devices. We also sell software products and services directly to the business groups and information technology (IT) organizations of businesses and governments. We operate in North America, Latin America, Europe, Middle East, Africa (EMEA) and the Asia/Pacific region through local subsidiaries as well as independent distributors.

**Operating Units and Segments**

We have four principal operating units:

The Progress OpenEdge Division (OpenEdge Division)

Sonic Software Corporation (Sonic)

The Progress Real Time Division (Real Time Division)

DataDirect Technologies (DataDirect)

***The Progress OpenEdge Division***, our largest operating unit, provides the Progress OpenEdge® platform, a unified set of development and deployment technologies, including the OpenEdge RDBMS, one of the leading embedded databases, that simplifies the job of building business applications. OpenEdge Division was formerly known as the Progress Company. OpenEdge Division released its latest major version, OpenEdge 10, in December 2003. The goal of the OpenEdge Division, along with its more than 2,000 application partners, is to enable end users to achieve a sustainable competitive advantage through application partner developed business solutions that simplify end



## **Table of Contents**

users' operations, are fast to implement, provide one of the lowest total costs of ownership, and have unparalleled reliability.

In May 2005, we acquired substantially all of the assets and assumed certain liabilities of EasyAsk, Inc. (EasyAsk) for an aggregate purchase price of approximately \$9 million, net of cash acquired. EasyAsk is a provider of natural language question/answer solutions that empower non-technical users to quickly find and retrieve critical business information from multiple enterprise data sources. EasyAsk is reported within the OpenEdge Division.

**Sonic Software Corporation**, our wholly owned subsidiary, invented and is a leading provider of the enterprise service bus. Sonic provides distributed infrastructure products that integrate applications and orchestrate business processes across the extended enterprise. The Sonic product line offers a standards-based foundation for building a service oriented architecture (SOA). Sonic ESB® enables the configuration, reliable connection, mediation and control of software services and their interactions. Sonic ESB is particularly well-suited for integrating large numbers of mission critical applications that must interoperate across a global enterprise and with the global enterprise's many business partners. Sonic Software also offers SonicMQ®, a highly scalable messaging server.

**The Progress Real Time Division** provides event stream processing, data management, data access, and synchronization products to enable the real-time enterprise. These products help businesses monitor, analyze and act on streaming event data, such as radio frequency identification (RFID) or stock tickers, accelerate the performance of existing relational databases and support occasionally-connected users requiring real-time access to shared enterprise data.

**DataDirect Technologies**, acquired in December 2003, provides data connectivity components that enable software developers to use industry standard interfaces, such as ODBC, JDBC and ADO.NET, to connect applications running on various platforms to major databases. DataDirect is the market leader in the relational data connectivity market, with components embedded in the products of over 250 top software companies and the applications of thousands of large enterprises. DataDirect also offers an XML development tool, Stylus Studio®, and has introduced DataDirect XQuery, the industry's first embeddable software product based on the XQuery and XQJ standards.

**Segments.** Based upon the aggregation criteria for segment reporting within consolidated financial statements, we have two reportable segments:

the Application Development and Deployment segment, which consists primarily of the OpenEdge Division and DataDirect, and

the Enterprise SOA Infrastructure segment, which consists primarily of Sonic Software and the Real Time Division.

These segments have changed from our previously reported segments as we combined the sales and marketing organizations of Sonic and Real Time in December 2005. Since we will be combining results for those two operating units in fiscal 2006, we have restated our segments in this Form 10-K/A to conform to our organizational structure moving forward.

For financial information relating to business segments and international operations, see Note 11 of the Consolidated Financial Statements appearing in this Form 10-K/A.

## **Recent Developments**

On January 30, 2006 we acquired, through a wholly-owned subsidiary, all of the outstanding shares of common stock of NEON Systems, Inc. (NEON) for an aggregate purchase price of approximately \$52 million, net of cash acquired. The purchase price also included the value of in-the-money stock options and warrants. NEON is a provider of mainframe integration products and services. The purpose of the acquisition was to broaden the product offerings of DataDirect. Upon the closing of the transaction, NEON became part of our DataDirect operating unit. We will account for the acquisition as a purchase, and accordingly, we will include the results of operations of NEON in our operating results from the date of acquisition.

## **Table of Contents**

On January 20, 2006, we acquired for a combination of cash and stock, through a wholly-owned subsidiary, all of the outstanding stock of Actional Corporation (Actional) for an aggregate purchase price of approximately \$32 million, net of cash acquired. Actional is a leading provider of Web services management software for visibility and run-time governance of distributed IT systems in a service-oriented architecture. The purpose of the acquisition was to broaden the Sonic product line. Upon the closing of the transaction, Actional became part of our Sonic operating unit. We will account for the acquisition as a purchase, and accordingly, we will include the results of operations of Actional in our operating results from the date of acquisition.

### **Our Products**

We develop, market and distribute software for the development, deployment, integration and management of business applications. We provide development tools that empower developers to deliver high-quality applications. We deliver reliable, high-performance deployment and integration products such as application servers, databases, enterprise service buses and messaging servers that are essential to the successful use of an application, result in a low total cost of ownership and extend the application's lifecycle. Our product lines are designed to comply with open standards and to deliver high levels of performance and scalability. Our products are generally licensed under perpetual licenses.

The following descriptions, organized by technology groups, provide details about our significant products:

#### **Development Products**

##### ***OpenEdge Studio***

OpenEdge Studio provides developers with a unified, highly productive development environment for building complex distributed business applications. OpenEdge Studio presents one workbench and one set of tools for developing a range of applications from client/server models to transaction processing over the Internet. OpenEdge contains Progress® AppBuilder, a central workbench that provides visual tools for defining objects, laying out interfaces and linking data, and the 4GL Development System, a toolset for writing Progress applications that includes an editor, compiler, data dictionary and data administration utilities.

##### ***WebSpeed® Workshop***

WebSpeed® Workshop is a solution for building and deploying highly scalable business Web applications that process large volumes of transactions. WebSpeed WorkShop combines a visual toolset, packaged Web objects, and SpeedScript, a scripting language specially purposed for internet applications to create a productive development environment.

##### ***Stylus Studio®***

Stylus Studio® is an advanced eXtensible Mark-up Language (XML) development environment. Stylus Studio includes numerous XML-related data maps, editors and debuggers. Stylus Studio has the capability to query and update relational data using the SQL/XML standard.

##### ***DataDirect XQuery***

DataDirect Xquery is an Xquery implementation for applications that need to process both XML and relational data sources. DataDirect Xquery provides special query optimization and mediation for optimal performance when accessing relational data. DataDirect Xquery includes XQuery (XML Query) Tools, a standards-based, advanced XQuery development environment.

#### **Deployment Products**

##### ***OpenEdge RDBMS***

The OpenEdge RDBMS products are high-performance relational databases that can scale from a single-user Windows system to symmetric multiprocessing and cache coherent non-uniform memory access systems, supporting

**Table of Contents**

thousands of concurrent users. In addition to offering scalability and a low total cost of ownership, the OpenEdge RDBMS products offer high availability, reliability, performance, and platform portability. OpenEdge RDBMS provides flexible data storage capabilities that allow multiple clients to access the same data via Progress 4GL or SQL access via Open DataBase Connectivity (ODBC) and Java DataBase Connectivity (JDBC). OpenEdge RDBMS products integrate with enterprise applications, tools and numerous third-party data management systems. The three OpenEdge RDBMS products, Enterprise, Workgroup and Personal, allow users to select a solution that satisfies their business objectives.

The OpenEdge Enterprise RDBMS is designed for mid-size and large user environments and the transaction processing throughput of high volume SQL-based and Progress 4GL-based on-line transaction processing applications. The OpenEdge Enterprise RDBMS was developed with a flexible, multithreaded, multiserver architecture. The OpenEdge Enterprise RDBMS is a powerful, open and large-scale enterprise database that can run across multiple hardware platforms and networks. The architecture of the storage engine lets applications take advantage of powerful computing systems. With support for over 10,000 concurrent users and numerous terabytes of data, it provides the capacity for large-scale, high-performance computing.

The OpenEdge Workgroup RDBMS, which offers many of the same powerful capabilities as the OpenEdge Enterprise RDBMS, is designed for deployment in a departmental or small business environment that involves a limited number of users (up to fifty). This department-level solution provides high performance, multi-user support and cross-platform interoperability. The OpenEdge Workgroup RDBMS runs on a wide variety of hardware and operating system platforms. The OpenEdge Personal RDBMS is bundled with OpenEdge development tools and is suitable for deploying single-user SQL-based and 4GL-based applications and for developing, prototyping and testing applications.

***OpenEdge Application Server***

OpenEdge Application Server supports an open, component-based model for partitioning applications and enables applications to be transformed into modular elements within an integrated environment. This enables business logic to be more easily distributed and reused. OpenEdge Application Server provides open, standards-based interoperability and integration to ensure that applications can support multiple user interface and integration methodologies. OpenEdge Application Server includes WebSpeed Transaction Server which is designed for high-throughput transaction processing over the Internet.

There are two editions of OpenEdge Application Server to address varying processing needs. OpenEdge Application Server Basic Edition provides a solution for deploying simple yet dynamic business applications for some small and mid-size businesses. OpenEdge Application Server Enterprise Edition provides an application server solution for mid-size and large businesses. The Enterprise Edition provides the foundation for delivering SOA and next-generation integration, including Web services, SonicMQ messaging and Sonic ESB.

***OpenEdge DataServers***

OpenEdge DataServers provide developers with a transparent interface to a wide range of database management systems. These products offer full read, write, update, insert and delete capabilities to diverse data management systems and enable developers to write OpenEdge-based applications once and deploy them across numerous data sources. OpenEdge DataServers provide native access to Oracle and Microsoft SQL Server and access to a wide range of ODBC-compliant data sources, including IBM DB2, IBM Informix On-Line and Sybase.

***ObjectStore®***

ObjectStore is an object-oriented data management solution for enterprise e-Business, telecommunications and commercial software applications. This scalable, high-performance system utilizes object-oriented data modeling and native support for Java® and C++ to provide the reliability, scalability and time-to-market demands required of mission-critical systems. ObjectStore provides developers with highly efficient data storage. ObjectStore's Cache-Forward architecture is designed to maximize the performance of an application through load balancing, cache affinity, transaction services, and overall component coordination and management. The Cache-Forward architecture creates local data caches for components from the ObjectStore server or other enterprise databases.

## **Table of Contents**

### ***DataXtend CE***

DataXtend CE provides a distributed data caching infrastructure that is automatically generated using model-driven, object-relational mapping tools. This data access and caching layer is designed to minimize bottlenecks in custom enterprise applications by optimizing relational database access. DataXtend CE provides graphical object-relational mapping tools and model-driven, interactive code generation designed to accelerate development. Built-in intelligent cache design incorporates the object model and schema for high performance. Cache clustering capabilities provide scalability and high availability.

### ***DataDirect Connect®***

DataDirect Connect for ODBC is a clientless wire protocol ODBC driver for all major databases, including IBM DB2, Informix, Oracle, Microsoft SQL Server, Progress OpenEdge and Sybase. Wire protocol drivers eliminate the need for the database vendor's client software, thereby making applications easier to configure, deploy and maintain, and increasing data access speeds. DataDirect Connect for JDBC is a Type 4 JDBC driver for high-performance database connectivity. DataDirect Connect for JDBC drivers support the latest database features, such as JTA (Java Transaction API). Other products from DataDirect include Connect64 for ODBC, Connect for .NET, Connect for ADO and Connect for SQL/XML.

### ***DataXtend RE***

DataXtend RE offers patented technology for two-way, read-write replication of databases and applications, supporting companies that need to manage data across multiple sites, geographies or systems. This technology enables enterprises to effectively distribute business applications within an enterprise or to remote offices and users, improving the quality of service and system availability.

## **Enterprise SOA Infrastructure Products**

### ***Sonic ESB®***

Sonic ESB is an enterprise service bus that is designed to simplify the integration and flexible reuse of business components using a standards-based, service-oriented architecture. Sonic ESB is designed to allow system architects to dynamically configure the reliable connection, mediation and control of services and their interactions. Sonic ESB spans clusters and security infrastructures to form a federated environment which can be managed from any point. With its configurable service interaction that eliminates hard-wired dependencies, Sonic ESB is designed to make it easier to deploy initial projects and, without recoding, evolve, scale, and extend them throughout the enterprise.

### ***SonicMQ®***

SonicMQ is a standards-based enterprise messaging system that is designed to deliver high performance, management capabilities and scalability for large enterprise deployments. The patent-pending Sonic Continuously Available Architecture (CAA) is designed to ensure continuous system performance, while the Dynamic Routing Architecture® and advanced clustering technologies are designed to ensure scalability to large numbers of messages, users and brokers. Sonic CAA provides high availability for SonicMQ message brokers, SonicMQ clients and the communications among clients, brokers, and destinations. The advanced distributed management and deployment infrastructure of SonicMQ simplifies operations and lowers the total cost of ownership for business-critical communication across the enterprise. SonicMQ is designed to have strong authentication, authorization, and encryption support to ensure that messages and systems are protected inside and outside the firewall. With its guaranteed message delivery system that ensures messages are not lost due to software, network, or hardware failure, SonicMQ is utilized for very complex business transactions and mission-critical communications.

### ***Sonic Orchestration Server***

Sonic Orchestration Server extends the intelligent routing capabilities of the Sonic ESB to enable the modeling, automation, and management of complex business processes across the extended enterprise. The Orchestration

## **Table of Contents**

Server leverages the reach of the ESB to include participating services in a coordinated and managed business process.

### ***Sonic XML Server***

Sonic XML Server provides high-speed XML processing, storage, and query services for management of Sonic ESB operational data. By processing XML messages in their native XML format, Sonic XML Server is designed to be fast, without imposing restrictions on XML message schema. Sonic XML Server can be used as an operational data cache and aggregation service and it can be deployed anywhere on the Sonic ESB to enhance performance, or support data warehousing, business event management, auditing and non-repudiation applications.

### ***Progress® Apama® Algorithmic Trading Platform***

Progress® Apama® provides a platform to enable next-generation algorithmic trading, giving trading groups within financial institutions full control over composing, deploying, and managing algorithmic trading strategies, such as VWAP, spread trading and index arbitrage management products.

### ***Progress® Apama® ESP***

Progress Apama ESP (Event Stream Processing) supports the processing of multiple streams of event data with the goal of identifying the meaningful events within those streams. Progress Apama ESP monitors event-oriented data, applies sets of analytic rules to those events in real time, and, through that real-time analysis, determines the appropriate action to be taken.

### ***Management Products***

#### ***Progress® Fathom®***

Progress® Fathom is a set of enterprise-class application management tools designed to increase the availability and performance of business systems. Progress Fathom enhances the availability and performance of Progress-based applications through system monitoring, alerting and automatic handling of corrective actions.

### ***Product Development***

Most of our products have been developed by our internal product development staff or the internal staffs of acquired companies. We believe that the features and performance of our products are competitive with those of other available development and deployment tools and that none of the current versions of our products are approaching obsolescence. However, we believe that significant investments in new product development and continuing enhancements of our current products will be required to enable us to maintain our competitive position.

Our product development staff consisted of 400 employees as of November 30, 2005. We have six development offices in North America, one in Belgium, and one in India. In fiscal years 2005, 2004 and 2003, we spent \$64.0 million, \$61.5 million and \$51.3 million, respectively, on product development, of which no amounts were capitalized in fiscal 2005, and \$0.3 million in fiscal 2004 and \$0.4 million in fiscal 2003 were capitalized.

### ***Customers***

We globally market our products primarily through application partners and, to some extent, directly to end users. Purchasers of Progress-based applications are generally either business managers or IT managers in corporations and government agencies. In addition, we market our DataDirect and, to a lesser extent, our Real Time and Sonic product lines to OEMs who embed and resell these products as part of an integrated solution. We use international distributors in countries where we do not have a direct presence. No single customer has accounted for more than 10% of our total revenue in any of our last three fiscal years.

### ***Application Partners***

## **Table of Contents**

Our application partners cover a broad range of markets, offer an extensive library of business applications and are a source of follow-on revenue. We have kept entry costs, consisting of primarily the initial purchase of development licenses, low to encourage a wide variety of application partners to build applications. An application partner typically takes six to twelve months to develop an application. Although many of our application partners have developed successful applications and have large installed customer bases, others are engaged in earlier stages of product development and marketing and may not contribute follow-on revenue to us for some time, if at all. However, if an application partner succeeds in marketing its applications, we obtain follow-on revenue as the application partner licenses our deployment products to allow its application to be installed and used by customers. Our OpenEdge Division offers a subscription model alternative to the traditional perpetual license model for application partners who have chosen to enable their business applications under a software as a service business model.

### ***Original Equipment Manufacturers (OEMs)***

We enter into arrangements with OEMs whereby the OEM embeds our products into its solutions, potentially either software or technology devices. The OEM channel is primarily utilized by DataDirect and, to a lesser extent, Sonic and Real Time. OEMs typically license the right to embed our products into their solutions and distribute such solutions for initial terms ranging from one to three years. Historically, a significant portion of our OEMs have renewed their agreement upon the expiration of the initial term.

### ***Direct End Users***

We license our products directly to corporations, government agencies and other organizations. Many end users who purchase application partner applications also purchase our development tools to supplement their internal application development or purchase add-on products directly from us. Like application partners, end user customers also license deployment products for internal applications.

### **Sales and Marketing**

We sell our products through our direct sales force in the United States and in over 25 other countries and through independent distributors in over 30 countries outside North America. The sales, marketing and service groups are organized by operating unit and by region within each operating unit as applicable. The OpenEdge Division operates by region in North America, EMEA, Asia/Pacific and Latin America. DataDirect, Real Time and Sonic Software operate by region within North America, EMEA and Japan. We believe that this structure allows us to maintain direct contact with and support the diverse market requirements of our customers. Our international operations provide focused local marketing efforts and are able to respond directly to changes in local conditions.

Sales personnel are responsible for developing direct end user accounts, recruiting new application partners and OEM accounts, managing existing application partner relationships and servicing existing customers. We actively seek to avoid conflict between the sales efforts of our application partners and our own direct sales efforts. We use our inside sales and customer service groups to enhance our direct sales efforts and to generate new business and follow-on business from existing customers. These groups may provide evaluation copies to application partners or end user organizations to help qualify them as prospective customers, and also sell additional development and deployment products to existing customers.

Our marketing groups within each operating unit conduct a variety of marketing programs designed to ensure a stream of market-ready products, raise the general awareness of us and our operating units, generate leads for the sales organization and promote the various product lines. These programs include public relations, direct mail, participation in trade shows, advertising and production of collateral literature. In fiscal 2005, we held five regional user conference events in the United States, Brazil, Mexico, Portugal and Australia.

### **Customer Support**

Our technical support staff provides telephone support to application developers and end-users. Customers may purchase maintenance services entitling them to software updates, technical support and technical bulletins. First year maintenance and any subsequent annual renewals are not included with our products and are purchased separately. We provide technical support to customers primarily through our technical support centers in Bedford,

## **Table of Contents**

Massachusetts; Rotterdam, The Netherlands; Slough, United Kingdom; and Melbourne, Australia. Local technical support for specific products is provided in certain countries as well.

The Progress Software Developers Network® (PSDN) is a set of online and offline services designed to help developers write best-of-breed business applications using Progress products and technologies. PSDN provides access to the latest information on Progress technology. Through PSDN Subscriptions, developers gain priority access to a complete, continuously updated set of Progress development and deployment products.

### **Professional Services**

Our global professional services organization delivers business solutions for customers through a combination of products, consulting and education. Our consulting organization offers project management, custom development, programming, application implementation and other services. Our consulting organization also provides services to Web-enable existing applications or to take advantage of the capabilities of new product releases. Our education organization offers numerous training options, from traditional instructor-led courses to advanced learning modules available on CDs. Personnel at our international subsidiaries and distributors provide consulting and training services for customers located outside North America.

### **Competition**

The computer software industry is intensely competitive. We experience significant competition from a variety of sources with respect to all our products. We believe that the breadth and integration of our product offerings have become increasingly important competitive advantages. Other factors affecting competition in the markets we serve include product performance in complex applications, application portability, vendor experience, ease of integration, price, training and support.

We compete in various markets with a number of entities including database vendors offering development tools in conjunction with their database systems, such as Microsoft Corporation, Oracle Corporation and IBM Corporation, as well as numerous enterprise application integration vendors, messaging vendors, event processing vendors and application development tools vendors. We believe that Oracle, Microsoft and IBM currently dominate the database market and that IBM dominates the messaging market. We do not believe that there is a dominant application development tools vendor, event processing vendor or enterprise application integration vendor. Some of our competitors have greater financial, marketing or technical resources than we have and may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than we can. Increased competition could make it more difficult for us to maintain our revenue and market presence.

### **Copyrights, Trademarks, Patents and Licenses**

We rely upon a combination of contractual provisions and copyright, patent, trademark and trade secret laws to protect our proprietary rights in our products. We distribute our products under software license agreements that grant customers a perpetual nonexclusive license to use our products and contain terms and conditions prohibiting the unauthorized reproduction or transfer of our products. In addition, we attempt to protect our trade secrets and other proprietary information through agreements with employees and consultants. Although we intend to protect our rights vigorously, there can be no assurance that these measures will be successful.

We seek to protect the source code of our products as trade secrets and as unpublished copyrighted works. We own twenty patents covering portions of our products. We also own twenty-five patent applications for some of our other product technologies. Where possible, we seek to obtain protection of our product names and service offerings through trademark registration and other similar procedures throughout the world.

DataDirect, DataDirect Connect, Dynamic Routing Architecture, Real Time, PeerDirect, Progress, Progress Apama, Progress OpenEdge, Persistence, Sonic ESB, SonicMQ, Stylus Studio and WebSpeed are registered trademarks of Progress Software Corporation or one of our subsidiaries in the U.S. and/or other countries. Cache-Forward, DataDirect Connect64, DataXtend, Fathom, OpenEdge, Sonic Orchestration Server and Sonic XML Server are trademarks of Progress Software Corporation or one of our subsidiaries in the U.S. and other countries. Java and all

**Table of Contents**

Java-based marks are trademarks or registered trademarks of Sun Microsystems, Inc. in the U.S. and other countries. Any other trademarks or trade names appearing in this Form 10-K/A are the property of their respective owners. We believe that due to the rapid pace of innovation within our industry, factors such as the technological and creative skills of our personnel are as important in establishing and maintaining a leadership position within the industry as are the various legal protections of our technology. In addition, we believe that the nature of our customers, the importance of our products to them and their need for continuing product support may reduce the risk of unauthorized reproduction.

**Employees**

As of November 30, 2005, we had 1,593 employees worldwide, including 618 in sales and marketing, 318 in customer support and services (including manufacturing and distribution), 400 in product development and 257 in administration. None of our U.S. employees are subject to a collective bargaining agreement. Employees in certain foreign jurisdictions are represented by local workers' councils and/or collective bargaining agreements as may be customary or required in those jurisdictions. We have experienced no work stoppages and believe our relations with employees are good.

We have various equity incentive plans that permit the granting of stock awards to eligible employees and the purchase of shares by eligible employees. The payment of cash bonuses and contributions to retirement plans is at the discretion of the compensation committee of the Board of Directors and the amounts depend on the level of attainment relative to our financial plan. We design these programs to reward employees for performance and reduce employee turnover, although there can be no assurance that such programs will be successful.

**Executive Officers of the Registrant**

The following table sets forth certain information regarding our executive officers.

| Name                | Age | Position  |
|---------------------|-----|---|
| Joseph W. Alsop     | 60  | Co-Founder and Chief Executive Officer and Director                           |
| James D. Freedman   | 57  | Senior Vice President and General Counsel                                     |
| David G. Ireland    | 59  | President, Progress OpenEdge Division   |
| Gregory J. O'Connor | 43  | President, Sonic Software Corporation   |
| Richard D. Reidy    | 46  | President, DataDirect Technologies  |
| Norman R. Robertson | 57  | Senior Vice President, Finance and Administration and Chief Financial Officer |
| Peter G. Sliwowski  | 41  | President, Progress Real Time Division  |
| Jeffrey P. Stamen   | 60  | Senior Vice President, Corporate Development and Strategy                     |

Mr. Alsop, our co-founder, has been a director and Chief Executive Officer since our inception in 1981.

Mr. Freedman was appointed Vice President and General Counsel in 1995 and was appointed Senior Vice President and General Counsel in August 2004. Mr. Freedman joined us in 1992.

Mr. Ireland joined us in 1997 as Vice President, Core Products and Services and was appointed Vice President and General Manager, Core Products and Services in 1998, Vice President and General Manager, Worldwide Field Operations in 1999 and President, Progress OpenEdge Division in 2000.



## **Table of Contents**

Mr. O Connor was appointed Vice President, Apptivity Engineering in 1998 and was appointed Vice President, Sonic Engineering in 1999 and President, Sonic Software Corporation in 2001. Mr. O Connor joined us in 1992.

Mr. Reidy was appointed Vice President, Development Tools in 1996 and was appointed Vice President, Product Development in 1997, Vice President, Products in 1999, Senior Vice President, Products and Corporate Development in 2000 and President, DataDirect Technologies in May 2004. Mr. Reidy joined us in 1985.

Mr. Robertson joined us in 1996 as Vice President, Finance and Chief Financial Officer and was appointed Vice President, Finance and Administration and Chief Financial Officer in 1997 and Senior Vice President, Finance and Administration and Chief Financial Officer in 2000.

Mr. Sliwowski was appointed Vice President, Development in 1997 and President, Progress Real Time Division in October 2004. Mr. Sliwowski joined us in 1988.

Mr. Stamen joined us in June 2004 as Senior Vice President, Corporate Development and Strategy. From 1999 to 2004, Mr. Stamen was CEO of Syncra Systems, Inc., a software developer.

### **Available Information**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our website at [www.progress.com](http://www.progress.com) as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. The information posted on our web site is not incorporated into this Annual Report.

### **Item 1A. Risk Factors**

We operate in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond our control. The following discussion highlights some of these risks.

***Our revenue and quarterly results may fluctuate, which could adversely affect our stock price.*** We have experienced, and may in the future experience, significant fluctuations in our quarterly operating results that may be caused by many factors. These factors include:

changes in demand for our products;

introduction, enhancement or announcement of products by us or our competitors;

market acceptance of our new products;

the growth rates of certain market segments in which we compete;

size and timing of significant orders;

budgeting cycles of customers;

mix of distribution channels;

mix of products and services sold;

mix of international and North American revenues;

fluctuations in currency exchange rates;

changes in the level of operating expenses;

changes in our sales incentive plans;

completion or announcement of acquisitions by us or competitors;

customer order deferrals in anticipation of new products announced by us or our competitors; and

general economic conditions in regions in which we conduct business.

***Revenue forecasting is uncertain, in large part, because we generally ship our products shortly after receipt of orders.*** Most of our expenses are relatively fixed, including costs of personnel and facilities, and are not easily reduced. Thus, an unexpected reduction in our revenue, or failure to achieve the anticipated rate of growth, would have a material adverse effect on our profitability. If our operating results do not meet our publicly stated guidance, if any, or the expectations of investors, our stock price may decline.

**Table of Contents**

***Our international operations expose us to additional risks, and changes in global economic and political conditions could adversely affect our international operations, our revenue and our net income.*** We typically generate between 55% and 60% of our total revenue from sales outside of North America. Political instability, oil price shocks and armed conflict in various regions of the world can lead to economic uncertainty and may adversely influence our business. If customers' buying patterns, such as decision-making processes, timing of expected deliveries and timing of new projects, unfavorably change due to economic or political conditions, there will be a material adverse effect on our business, financial condition and operating results. Other potential risks inherent in our international business include:

longer payment cycles;

greater difficulties in accounts receivable collection;

unexpected changes in regulatory requirements;

export restrictions, tariffs and other trade barriers;

difficulties in staffing and managing foreign operations;

political instability;

reduced protection for intellectual property rights in some countries;

seasonal reductions in business activity during the summer months in Europe and certain other parts of the world;

economic instability in emerging markets; and

potentially adverse tax consequences.

Any one or more of such factors could have a material adverse effect on our international operations, and, consequently, on our business, financial condition and operating results.

***Fluctuations in foreign currency exchange rates could have an adverse impact on our financial condition and results of operations.*** Because a majority of our total revenue is derived from international operations that are primarily conducted in foreign currencies, changes in the value of these foreign currencies relative to the U.S. dollar may affect our results of operations and financial position. In the first six months of fiscal 2005, as well as in fiscal years 2002 through 2004, the weakening of the U.S. dollar against most major currencies, primarily the euro and the British pound, positively affected our results. However, the U.S. dollar strengthened against most major currencies in the last six months of fiscal 2005 to approximate levels from one year earlier, and further unfavorable changes in foreign currency exchange rates may occur. We seek to reduce our exposure to fluctuations in foreign currency exchange rates by entering into foreign exchange option and forward contracts to hedge certain transactions of selected foreign currencies (mainly in Europe and Asia Pacific). There can be no assurance that our currency hedging transactions will be effective in reducing the effect on us of fluctuations in foreign currency exchange rates. Further, if for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, our business could be adversely affected.

***Technology and customer requirements evolve rapidly in our industry, and if we do not continue to develop new products and enhance our existing products in response to these changes, our business could be harmed.*** Ongoing enhancements to our product sets will be required to enable us to maintain our competitive position. There can be no assurance that we will be successful in developing and marketing enhancements to our products on a timely basis, or that the enhancements will adequately address the changing needs of the marketplace. Overlaying the risks associated with our existing products and enhancements are ongoing technological developments and rapid changes in customer

requirements. Our future success will depend upon our ability to develop and introduce in a timely manner new products that take advantage of technological advances and respond to new customer requirements. The development of new products is increasingly complex and uncertain, which increases the risk of delays. There can be no assurance that we will be successful in developing new products incorporating new technology on a timely basis, or that our new products will adequately address the changing needs of the marketplace. Failure to develop new products and product enhancements that meet market needs in a timely manner could have a material adverse effect on our business, financial condition and operating results.

***We are substantially dependent on our core product, Progress OpenEdge.*** We derive a significant portion of our revenue from software license and maintenance revenue attributable to our core product line, Progress OpenEdge, and other products that complement OpenEdge and are generally licensed only in conjunction with OpenEdge.

**Table of Contents**

Accordingly, our future results depend on continued market acceptance of OpenEdge and any factor adversely affecting the market for OpenEdge could have a material adverse effect on our business, financial condition and operating results.

***Higher costs associated with some of our newer products could adversely affect our operating margins.*** Some of our newer products, such as the Sonic and Real Time product sets, require a higher level of development, distribution and support expenditures, on a percentage of revenue basis, than the OpenEdge or DataDirect product lines. If revenue generated from these products becomes a greater percentage of our total revenue and if the expenses associated with these products do not decrease on a percentage of revenue basis, then our operating margins will be adversely affected.

***We may make acquisitions or investments in new businesses, products or technologies that involve additional risks, which could disrupt our business or harm our financial condition or results of operations.*** As part of our business strategy, we have made, and expect to continue to make, acquisitions of businesses or investments in companies that offer complementary products, services and technologies, such as the acquisitions of DataDirect and Persistence in fiscal 2004, Apama and EasyAsk in fiscal 2005 and our recently completed acquisitions of Actional Corporation and NEON Systems, Inc. in the first quarter of fiscal 2006. Such acquisitions or investments involve a number of risks, including the risks of assimilating the operations and personnel of acquired companies, realizing the value of the acquired assets relative to the price paid, distraction of management from our ongoing businesses and potential product disruptions associated with the sale of the acquired company's products. These factors could have a material adverse effect on our business, financial condition and operating results. Consideration paid for any future acquisitions could include our stock. As a result, future acquisitions could cause dilution to existing shareholders and to earnings per share.

***We recognize a substantial portion of our revenue from sales made through third parties, including our application partners and OEMs, and adverse developments in the businesses of these third parties or in our relationships with them could harm our revenues and results of operations.*** Our future results also depend upon our continued successful distribution of our products through our application partner and OEM channels. Application partners utilize our technology to create their applications and resell our products along with their own applications. OEMs embed our products within their software products or technology devices. The activities of these third parties are not within our direct control. Our failure to manage our relationships with these third parties effectively could impair the effectiveness of our sales, marketing and support activities. A reduction in the sales efforts, technical capabilities or financial viability of these parties, a misalignment of interest between us and them, or a termination of our relationship with a major application partner or OEM could have a negative effect on our sales and financial results. Any adverse effect on the application partners' or OEMs' businesses related to competition, pricing and other factors could also have a material adverse effect on our business, financial condition and operating results.

***The market for enterprise integration and messaging products and services in which our Sonic Software subsidiary participates is rapidly evolving and highly competitive, and failure of our Sonic ESB and other enterprise infrastructure products to achieve and maintain market acceptance could harm our business.*** We are currently developing and enhancing the Sonic product set and other related new products and services. The market for enterprise application integration, Web services, messaging products and other Internet business-to-business products is highly competitive. Many potential customers have made significant investments in proprietary or internally developed systems and would incur significant costs in switching to the Sonic product set or other third-party products. Global e-commerce and online exchange of information on the Internet and other similar open wide area networks continue to evolve. If our Sonic products are not successful in penetrating these evolving markets, our results of operations will be adversely affected.

**Table of Contents**

***The software industry in which we participate is intensely competitive, and our inability to compete effectively would harm our business.*** We experience significant competition from a variety of sources with respect to the marketing and distribution of our products. Many of our competitors have greater financial, marketing or technical resources than we do and may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than we can. Increased competition could make it more difficult for us to maintain our market presence or lead to downward pricing pressure. The marketplace for new products is intensely competitive and characterized by low barriers to entry. As a result, new competitors possessing technological, marketing or other competitive advantages may emerge and rapidly acquire market share.

In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties, thereby increasing their ability to deliver products that better address the needs of our prospective customers. Current and potential competitors also may be more successful than we are in having their products or technologies widely accepted. There can be no assurance that we will be able to compete successfully against current and future competitors, and our failure to do so could have a material adverse effect upon our business, prospects, financial condition and operating results.

***We rely on the experience and expertise of our skilled employees, and must continue to attract and retain qualified technical, marketing and managerial personnel in order to succeed.*** Our future success will depend in large part upon our ability to attract and retain highly skilled technical, managerial and marketing personnel. There is significant competition for such personnel in the software industry. There can be no assurance that we will continue to be successful in attracting and retaining the personnel we require to develop new and enhanced products and to continue to grow and operate profitably.

***Our success is dependent upon our proprietary software technology, and our inability to protect it would harm our business.*** We rely principally on a combination of contract provisions and copyright, trademark, patent and trade secret laws to protect our proprietary technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult. There can be no assurance that the steps we take to protect our proprietary rights will be adequate to prevent misappropriation of our technology or that others will not independently develop similar technology.

***We could be subject to claims that we infringe intellectual property rights of others, or incur substantial cost in protecting our own technology, either of which could harm our business, financial condition or results of operations.*** Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement. Although we believe that our products and technology do not infringe on any existing proprietary rights of others, there can be no assurance that third parties will not assert infringement claims in the future or that any such claims will not be successful. Such litigation could result in substantial costs and diversion of resources, whether or not we ultimately prevail on the merits. Such litigation could also lead to our being prohibited from selling one or more of our products, cause reluctance by potential customers to purchase our products, or result in liability to our customers and could have a material adverse effect on our business, financial condition and operating results.

***The loss of technology licensed from third parties could adversely affect our ability to deliver our products.*** We utilize certain technology which we license from third parties, including software that is integrated with internally developed software and used in our products to perform key functions. There can be no assurance that this technology, or functionally similar technology, will continue to be available on commercially reasonable terms in the future, or at all. The loss of any significant third-party technology license could cause delays in our ability to deliver our products or services until equivalent technology is developed internally or equivalent third-party technology, if available, is identified, licensed and integrated.

***Our common stock price may continue to be volatile, which could result in losses for investors.*** The market price of our common stock, like that of other technology companies, is highly volatile and is subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, changes in financial estimates by securities analysts or other events or factors. Our stock price

may also be affected by broader market trends unrelated to our performance. As a result, purchasers of our

## **Table of Contents**

common stock may be unable at any given time to sell their shares at or above the price they paid for them.

### **Item 1B. Unresolved Staff Comments**

As of the date of this report, we do not have any open comments or communications from the Securities and Exchange Commission (SEC) related to our financial statements or periodic filings with the SEC.

### **Item 2. Properties**

We own our principal administrative, sales, support, marketing, product development and distribution facilities, which are located in two buildings totaling approximately 200,000 square feet in Bedford, Massachusetts. In addition, we maintain offices in leased facilities in approximately 26 other locations in North America and approximately 42 locations outside North America. The terms of our leases generally range from one to seven years. We believe that our facilities are adequate for our current needs and that suitable additional space will be available as needed.

### **Item 3. Legal Proceedings**

On June 23, 2006, we received written notice that the Boston, Massachusetts office of the Securities and Exchange Commission is conducting an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. The informal inquiry has been expanded to cover periods through the present. The SEC has requested testimony from certain of our officers and documents relating to our stock option practices for the period under investigation. We have produced responsive documents and are in the process of producing additional documents. We are unable to predict accurately what consequences may arise from the SEC inquiry. We have already incurred, and expect to continue to incur, significant legal and accounting expenses arising from the inquiry. The inquiry could also divert the attention of our management and harm our business. If the SEC institutes legal action, we could face significant fines and penalties and be required to take remedial actions determined by the SEC or a court. Although we have filed certain restated financial statements that we believe correct the accounting errors arising from our past option-granting practices, the filing of those financial statements will not resolve the pending SEC inquiry. The SEC has not reviewed our restated financial statements, and any future review could lead to further restatements or other modifications of our financial statements.

On July 19, 2006, we received a staff determination letter from the Nasdaq Stock Market stating that our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended May 31, 2006 was a violation of Nasdaq rules and that our securities would be delisted unless we requested a hearing. We requested a hearing, and this request stayed the delisting pending the outcome of the hearing. On October 13, 2006, we received a similar staff determination letter with respect to our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended August 31, 2006. The outcome of the hearing resulted in our delisting being deferred until November 30, 2006 based on our ability to meet certain conditions, including the filing of our delayed and restated financial statements by that date and providing Nasdaq with information regarding the results of our internal investigation. We have provided the Nasdaq Hearing Department with certain requested information. On November 29, 2006, we requested an extension of time until December 15, 2006 to file our delayed and restated financial statements. On December 15, 2006, we requested another such extension until December 18, 2006. The Nasdaq Listing Qualifications Panel has not granted us a formal written extension of the above conditions. If Nasdaq does not grant our requested extension, or if we do not meet any extended deadline for those filings or if Nasdaq is not satisfied with the result of our internal investigation, our common stock may be delisted.

On August 17, 2006, a derivative complaint styled *Arkansas Teacher Retirement System, Derivatively on Behalf of Progress Software Corporation, v. Joseph Alsop et al.* was filed in the United States District Court for the District of Massachusetts by a party identifying itself as one of our shareholders purporting to act on our behalf against our directors and certain of our present and former officers. We are also named as a nominal defendant. The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from an alleged option backdating scheme. The complaint seeks monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. A motion to dismiss the derivative complaint has been filed and is pending. We have also received derivative demands relating to substantially the same allegations from three purported shareholders, including the plaintiff that filed the derivative complaint. On November 30, 2006, the plaintiff filed an amended complaint. The ultimate outcome of these complaints could have a material adverse effect on our results of operations.



We expect to incur additional legal expenses arising from the derivative action, including the advancement of legal expenses to our directors and officers in connection with the derivative action. We have indemnification obligations to our directors and officers, and the outcome of the derivative or any other litigation may require that we indemnify some or all of our directors and officers for expenses they may incur in defending the litigation and other losses. We are subject to various other legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these other claims cannot be predicted with certainty, management does not believe that the outcome of any of these other legal matters will have a material adverse effect on our consolidated financial position or results of operations.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders**

We did not submit any matter to a vote of our shareholders during the fourth quarter of the fiscal year ended November 30, 2005.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The following table sets forth, for the periods indicated, the range of high and low sale prices for our common stock. Our common stock trades on the Nasdaq National Market under the symbol PRGS.

| Year Ended November 30, | 2005     |          | 2004     |          |
|-------------------------|----------|----------|----------|----------|
|                         | High     | Low      | High     | Low      |
| First Quarter           | \$ 24.23 | \$ 20.97 | \$ 24.46 | \$ 20.10 |
| Second Quarter          | 29.88    | 22.30    | 24.75    | 17.87    |
| Third Quarter           | 32.49    | 27.20    | 22.46    | 17.82    |
| Fourth Quarter          | 35.84    | 29.26    | 23.33    | 18.97    |

We have not declared or paid cash dividends on our common stock and we do not plan to pay cash dividends to our shareholders in the near future. As of December 31, 2005, our common stock was held by approximately 8,000 shareholders of record or through nominee or street name accounts with brokers.

Information related to our repurchases of our common stock by month in the fourth quarter of fiscal 2005 is as follows:

*(In thousands, except per share data)*

| Period:                      | Total<br>Number<br>Of Shares<br>Purchased<br>(1) | Average<br>Price<br>Paid<br>per Share | Total Number<br>of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans<br>or Programs | Maximum<br>Number of<br>Shares that May<br>Yet Be<br>Purchased<br>Under the Plans<br>or<br>Programs (2) |
|------------------------------|--|---------------------------------------|--|---|
| Sep. 1, 2005 - Sep. 30, 2005 |  |                                       |  | 9,597   |
| Oct. 1, 2005 - Oct. 31, 2005 | 81   | \$ 30.00                              | 81   | 9,919   |
| Nov. 1, 2005 - Nov. 30, 2005 |  |                                       |  | 9,919   |
|                              | 81   | \$ 30.00                              | 81   | 9,919   |

(1) All shares were purchased in open market transactions.

(2) In September 2005, the Board of Directors

authorized, for  
the period from  
October 1, 2005  
through  
September 30,  
2006, the  
purchase of up to  
10,000,000  
shares of our  
common stock.  
In October 2005,  
this authorization  
superseded the  
previous  
authorization that  
had been in  
place.

**Table of Contents****Item 6. Selected Financial Data**

The following table sets forth selected financial data for the last five fiscal years and reflects the restatement of our consolidated financial statements for the items discussed in Note 14 of the Consolidated Financial Statements appearing in this Form 10-K/A.

*(In thousands, except per share data)*

| Year ended November 30,                   | 2005 (1)         | 2004 (1)         | 2003 (1)         | 2002 (2)         | 2001 (2)         |
|---|------------------|------------------|------------------|------------------|------------------|
|   | (as<br>restated) | (as<br>restated) | (as<br>restated) | (as<br>restated) | (as<br>restated) |
| Revenue                                   | \$ 405,376       | \$ 362,662       | \$ 309,060       | \$ 273,123       | \$ 263,584       |
| Income from operations                    | 59,950           | 42,414           | 32,421           | 23,823           | 16,565           |
| Net income                                | 46,257           | 29,368           | 24,148           | 17,470           | 14,296           |
| Basic earnings per share                  | 1.21             | 0.82             | 0.71             | 0.49             | 0.40             |
| Diluted earnings per share                | 1.12             | 0.76             | 0.65             | 0.47             | 0.38             |
| Cash and short-term investments           | 266,420          | 191,267          | 219,131          | 177,193          | 174,516          |
| Total assets                              | 561,715          | 446,814          | 367,770          | 290,166          | 299,380          |
| Long-term debt, including current portion | 2,200            | 2,438            |                  |                  |                  |
| Shareholders' equity                      | 374,004          | 265,317          | 220,760          | 172,963          | 185,176          |

(1) See Note 14 of the Consolidated Financial Statements for a description of the restatement and its effects.

(2) The following table reflects the adjustments related to the restatements for periods not derived from the accompanying audited consolidated financial statements:

*(In thousands, except per share data)*

| Year ended November 30,               | 2002             |              | 2001             |                  |                           |
|---------------------------------------|------------------|--------------|------------------|------------------|---------------------------|
|                                       | (as<br>reported) | (adjustment) | (as<br>restated) | (as<br>reported) | (adjustment)<br>restated) |
| Revenue                               | \$ 273,123       |              | \$ 273,123       | \$ 263,584       | \$ 263,584                |
| Income from operations                | 28,224           | (4,401)      | 23,823           | 21,305           | (4,740)<br>16,565         |
| Net income                            | 20,587           | (3,117)      | 17,470           | 17,643           | (3,347)<br>14,296         |
| Basic earnings per share              | 0.58             | (0.09)       | 0.49             | 0.50             | (0.10)<br>0.40            |
| Diluted earnings per share            | 0.54             | (0.07)       | 0.47             | 0.46             | (0.08)<br>0.38            |
| Cash and short-term investments       | 177,193          |              | 177,193          | 174,516          | 174,516                   |
| Total assets                          | 290,166          |              | 290,166          | 299,380          | 299,380                   |
| Long-term debt, incl. current portion |                  |              |                  |                  |                           |
| Shareholders' equity                  | 172,963          |              | 172,963          | 185,176          | 185,176                   |

We have completed a number of acquisitions over the last three fiscal years which may affect year over year comparisons of our selected financial data. See a description of such acquisitions under the heading "Overview" in Item 7.

**Table of Contents****Restatement of Financial Results for Periods Prior to Fiscal 2001**

The financial information set forth below reflects the restatement of our consolidated financial statements for the years ended November 30, 1998, 1999 and 2000 for the items discussed in Note 14 of the Consolidated Financial Statements appearing in this Form 10-K/A. We did not consider the effects of the restatement on periods prior to fiscal 1998 to be material and have not restated such years separately. The impact on the net income for the year ended November 30, 1996 was \$(0.3) million and the impact for the year ended November 30, 1997 was \$(0.4) million. Previously reported stock-based compensation expense in each of fiscal 1996 and 1997 was nominal. All adjustments for these periods relate to compensation expense, net of taxes, associated with the stock option review.

*(In thousands, except per share data)*

| Year ended November 30,               | 2000          |              | 1999          |              | (as restated) |
|---------------------------------------|---------------|--------------|---------------|--------------|---------------|
|                                       | (as reported) | (Adjustment) | (as restated) | (Adjustment) |               |
| Revenue                               | \$ 273,080    |              | \$ 273,080    | \$ 286,147   | \$ 286,147    |
| Income from operations                | 38,695        | (3,922)      | 34,773        | 46,704       | 43,809        |
| Net income                            | 33,651        | (2,741)      | 30,910        | 34,991       | 32,968        |
| Basic earnings per share              | 0.94          | (0.07)       | 0.87          | 1.01         | 0.96          |
| Diluted earnings per share            | 0.85          | (0.04)       | 0.81          | 0.89         | 0.88          |
| Cash and short-term investments       | 158,106       |              | 158,106       | 158,665      | 158,665       |
| Total assets                          | 278,805       |              | 278,805       | 256,554      | 256,554       |
| Long-term debt, incl. current portion |               |              |               |              |               |
| Shareholders equity                   | 166,813       |              | 166,813       | 142,311      | 142,311       |

*(In thousands, except per share data)*

| Year ended November 30,               | 1998          |              | (as restated) |
|---------------------------------------|---------------|--------------|---------------|
|                                       | (as reported) | (Adjustment) |               |
| Revenue                               | \$ 241,247    |              | \$ 241,247    |
| Income from operations                | 30,027        | (2,400)      | 27,627        |
| Net income                            | 22,758        | (1,674)      | 21,084        |
| Basic earnings per share              | 0.66          | (0.05)       | 0.61          |
| Diluted earnings per share            | 0.59          | (0.02)       | 0.57          |
| Cash and short-term investments       | 113,999       |              | 113,999       |
| Total assets                          | 206,708       |              | 206,708       |
| Long-term debt, incl. current portion |               |              |               |
| Shareholders equity                   | 102,693       |              | 102,693       |

**Restated Pro Forma Disclosures of Stock-Based Compensation Prior to 2003**

The financial information set forth below reflects our restated pro forma disclosures made in accordance with Statement of Financial Accounting Standard No. 123, Accounting for Stock-Based Compensation, for the years ended November 30, 2002, 2001, 2000, 1999 and 1998 for the items discussed in note 1 to the consolidated financial statements included in this Form 10-K/A.

*(In thousands, except per share data)*

| Year Ended November 30, | 2002 | 2001 | 2000 | 1999 | 1998 |
|-------------------------|------|------|------|------|------|
|-------------------------|------|------|------|------|------|

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|  |          |          |           |           |           |
|--|----------|----------|-----------|-----------|-----------|
| Net income, as restated  | 17,470   | 14,296   | 30,910    | 32,968    | 21,084    |
| Add: stock-based compensation included above, net of tax   | 3,117    | 3,347    | 2,818     | 2,104     | 1,674     |
| Less: stock-based compensation expense determined under fair value method for all awards, net of tax | (10,608) | (9,178)  | (7,990)   | (4,906)   | (3,289)   |
| Pro forma net income   | \$ 9,979 | \$ 8,465 | \$ 25,738 | \$ 30,166 | \$ 19,469 |
| Earnings per share:  |          |          |           |           |           |
| Basic, as reported   | \$ 0.49  | \$ 0.40  | \$ 0.87   | \$ 0.96   | \$ 0.61   |
| Basic, pro forma   | \$ 0.28  | \$ 0.24  | \$ 0.72   | \$ 0.87   | \$ 0.57   |
| Diluted, as reported   | \$ 0.47  | \$ 0.38  | \$ 0.81   | \$ 0.88   | \$ 0.57   |
| Diluted, pro forma   | \$ 0.27  | \$ 0.23  | \$ 0.67   | \$ 0.80   | \$ 0.53   |

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Overview**

We develop, market and distribute software to simplify and accelerate the development, deployment, integration and management of business applications. Our mission is to deliver software products and services that empower partners and customers to improve their development, deployment, integration and management of quality applications worldwide. Our products include development tools, databases, application servers, messaging servers, application management tools, data connectivity products and integration products that enable the highly distributed deployment of responsive applications across internal networks, the Internet and occasionally-connected. Through our various operating units, we market our products globally to a broad range of organizations in manufacturing, distribution, finance, retail, healthcare, telecommunications, government and many other fields.

We derive a significant portion of our revenue from international operations. In the first six months of fiscal 2005, as well as in fiscal years 2002 through 2004, the weakening of the U.S. dollar against most major currencies, primarily the euro and the British pound, positively affected our results. However, the U.S. dollar strengthened against most major currencies in the last six months of fiscal 2005 to approximate levels from one year earlier.

We conduct business through four primary operating units. Our principal operating unit conducts business as the Progress OpenEdge Division. The OpenEdge Division provides the Progress® OpenEdge® platform, a set of development and deployment technologies, including the OpenEdge RDBMS, one of the leading embedded databases, for building business applications. Another operating unit, Sonic Software Corporation, is focused on enterprise application integration and the emerging market for the enterprise service bus, or ESB, and operates as a subsidiary. Sonic provides distributed infrastructure products that integrate applications and orchestrate business processes across the extended enterprise. The third operating unit is the Progress Real Time Division (formerly ObjectStore). The Progress Real Time Division provides event stream processing, data management, data access and synchronization products to enable the real-time enterprise. The division includes the recent acquisitions of Persistence Software and Apama and the integration of PeerDirect, creating a comprehensive source of real-time enterprise products. The fourth operating unit, DataDirect, provides standards-based data connectivity software.

During fiscal years 2003, 2004 and 2005, we completed a number of acquisitions, including eXcelon Corporation in December 2002, DataDirect Technologies Limited in December 2003, Persistence Software Inc. in November 2004, Apama, Inc. in April 2005 and EasyAsk, Inc. in May 2005. These acquisitions were designed to expand the size and breadth of our business and/or add complementary products and technologies to existing product sets.

Since the beginning of fiscal 2005, we have consummated the following transactions:

On April 6, 2005, we acquired the stock of Apama, Inc. (Apama) for an aggregate purchase price of approximately \$24.7 million, net of cash acquired. Apama is a provider of event stream processing software focused on the financial services industry. Apama has become part of the Progress Real Time Division.

On May 12, 2005, we acquired substantially all of the assets and assumed certain liabilities of EasyAsk, Inc. (EasyAsk) for an aggregate purchase price of approximately \$9.0 million, net of cash acquired. EasyAsk is a provider of natural language question/answer and eCommerce search solutions. EasyAsk is reported as part of our OpenEdge Division.

On January 20, 2006, we acquired, through a wholly-owned subsidiary, substantially all of the assets and assumed certain liabilities of Actional Corporation (Actional) for an aggregate purchase price of approximately \$32 million, net of cash. Actional is a leading provider of Web services management software for visibility and run-time governance of distributed IT systems in a service-oriented architecture (SOA). The acquisition will be accounted for as a purchase, and accordingly, the results of operations of Actional will be included in our operating results from the date of acquisition. The purchase price was paid in cash from available funds.

On January 30, 2006 we acquired, through a wholly-owned subsidiary, all of the outstanding shares of common stock of NEON Systems, Inc. (NEON) for an aggregate purchase price of approximately \$52





## **Table of Contents**

million, net of cash acquired. The purchase price also included the value of in-the-money stock options and warrants. NEON is a provider of mainframe integration products and services. The purpose of the acquisition was to broaden the product offerings of DataDirect. Upon the closing of the transaction, NEON became part of our DataDirect operating unit.

### **Restatement of Consolidated Financial Statements**

On August 29, 2006, the Audit Committee of our Board of Directors concluded that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements, and that our consolidated financial statements, including the reports of our independent registered public accounting firm thereon, and our earnings releases and similar communications for the year ended November 30, 1996 and subsequent periods, should no longer be relied upon.

On November 28, 2006, our Board of Directors concluded that our consolidated financial statements for each of the years during the three year period ended November 30, 2005 and for the three months ended February 28, 2006, as well as the selected financial data for the years ended November 30, 2002 and 2001 (as well as for certain prior periods not included in these financial statements) should be restated to record additional non-cash stock-based compensation expense, and related tax effects, resulting from stock options granted during fiscal years 1996 to 2005 that were incorrectly accounted for under GAAP. This decision was based on the determination that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements.

Our decision to restate our financial statements was based on the facts obtained by an internal investigation into our stock option accounting. This investigation was initiated voluntarily by our Board of Directors in May 2006 as a result of media and analysts' reports regarding stock option grant practices of numerous companies, including Progress Software, as well as investor inquiries. The investigation was conducted initially under the direction of the Audit Committee of the Board of Directors, which included an independent director who also served on the Compensation Committee of our Board of Directors. In September 2006, our Board of Directors created the Special Committee of the Board of Directors, consisting only of independent directors who had never served on the Compensation Committee of our Board of Directors, to continue the investigation. The investigation was jointly conducted by our outside legal counsel and by special legal counsel retained by the Special Committee, which counsel had no prior relationship with us or our management.

### ***Special Committee Conclusions***

Several key findings and additional details related to the Special Committee's review are described below:

The Special Committee, advised by outside legal counsel and special legal counsel, concluded that nearly all option grants made between December 1995 and July 2005 were accounted for improperly, and concluded that stock-based compensation expense associated with nearly all grants was misstated in fiscal years 1996 through 2005 and in the first quarter of fiscal 2006.

The Special Committee identified several practices which caused errors related to stock option grant measurement dates and stock-based compensation. First, our option grants were made by means of unanimous written consents executed by the Compensation Committee. However, during the period from December 1995 through July 2005, the Compensation Committee generally did not execute those written consents on the dates appearing on those consents. Instead, the consents were generally executed by the Compensation Committee after the dates stated on the consents.

In addition, during fiscal years 1996 through 2002, we generally selected the dates used as the grant dates retrospectively. Particularly for our annual grants, which represented the largest number of options granted each year, we generally chose as the grant date a date on which the closing price of our common stock was at or near the lowest price for the quarter in which the annual grant was made.

For our large annual grants made between December 2002 and November 2004, we used as the measurement date the date reported by our Section 16 officers as the grant date on their Forms 4, which were timely filed.

Generally, however, as of the reported grant date, we had not made a final determination

**Table of Contents**

of the number of options to be granted to individual recipients other than our Section 16 officers and chose as the grant date the date with the lowest price within the 2-day Section 16 reporting period.

The Special Committee also concluded, based on its review of the facts and circumstances surrounding our option grant practices, that past and present members of management knew that relevant accounting rules required us to record stock-based compensation charges when we made below fair market value option grants and recorded such charges when discounted grants were identified; however, management did not apply those rules correctly or assure that they were being applied correctly to option grants when grant dates were selected retrospectively and therefore failed to record necessary accounting charges. The Special Committee further concluded that there was no evidence to indicate that the practices that caused errors related to stock option grant measurement dates and stock-based compensation resulted from willful misconduct.

Outside counsel routinely attended meetings of the Board of Directors and were actively involved in the affairs of the Company. There is evidence that outside counsel was aware of the retrospective dating of unanimous written consents and that certain members of the compensation committee and management may have relied on such involvement in believing that certain aspects of the Company's stock option granting practices were acceptable.

In 2005, members of the Compensation Committee and management undertook to change the process for granting stock options on a going forward basis. During the second half of fiscal 2005, prior to the commencement of the investigation by the Audit Committee and the Special Committee, we revised our stock option grant practices. The revised grant process includes, among other things, fixed grant dates during the year, review by the Compensation Committee of a preliminary grant list in advance of the fixed grant date and a final approval by the Compensation Committee of the final list of grant recipients on the fixed grant date. When this change in process occurred, we did not consider whether we should have used a different accounting treatment for historical option grants under our previous process.

The Special Committee concluded that there was no evidence to indicate that the practices that caused errors related to stock option grant measurement dates and stock-based compensation resulted from willful misconduct, but the Special Committee also concluded that it would be inappropriate for certain employees who participated in, or knew or should have known of, the practices described above, to retain the benefit arising from the below-market nature of the option grants. These employees were the Chief Executive Officer, the Senior Vice President and Chief Financial Officer, the Vice President and Controller, the Senior Vice President and General Counsel and one non-officer employee.

Accordingly, the Special Committee requested and each of these persons has agreed that all outstanding options to purchase our common stock issued to such persons during periods when they participated in, or knew or should have known of, the practices described above will be amended to increase the exercise prices of these options to an amount equal to the fair market value of our common stock on the measurement dates of such options for accounting and tax purposes, as determined by the Special Committee. To the extent that any such below-market option has already been exercised, each such person has agreed to pay us an amount equal to the bargain element of the grant, i.e., the amount by which the fair market value exceeded the exercise price on the measurement date. The payment will be reduced by the amount of any federal and state taxes on the bargain element already paid or incurred by the individual in connection with such exercise. Among other things, we will accept as payment the cancellation of vested options having an in-the-money value equal to the amount of the payment.

Each of our non-employee directors has agreed voluntarily to amend any below-market option he received to increase its exercise price and, to the extent the option has already been exercised, to make a payment to us on the same terms as apply to the five employees.

We have also taken steps, and will in the future take additional steps, to enhance our corporate governance processes. In November 2006 we added a new independent director, Charles Kane, to our Board of Directors. Also, the Special Committee has recommended, and our Board of Directors has resolved, to take additional steps, including:

adding at least one additional independent director as a member of the Board of Directors;

appointing a non-management director as Chairman;

enhancing the structure for reporting by management to the Board; and

**Table of Contents**

directing the Nominating and Governance Committee of the Board to conduct a comprehensive review of our governance structure to ensure that it is following best practices to ensure sound governance and legal compliance.

For this restatement, we determined the actual grant or measurement date for options by determining when the last step in the process necessary to complete a grant took place. We considered receipt of an executed unanimous written consent from each member of the Compensation Committee as the last required step. After comparing the grant or measurement dates that we historically used during fiscal years 1996 through 2005 to the actual grant dates identified by determining when the last step in the process necessary to complete a grant took place, we determined that certain options were granted at an exercise price below the fair market value of our common stock on the actual grant date. As a result of this determination, we recorded additional stock-based compensation charges of \$29.2 million for the years ended November 30, 1996 through November 30, 2005.

As a result of the errors in determining measurement dates, we also recorded payroll withholding tax-related adjustments for the exercise of certain options formerly classified as ISO grants under Internal Revenue Service regulations. These options were determined to have been granted with an exercise price below the fair market value of our common stock on the actual grant date, and thus did not qualify for ISO tax treatment. Because these options did not qualify for ISO tax treatment, we should have withheld additional taxes on exercise of those options. Accordingly, we recorded estimated payroll withholding tax liabilities of \$2.4 million for the years ended November 30, 2003 through November 30, 2005 in connection with the disqualification of such ISO tax treatment. We have included in the estimated payroll withholding liabilities an estimate of a gross-up in income for any payments to be made on behalf of employees. The related reduction in the provision for income taxes associated with the additional stock-based compensation charges and the additional payroll withholding taxes expense totaled \$9.6 million for the years ended November 30, 1996 through November 30, 2005. The net effect of these amounts decreased net income by \$22.0 million for the fiscal years ended November 30, 1996 through November 30, 2005.

The following table details the components of the adjustments recorded in the Statements of Operations by fiscal year: *(In thousands)*

| Year Ended November 30, | Cost and Operating Expenses      |                             |               | Income Tax Benefit | Total Adjustments |
|-------------------------|----------------------------------|-----------------------------|---------------|--------------------|-------------------|
|                         | Stock-based Compensation Expense | Payroll Withholding Expense | Total Expense |                    |                   |
| 2003                    | \$ 3,623                         | \$ 708                      | \$ 4,331      | \$ 1,405           | \$ 2,926          |
| 2004                    | 3,468                            | 482                         | 3,950         | 1,217              | 2,733             |
| 2005                    | 2,611                            | 1,204                       | 3,815         | 1,139              | 2,676             |
| Total                   | \$ 9,702                         | \$ 2,394                    | \$ 12,096     | \$ 3,761           | \$ 8,335          |

In addition, the deductibility on our tax returns of the income recognized on certain stock option exercises by the five most highly compensated executive officers is limited by Section 162(m) of the Internal Revenue Code. We recorded an adjustment of \$0.8 million and \$5.1 million to additional paid-in capital in fiscal 2003 and fiscal 2005, respectively, with a corresponding increase of \$0.8 million to income taxes payable and a reduction of \$5.1 million to deferred tax assets.

Options determined to have been granted with an exercise price below the fair market value of our common stock on the actual grant date and vesting subsequent to December 2004 result in nonqualified deferred compensation for purposes of Section 409A of the Internal Revenue Code, and holders are subject to an excise tax on the value of the options in the year in which they vest. We have determined that options to purchase approximately 3.1 million shares of our common stock held by current and former employees may be subject to adverse tax consequences under Section 409A.



## **Table of Contents**

In order to mitigate the unfavorable personal tax consequences under Section 409A, we intend to offer holders of these options the opportunity to amend their affected options. Specifically, we expect to conduct a tender offer pursuant to which we will offer to amend the affected options to increase the exercise price to the fair market value of our common stock on the revised grant date, and to give the option holders (excluding certain executive officers and employees) a cash payment for the increase in the exercise price.

We expect to provide to option holders who are eligible for the tender offer, and to file with the Securities and Exchange Commission, a formal Offer to Amend, a related Letter of Transmittal and other documents describing the tender offer in detail. Eligible option holders should read these tender offer documents carefully when they are available because they will contain important information about the tender offer. Eligible option holders can obtain the tender offer documents, when available, and other related documents filed with the Commission for free at the Commission's web site ([www.sec.gov](http://www.sec.gov)) or at no cost from us.

We also intend to enter into option amendment agreements containing similar terms with a limited number of individuals for whom the deadline for such an amendment is December 31, 2006. We will account for the impact of the tender offer and these option amendment agreements as a stock option modification under SFAS 123R and recognize additional stock-based compensation expense, with a corresponding offset to additional paid-in capital, over the vesting period of the modified options. We will record a liability for the present value of the expected cash payments, with a corresponding reduction in additional paid-in capital, and recognize interest expense through the period up to each payment date.

We also plan to compensate holders of exercised options for the consequences of Section 409A and plan to take steps to compensate holders for the loss of value arising from the cancellation of vested, in-the-money options from May 2006 to the filing of our restated consolidated financial statements, including any consequences arising under Section 409A. We estimate that we will incur additional compensation expense of \$0.7 million in the fourth quarter of fiscal 2006 in connection with these actions.

We also restated our balance sheets to reclassify auction rate securities to short-term investments from cash and equivalents and the related purchases and sales of such securities in the statements of cash flows.

The accompanying discussion in Results of Operations below reflects the effects of the restatement described above.

### *Related Proceedings*

On June 23, 2006, we received written notice that the Boston, Massachusetts office of the Securities and Exchange Commission is conducting an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. The informal inquiry has been expanded to cover periods through the present. The SEC has requested testimony from certain of our officers and documents relating to our stock option practices for the period under investigation. We have produced responsive documents and are in the process of producing additional documents. We are unable to predict accurately what consequences may arise from the SEC inquiry. We have already incurred, and expect to continue to incur, significant legal and accounting expenses arising from the inquiry. The inquiry could also divert the attention of our management and harm our business. If the SEC institutes legal action, we could face significant fines and penalties and be required to take remedial actions determined by the SEC or a court. Although we have filed certain restated financial statements that we believe correct the accounting errors arising from our past option-granting practices, the filing of those financial statements will not resolve the pending SEC inquiry. The SEC has not reviewed our restated financial statements, and any future review could lead to further restatements or other modifications of our financial statements.

On August 17, 2006, a derivative complaint styled *Arkansas Teacher Retirement System, Derivatively on Behalf of Progress Software Corporation, v. Joseph Alsop et al.* was filed in the United States District Court for the District of Massachusetts by a party identifying itself as one of our shareholders purporting to act on our behalf against our directors and certain of our present and former officers. We are also named as a nominal defendant. The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from an alleged option backdating scheme. The complaint seeks monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. A motion to dismiss the derivative complaint has been filed and is pending. We have also received derivative demands relating to substantially the same allegations from three purported shareholders,

including the plaintiff that filed the derivative complaint. On November 30, 2006, the plaintiff filed an amended complaint. The ultimate outcome of these complaints could have a material adverse effect on our results of operations. We expect to incur additional legal expenses arising from the derivative action, including the advancement of legal expenses to our directors and officers in connection with the derivative action. We have indemnification obligations to our directors and officers, and the outcome of the derivative or any other litigation may require that we indemnify some or all of our directors and officers for expenses they may incur in defending the litigation and other losses.

*NASDAQ Delisting Notice*

On July 19, 2006, we received a staff determination letter from the Nasdaq Stock Market stating that our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended May 31, 2006 was a violation of Nasdaq rules and that our securities would be delisted unless we requested a hearing. We requested a hearing, and this request stayed the delisting pending the outcome of the hearing. On October 13, 2006, we received a similar staff determination letter with respect to our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended August 31, 2006. The outcome of the hearing resulted in our delisting being deferred until November 30, 2006 based on our ability to meet certain conditions, including the filing of our delayed and restated financial statements by that date and providing Nasdaq with information regarding the results of our internal investigation.



## **Table of Contents**

We have provided the Nasdaq Hearing Department with certain requested information. On November 29, 2006, we requested an extension of time until December 15, 2006 to file our delayed and restated financial statements. On December 15, 2006, we requested another such extension until December 18, 2006. The Nasdaq Listing Qualifications Panel has not granted us a formal written extension of the above conditions. If Nasdaq does not grant our requested extension, or if we do not meet any extended deadline for those filings or if Nasdaq is not satisfied with the result of our internal investigation, our common stock may be delisted.

### **Critical Accounting Policies**

Management's discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. We make estimates and assumptions in the preparation of our consolidated financial statements that affect the reported amounts of assets and liabilities, revenue and expenses and related disclosures of contingent assets and liabilities. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. However, actual results may differ from these estimates.

We have identified the following critical accounting policies that require the use of significant judgments and estimates in the preparation of our consolidated financial statements. This listing is not a comprehensive list of all of our accounting policies. For further information regarding the application of these and other accounting policies, see Note 1 of the Consolidated Financial Statements appearing in this Form 10-K/A.

**Revenue Recognition** Our revenue recognition policy is significant because revenue is a key component affecting results of operations. In determining when to recognize revenue from a customer arrangement, we are often required to exercise judgment regarding the application of our accounting policies to a particular arrangement. For example, judgment is required in determining whether a customer arrangement has multiple elements. When such a situation exists, judgment is also involved in determining whether vendor-specific objective evidence (VSOE) of fair value for the undelivered elements exists. While we follow specific and detailed rules and guidelines related to revenue recognition, we make and use significant management judgments and estimates in connection with the revenue recognized in any reporting period, particularly in the areas described above, as well as collectibility. If management made different estimates or judgments, material differences in the timing of the recognition of revenue could occur.

**Allowance for Doubtful Accounts** We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. We establish this allowance using estimates that we make based on factors such as the composition of the accounts receivable aging, historical bad debts, changes in payment patterns, changes to customer creditworthiness and current economic trends. If we used different estimates, or if the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, we would require additional provisions for doubtful accounts that would increase bad debt expense.

**Goodwill and Intangible Assets** We had goodwill and net intangible assets of \$132.2 million at November 30, 2005. We assess the impairment of goodwill and identifiable intangible assets on an annual basis and whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We would record an impairment charge if such an assessment were to indicate that the fair value of such assets was less than the carrying value. Judgment is required in determining whether an event has occurred that may impair the value of goodwill or identifiable intangible assets. Factors that could indicate that an impairment may exist include significant underperformance relative to plan or long-term projections, strategic changes in business strategy, significant negative industry or economic trends or a significant decline in our stock price or in the value of one of our reporting units for a sustained period of time. We utilize discounted cash flow models or valuation reports from third-party firms to determine the fair value of our reporting units. We must make assumptions about future cash flows, future operating plans, discount rates and other factors in the models and valuation reports. Different assumptions and judgment determinations could yield different conclusions that would result in an impairment charge to income in the period that such change or determination was made.

**Income Tax Accounting** We had a net deferred tax asset of \$33.2 million at November 30, 2005. We record valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. We consider scheduled reversals of temporary differences, projected future taxable income, ongoing tax planning strategies and other matters in assessing the need for and the amount of a valuation allowance. If we were to change



**Table of Contents**

our assumptions or otherwise determine that we were unable to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period that such change or determination was made.

**Stock-based Compensation Expense** We record stock-based compensation charges under APB25 for the difference in value, if any, between our common stock price on the measurement date and the exercise price of options. We recognize stock-based compensation charges ratably over the vest period, generally five years. We record the compensation charges in the line items of the statements of operations based on the function of the grant recipient. For this restatement, we determined the actual grant or measurement date for options by determining when the last step in the process necessary to complete a grant took place. We considered receipt of an executed unanimous written consent from each member of the Compensation Committee as the last required step. For certain grant dates, corroborative evidence of when the last signed consent was received by us is not available. In those situations, we determined that the most likely date on which we received the signed unanimous written consent was five business days after the transmittal date of the consent to the members of the compensation committee. We prepared a sensitivity analysis of the impact of utilizing a different number of potential business days from transmittal date, ranging from three to eight business days, and determined that the difference in the amount of stock-based compensation charges in any one year would not be significant. See New Accounting Pronouncements for discussion of the impact of adopting SFAS 123R in the first quarter of fiscal 2006.

**Results of Operations**

The following table sets forth certain income and expense items as a percentage of total revenue, and the percentage change in dollar amounts of such items compared with the corresponding period in the previous fiscal year.

| Year Ended November 30,                                       | Percentage of Total Revenue |      |      | Period-to-Period Change        |                                |
|---|-----------------------------|------|------|--------------------------------|--------------------------------|
|   | 2005                        | 2004 | 2003 | 2005<br>Compared<br>to<br>2004 | 2004<br>Compared<br>to<br>2003 |
| Revenue:  |                             |      |      |                                |                                |
| Software licenses   | 39%                         | 39%  | 35%  | 12%                            | 28%                            |
| Maintenance and services                                      | 61                          | 61   | 65   | 12                             | 11                             |
| Total revenue   | 100                         | 100  | 100  | 12                             | 17                             |
| Costs of revenue:   |                             |      |      |                                |                                |
| Cost of software licenses                                     | 2                           | 2    | 3    | (9)                            | 6                              |
| Cost of maintenance and services                              | 14                          | 15   | 17   | 6                              | (1)                            |
| Amortization of acquired intangibles for purchased technology | 1                           | 1    | 0    | 25                             | 270                            |
| Total costs of revenue  | 17                          | 18   | 20   | 5                              | 5                              |
| Gross profit  | 83                          | 82   | 80   | 13                             | 20                             |
| Operating expenses:   |                             |      |      |                                |                                |
| Sales and marketing   | 39                          | 40   | 41   | 7                              | 16                             |
| Product development   | 15                          | 17   | 16   | 5                              | 20                             |
| General and administrative                                    | 11                          | 11   | 11   | 8                              | 16                             |
| Amortization of other acquired intangibles                    | 1                           | 1    | 1    | 44                             | 152                            |
|   | 1                           |      |      | *                              | *                              |

|  |     |    |    |     |      |
|--|-----|----|----|-----|------|
| Compensation expense from repurchase of subsidiary stock options |     |    |    |     |      |
| Acquisition-related expenses, net                                | 1   | 1  | 0  | 31  | *    |
| Total operating expenses   | 68  | 70 | 69 | 9   | 19   |
| Income from operations   | 15  | 12 | 11 | 41  | 31   |
| Other income (expense), net                                      | 0   | 0  | 0  | 268 | (56) |
| Income before provision for income taxes                         | 15  | 12 | 11 | 46  | 26   |
| Provision for income taxes                                       | 4   | 4  | 3  | 21  | 36   |
| Net income   | 11% | 8% | 8% | 58% | 22%  |

\* not meaningful

**Fiscal 2005 Compared to Fiscal 2004**

**Table of Contents**

*Revenue.* Our total revenue increased 12% from \$362.7 million in fiscal 2004 to \$405.4 million in fiscal 2005. Our revenue increased principally due to increased volume of software license and maintenance sales for of all of our major product lines. In addition, approximately two percentage points of the revenue increase is attributable to favorable changes in currency exchange rates from those in effect in fiscal 2004 to those in effect during fiscal 2005. Revenue from the Progress OpenEdge product line increased 6% from \$290.3 million in fiscal 2004 to \$308.2 million in fiscal 2005. Revenue derived from the Sonic product line increased 24% from \$26.2 million in fiscal 2004 to \$32.5 million in fiscal 2005. Revenue from the Real Time product line increased 56% from \$18.6 million in fiscal 2004 to \$28.9 million in fiscal 2005. Revenue from the DataDirect product line increased 26% from \$28.2 million in fiscal 2004 to \$35.7 million in fiscal 2005. We estimate that revenue from the products obtained in the acquisitions of Persistence, Apama and EasyAsk contributed less than 5% of total revenue in fiscal 2005.

Software license revenue increased 12% from \$140.5 million in fiscal 2004 to \$156.8 million in fiscal 2005. The increase in software license revenue in fiscal 2005 was primarily due to growth from the DataDirect, Real Time and Sonic product lines. These product lines accounted for 36% of software license revenue in fiscal 2005 as compared to 30% in fiscal 2004. Software license revenue from indirect channels, including application partners and OEMs, and from sales to direct end users, both increased in fiscal 2005 as compared to fiscal 2004. Software license revenue from the Progress OpenEdge product set increased year over year, primarily within the deployment and management products. Approximately two percentage points of the increase in software license revenue is attributable to favorable changes in currency exchange rates from those in effect in fiscal 2004 to those in effect during fiscal 2005.

Maintenance and services revenue increased 12% from \$222.2 million in fiscal 2004 to \$248.6 million in fiscal 2005. The increase in maintenance and services revenue was primarily the result of growth in our installed customer base, renewal of maintenance agreements and an increase in professional services revenue. Approximately two percentage points of the increase in maintenance and services revenue is attributable to favorable changes in currency exchange rates from those in effect in fiscal 2004 to those in effect during fiscal 2005.

Total revenue generated in markets outside North America increased 10% from \$208.9 million in fiscal 2004 to \$229.4 million in fiscal 2005 and represented 58% of total revenue in fiscal 2004 and 57% of total revenue in fiscal 2005. Revenue from the three major regions outside of North America, consisting of EMEA, Latin America and Asia Pacific, each increased in fiscal 2005 as compared to fiscal 2004. Total revenue generated in markets outside North America would have represented 56% of total revenue if exchange rates had been constant in fiscal 2005 as compared to the exchange rates in effect in fiscal 2004. The decrease in the percentage of business derived from international operations in fiscal 2005 is primarily the result of the higher percentage increase generated in markets within North America.

We anticipate total revenue in fiscal 2006 to be in the range of \$437 million to \$449 million, representing an increase of 8% to 11% as compared to fiscal 2005. This revenue expectation assumes the continued success of our application partners and other channel partners, continued improvement in our ability to generate new business in end user accounts and continued growth and success from the newer product lines of DataDirect, Real Time and Sonic. This revenue expectation also includes expected amounts from the recently completed NEON and Actional acquisitions. However, many factors, including external factors such as geopolitical issues or a significant strengthening of the U.S. dollar against currencies from which we derive a significant portion of our business, could negatively impact this revenue expectation.

*Cost of Software Licenses.* Cost of software licenses consists primarily of costs of product media, documentation, duplication, packaging, electronic software distribution, royalties and amortization of capitalized software costs. Cost of software licenses decreased 9% from \$9.0 million in fiscal 2004 to \$8.2 million in fiscal 2005, and decreased as a percentage of software license revenue from 6% to 5%. The dollar decrease was primarily due to lower third party product sales and increased adoption by customers of electronic software delivery. Cost of software licenses as a percentage of software license revenue may vary from period to period depending upon the relative product mix. However, we expect the cost of software licenses for fiscal 2006 to remain at the lower end of the past few years historical range of 5% to 8% of the related software license revenue.

**Table of Contents**

*Cost of Maintenance and Services.* Cost of maintenance and services consists primarily of costs of providing customer technical support, education and consulting. Cost of maintenance and services increased 6% from \$52.7 million in fiscal 2004 to \$55.8 million in fiscal 2005, and decreased as a percentage of maintenance and services revenue from 24% to 22%. The maintenance and services revenue margin improvement was due to maintenance revenue, which has a substantially higher margin than professional services revenue, representing a greater proportion of the total maintenance and services revenue in 2005. The total dollar amount in fiscal 2005 increased due to the impact of year-over-year changes in exchange rates and headcount-related expenses. Our technical support, education and consulting headcount decreased by less than 1% from the end of fiscal 2004 to the end of fiscal 2005.

*Amortization of Acquired Intangibles for Purchased Technology.* Amortization of acquired intangibles for purchased technology primarily represents the amortization of the value assigned to intangible assets obtained in business combinations. Amortization of acquired intangibles for purchased technology increased from \$4.1 million in fiscal 2004 to \$5.1 million in fiscal 2005. The increase was due to amortization expense associated with the acquisitions of Apama and EasyAsk.

*Gross Profit.* Our gross profit increased 13% from \$296.9 million in fiscal 2004 to \$336.3 million in fiscal 2005. The gross profit percentage increased from 82% of total revenue in fiscal 2004 to 83% of total revenue in fiscal 2005 due primarily to slight improvements in the margins of both software license sales as well as maintenance and services revenue.

*Sales and Marketing.* Sales and marketing expenses increased 7% from \$147.7 million in fiscal 2004 to \$158.5 million in fiscal 2005, but decreased as a percentage of total revenue from 40% to 39%. The increase in sales and marketing expenses was due to the addition of sales and marketing personnel and related expenses resulting from the acquisitions of Persistence, Apama and EasyAsk, as well as a slight increase in variable compensation expense as a result of increased sales. Expenses also increased due to the impact of year-over-year changes in exchange rates, as a significant percentage of sales and marketing expenses are incurred outside of North America. In fiscal 2005 sales and marketing expenses included \$0.1 million of stock based compensation related to restricted share issuance. Our sales support and marketing headcount increased by 1% from the end of fiscal 2004 to the end of fiscal 2005.

*Product Development.* Product development expenses increased 5% from \$61.2 million in fiscal 2004 to \$64.0 million in fiscal 2005, but decreased as a percentage of revenue from 17% to 15%. The most significant development efforts in fiscal 2005 related to an updated version Progress® OpenEdge 10, the introduction of DataDirect Xquery and updated versions of the Sonic and Real Time product lines. The dollar increase was primarily due to expenses related to the development teams associated with the recently acquired Persistence and Apama products and the start-up of our offshore development center in India. There were no capitalized software development costs in fiscal 2005 due to the timing and stage of development of projects that might otherwise qualify for capitalization under our software capitalization policy. Capitalized software costs associated with Progress OpenEdge 10 totaled \$0.3 million in fiscal 2004 as compared to none in fiscal 2005. Our product development headcount increased 6% from the end of fiscal 2004 to the end of fiscal 2005.

*General and Administrative.* General and administrative expenses include the costs of our finance, human resources, legal, information systems and administrative departments. General and administrative expenses increased 8% from \$40.0 million in fiscal 2004 to \$43.3 million in fiscal 2005, and remained the same as a percentage of revenue at 11%. The dollar increase was primarily due to headcount related costs, transition and integration costs associated with acquisitions, higher professional services fees and the impact of changes in exchange rates. Our administrative headcount increased 7% from the end of fiscal 2004 to the end of fiscal 2005.

*Amortization of Other Acquired Intangibles.* Amortization of other acquired intangibles primarily represents the amortization of value assigned to intangible assets obtained in business combinations other than assets identified as purchased technology. Amortization of other acquired intangibles increased from \$3.0 million in fiscal 2004 to \$4.3 million in fiscal 2005. The increase was due to amortization expense associated with the acquisitions of Apama and EasyAsk and the full year impact of the acquisition of Persistence.

*Compensation Expense from Repurchase of Subsidiary Stock Options.* Compensation expense from repurchase of subsidiary stock options in fiscal 2005 consisted of costs of \$2.8 million related to the settlement and pay-out to Sonic employees who held vested, in-the-money options to purchase Sonic common stock.



**Table of Contents**

*Acquisition-Related Expenses.* Acquisition-related expenses for fiscal 2005 totaling \$3.4 million include expenses of \$4.0 million for retention bonuses to Apama and EasyAsk employees who joined us, of which \$2.0 million is attributable to sales and marketing, \$1.6 million is attributable to product development, and \$0.4 million is attributable to general and administrative. These costs were partially offset by a credit of \$0.6 million for settlement of pre-acquisition assets and liabilities related to a previous acquisition. Acquisition-related expenses for fiscal 2004 include in-process research and development from the acquisition of DataDirect of \$2.6 million, which was expensed when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. The value of in-process research and development was determined based on an appraisal from an independent third party. There was no in-process research and development associated with the Apama or EasyAsk acquisitions in fiscal 2005.

*Income from Operations.* Income from operations increased 41% from \$42.4 million in fiscal 2004 to \$60.0 million in fiscal 2005 and increased as a percentage of total revenue from 12% in fiscal 2004 to 15% in fiscal 2005. Noncash charges for amortization of purchased intangibles and in-process research and development decreased from 3% of total revenue in fiscal 2004 to 2% of total revenue in fiscal 2005. If we are able to meet our forecasted revenue target and expenses occur as planned in fiscal 2006, we expect income from operations as a percentage of revenue to be between 10% and 11% for fiscal 2006.

*Other Income.* Other income increased 268% from \$0.8 million in fiscal 2004 to \$3.1 million in fiscal 2005. The increase was primarily related to an increase in interest income. The increase in interest income was primarily due to higher interest rates and higher average cash and short-term investment balances, partially offset by foreign exchange hedging and transaction expenses.

*Provision for Income Taxes.* Our effective tax rate decreased from 32% in fiscal 2004 to 27% in fiscal 2005. During the third quarter of fiscal 2005, the IRS completed an examination of our United States income tax returns for fiscal years through 2002. The provision for taxes in fiscal 2005 includes a tax benefit of \$3.8 million resulting from the reversal of accruals for estimated income tax liabilities that were no longer required. The decrease in the effective tax rate in fiscal 2005 as compared to fiscal 2004 was primarily due to this benefit. See Note 9 of the Consolidated Financial Statements appearing in this Form 10-K/A. We estimate that our effective tax rate will be approximately 33% in fiscal 2006.

**Fiscal 2004 Compared to Fiscal 2003**

*Revenue.* Our total revenue increased 17% from \$309.1 million in fiscal 2003 to \$362.7 million in fiscal 2004. Total revenue would have increased by approximately 11% if exchange rates had been constant in fiscal 2004 as compared to the exchange rates in effect in fiscal 2003.

Total revenue from the Progress OpenEdge product line increased 7% from \$272.5 million in fiscal 2003 to \$290.3 million in fiscal 2004. Revenue derived from the Sonic product line increased 14% from \$23.0 million in fiscal 2003 to \$26.2 million in fiscal 2004. Revenue from the Real Time product line increased 38% from \$13.5 million in fiscal 2003 to \$18.6 million in fiscal 2004. Revenue from the DataDirect product line, which was acquired in the December 2003 acquisition of DataDirect Technologies, contributed \$28.2 million of revenue in fiscal 2004. Software license revenue increased 28% from \$109.7 million in fiscal 2003 to \$140.5 million in fiscal 2004. Software license revenue would have increased by approximately 22% if exchange rates had been constant in fiscal 2004 as compared to the exchange rates in effect in fiscal 2003. The increase in software license revenue was positively affected by the addition of DataDirect, which accounted for 13% of software license revenue in fiscal 2004. Software license revenue from indirect channels, including application partners and OEMs, and from sales to direct end users, both increased in fiscal 2004 as compared to fiscal 2003. Software license revenue from the Progress OpenEdge product set increased year over year, primarily within the database products. Software license revenue also increased from newer products such as the Sonic and Real Time product lines.

Maintenance and services revenue increased 11% from \$199.4 million in fiscal 2003 to \$222.2 million in fiscal 2004. Maintenance and services revenue would have increased by approximately 5% if exchange rates had been



**Table of Contents**

constant in fiscal 2004 as compared to the exchange rates in effect in fiscal 2003. The increase in maintenance and services revenue was also the result of growth in our installed customer base, renewal of maintenance agreements and the acquisition of DataDirect, partially offset by a decline in professional services revenue. The decline in professional services revenue was primarily the result of a continued decrease in consulting revenue in the EMEA region as a result of economic conditions and a slower overall market for professional services.

Total revenue generated in markets outside North America increased 12% from \$187.0 million in fiscal 2003 to \$208.9 million in fiscal 2004 and represented 61% of total revenue in fiscal 2003 and 58% of total revenue in fiscal 2004. Revenue from the three major regions outside of North America, consisting of EMEA, Latin America and Asia Pacific, each increased in fiscal 2004 as compared to fiscal 2003. Total revenue generated in markets outside North America would have represented 55% of total revenue if exchange rates had been constant in fiscal 2004 as compared to the exchange rates in effect in fiscal 2003. The decrease in the percentage of business derived from international operations in fiscal 2004 is primarily the result of the addition of DataDirect. The customer base for DataDirect is more concentrated within North America.

*Cost of Software Licenses.* Cost of software licenses increased 6% from \$8.5 million in fiscal 2003 to \$9.0 million in fiscal 2004, but decreased as a percentage of software license revenue from 8% to 6%. The dollar increase was primarily due to higher royalty expense for products and technologies licensed from third parties.

*Cost of Maintenance and Services.* Cost of maintenance and services consists primarily of costs of providing customer technical support, education and consulting. Cost of maintenance and services decreased 1% from \$53.0 million in fiscal 2003 to \$52.7 million in fiscal 2004 and decreased as a percentage of maintenance and services revenue from 27% to 24%. The maintenance and services revenue margin improvement was due to maintenance revenue, which has a substantially higher margin than professional services revenue, representing a greater proportion of the total maintenance and services revenue in 2004. The total dollar amount in fiscal 2004 increased due to the impact of year-over-year changes in exchange rates and additional technical support personnel and related costs associated with DataDirect, but were offset by lower outside contractor expenses in professional services. Our technical support, education and consulting headcount increased by 5% from the end of fiscal 2003 to the end of fiscal 2004.

*Amortization of Acquired Intangibles for Purchased Technology.* Amortization of acquired intangibles for purchased technology increased from \$1.1 million in fiscal 2003 to \$4.1 million in fiscal 2004. The increase was due to amortization expense associated with the acquisition of DataDirect.

*Gross Profit.* Our gross profit increased from 80% in fiscal 2003 to 82% in fiscal 2004 due primarily to an increase in the margin associated with maintenance and services revenue and, to a lesser extent, an increase in the margin associated with software licenses.

*Sales and Marketing.* Sales and marketing expenses increased 16% from \$127.3 million in fiscal 2003 to \$147.7 million in fiscal 2004, but decreased as a percentage of total revenue from 41% to 40%. The increase in sales and marketing expenses was due to the addition of sales and marketing personnel and related expenses resulting from the acquisition of DataDirect as well as a slight increase in the level of discretionary marketing spending for trade shows, advertising campaigns, lead generation, direct mail solicitations and other events. Expenses also increased due to the impact of year-over-year changes in exchange rates as a significant percentage of sales and marketing expenses are incurred outside of North America. Our sales support and marketing headcount increased by 7% from the end of fiscal 2003 to the end of fiscal 2004.

*Product Development.* Product development expenses increased 20% from \$50.9 million in fiscal 2003 to \$61.2 million in fiscal 2004 and increased as a percentage of revenue from 16% to 17%. The most significant development efforts in fiscal 2004 related to the release of Progress OpenEdge 10, new releases of Sonic ESB and SonicMQ and updated versions of the DataDirect and Real Time product lines. The dollar increase was primarily due to an increase in headcount and related expenses resulting from the acquisition of DataDirect. Capitalized software costs associated with Progress OpenEdge 10 totaled \$0.3 million in fiscal 2004 as compared to \$0.4 million in fiscal 2003. Amounts capitalized represented less than 1% of total product development spending. Our product development headcount increased 29% from the end of fiscal 2003 to the end of fiscal 2004.

**Table of Contents**

*General and Administrative.* General and administrative expenses increased 16% from \$34.5 million in fiscal 2003 to \$40.0 million in fiscal 2004, but remained the same percentage of revenue at 11%. The dollar increase was primarily due to headcount related costs, transition and integration costs associated with acquisitions, higher professional services fees and the impact of changes in exchange rates. Our administrative headcount increased 10% from the end of fiscal 2003 to the end of fiscal 2004.

*Amortization of Other Acquired Intangibles.* Amortization of other acquired intangibles increased from \$1.2 million in fiscal 2003 to \$3.0 million in fiscal 2004. The increase was due to amortization expense associated with the acquisition of DataDirect.

*Acquisition-Related Expenses.* Acquired in-process research and development from the acquisition of DataDirect totaled \$2.6 million in fiscal 2004 and was expensed when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. The value of in-process research and development was determined based on an independent appraisal from a third party. In fiscal 2003, we incurred \$0.2 million of in-process research and development related to the acquisition of eXcelon.

*Income From Operations.* Income from operations increased 31% from \$32.4 million in fiscal 2003 to \$42.4 million in fiscal 2004 and increased as a percentage of total revenue from 11% in fiscal 2003 to 12% in fiscal 2004. Noncash charges for amortization of purchased intangibles and in-process research and development increased from 1% of total revenue in fiscal 2003 to 3% of total revenue in fiscal 2004.

*Other Income.* Other income decreased 56% from \$1.9 million in fiscal 2003 to \$0.8 million in fiscal 2004. The decrease was primarily due to lower interest income, resulting from lower interest rates and the reduction in cash and short-term investment balances due to the acquisition of DataDirect.

*Provision for Income Taxes.* Our effective tax rate increased from 30% in fiscal 2003 to 32% in fiscal 2004. The increase in the effective tax rate was due to a change in expected rates for state taxes on deferred taxes and lower benefits from tax-exempt interest.

**Effect of the Restatement on Previously Reported Interim Results**

The impact of the additional stock-based compensation charges and related tax effects on our previously reported interim results was to decrease income from operations as a percentage of total revenue by approximately one percentage point in each quarter for fiscal years 2004 and 2005. The changes in the line item year-over-year comparisons on a quarterly basis as a result of the restatement were consistent with the changes in the line item year-over-year comparisons on annual basis. We have included additional details of the effects of the restatement on our interim results in Note 15 of the Consolidated Financial Statements appearing in this Form 10-K/A.

**Liquidity and Capital Resources**

Our cash and short-term investments totaled \$266.4 million at November 30, 2005. The increase of \$75.2 million from the end of fiscal 2004 was due to cash generated from operations and proceeds from exercises of stock options and stock issuances under our stock purchase plan, partially offset by cash used for the acquisitions of Apama and EasyAsk, stock repurchases and purchases of property and equipment.

In fiscal years 2005, 2004 and 2003, we generated \$80.6 million, \$72.2 million and \$57.7 million, respectively, in cash from operations. The increase in cash generated from operations in each year was primarily due to higher net income. The increase in fiscal 2004 over fiscal 2003 was also due to increases in deferred revenue, primarily the result of increased billings for maintenance.

Accounts receivable at November 30, 2005 increased by \$3.0 million from the end of fiscal 2004. The increase was primarily the result of higher revenue. There was no significant impact on accounts receivable from customer balances obtained from acquired companies in fiscal 2005 or fiscal 2004. Accounts receivable days sales outstanding (DSO) decreased by 3 days to 56 days at the end of fiscal 2005 as compared to 59 days at the end of fiscal 2004 and 57 days at the end of fiscal 2003. We target a DSO range of 60 to 80 days.

**Table of Contents**

In fiscal years 2005, 2004 and 2003, we purchased \$10.9 million, \$13.1 million (including amounts associated with the assumption of a mortgage of \$2.4 million) and \$7.1 million, respectively, of property and equipment. The amount for fiscal 2004 included the purchase of a building adjacent to our headquarters for \$4.7 million. The remaining amounts in fiscal 2004 and in each of fiscal years 2005 and 2003 consisted primarily of computer equipment, software and building and leasehold improvements. We financed these purchases primarily from cash generated from operations, except with respect to the building purchase which included the required assumption of an existing mortgage.

In fiscal years 2005, 2004 and 2003, we purchased and retired 461,000 shares, 647,000 shares and 686,000 shares, respectively, of our common stock for \$11.7 million, \$13.0 million and \$12.1 million, respectively. Since beginning our stock repurchase program in 1996, we have purchased and retired 18,719,000 shares at a cost of \$202.5 million. In September 2005, the Board of Directors authorized, for the period from October 1, 2005 through September 30, 2006, the purchase of up to 10,000,000 shares of our common stock, at such times that we deem such purchases to be an effective use of cash.

In fiscal years 2005, 2004 and 2003, we used cash to complete several acquisitions. Each of these acquisitions was accounted for as a purchase, and accordingly, the results of operations of the acquired companies are included in our operating results from the date of acquisition. In each case, the purchase price was paid in cash from available funds:

In May 2005, we acquired substantially all of the assets and assumed certain liabilities of EasyAsk for an aggregate purchase price of approximately \$9.0 million, net of cash acquired

In April 2005, we acquired the stock of Apama for an aggregate purchase price of approximately \$24.7 million, net of cash acquired

In November 2004, we acquired the stock of Persistence for an aggregate purchase price of approximately \$11.8 million, net of cash acquired

In December 2003, we acquired substantially all of the assets and certain subsidiaries and assumed certain liabilities of DataDirect Technologies Limited for an aggregate purchase price of approximately \$87.5 million, net of cash acquired

In December 2002, we acquired the stock of eXcelon for an aggregate purchase price of approximately \$33.8 million, net of cash acquired.

We include standard intellectual property indemnification provisions in our licensing agreements in the ordinary course of business. Pursuant to our product license agreements, we will indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally business partners or customers, in connection with certain patent, copyright or other intellectual property infringement claims by third parties with respect to our products. Other agreements with our customers provide indemnification for claims relating to property damage or personal injury resulting from the performance of services by us or our subcontractors. Historically, our costs to defend lawsuits or settle claims relating to such indemnity agreements have been insignificant. Accordingly, the estimated fair value of these indemnification provisions is immaterial.

We are subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on our consolidated financial position or results of operations.

In connection with the purchase of a building adjacent to our headquarters in fiscal 2004, we were required to assume long-term debt of \$2.4 million.

We believe that existing cash balances together with funds generated from operations will be sufficient to finance our operations and meet our foreseeable cash requirements (including planned capital expenditures, lease commitments, debt payments, potential cash acquisitions and other long-term obligations) through at least the next twelve months.



**Table of Contents****Contractual Obligations**

We have no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K. The following table details our contractual obligations as of November 30, 2005:

*(In thousands)*

| Contractual Obligations | Total     | Payments Due by Period |              |              |                         |
|-------------------------|-----------|------------------------|--------------|--------------|-------------------------|
|                         |           | Less than<br>1<br>Year | 1-3<br>Years | 3-5<br>Years | More than<br>5<br>Years |
| Long-term debt          | \$ 2,200  | \$ 262                 | \$ 586       | \$ 687       | \$ 665                  |
| Operating leases        | 24,752    | 8,074                  | 9,283        | 4,014        | 3,381                   |
| Total                   | \$ 26,952 | \$ 8,336               | \$ 9,869     | \$ 4,701     | \$ 4,046                |

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), Share-Based Payment (SFAS 123R). This Statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS 123R requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost over the period that such services are performed. In April 2005, the SEC announced that the SFAS 123R effective transition date will be extended to the annual period beginning after June 15, 2005. We adopted SFAS 123R on December 1, 2005 using the modified-prospective transition method.

Adoption of SFAS 123R will materially increase our stock compensation expense and decrease our net income and basic and diluted earnings per share. However, adoption of SFAS 123R will have no impact on our financial position. For fiscal 2006, total stock-based compensation expense, including amounts from the issuance of restricted shares in fiscal 2005 and amounts from stock options using the fair value provisions of SFAS 123R, is estimated to be approximately \$23 million. In order to develop the fiscal 2006 stock-based compensation expense estimate, we utilized assumptions, including, among other items, projected option grants, expected life and volatility, which were similar to the amounts in fiscal 2005. SFAS 123R also requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to a variety of risks, including changes in interest rates affecting the return on our investments and foreign currency fluctuations. We have established policies and procedures to manage our exposure to fluctuations in interest rates and foreign currency exchange rates.

Exposure to market rate risk for changes in interest rates relates to our investment portfolio. We have not used derivative financial instruments in our investment portfolio. We place our investments with high-quality issuers and have policies limiting, among other things, the amount of credit exposure to any one issuer. We seek to limit default risk by purchasing only investment-grade securities. Our investments have an average remaining maturity of less than two years and are primarily fixed-rate instruments. In addition, we have classified all of our debt securities as available for sale. This classification reduces the income statement exposure to interest rate risk if such investments are held until their maturity date. Based on a hypothetical 10% adverse movement in interest rates, the potential losses in future earnings, fair value of risk-sensitive instruments and cash flows are immaterial.

We enter into foreign exchange option and forward contracts to hedge certain transactions of selected foreign currencies (mainly in Europe and Asia Pacific) against fluctuations in exchange rates. We have not entered into foreign exchange option and forward contracts for speculative or trading purposes. We base our accounting policies for these contracts on the designation of the contracts as hedging instruments. The criteria we use for designating a

contract as a hedge include the contract's effectiveness in risk reduction and matching of derivative instruments to the underlying transactions. We generally recognize market value increases and decreases on the foreign exchange option and forward contracts in income in the same period as gains and losses on the underlying transactions. We

**Table of Contents**

operate in certain countries where there are limited forward currency exchange markets and thus we have unhedged transaction exposures in these currencies. There were no outstanding foreign exchange option contracts at November 30, 2005. In December 2005, we entered into foreign exchange option contracts with a notional value of \$100.2 million. We also hedge net intercompany balances. We generally do not hedge the net assets of our international subsidiaries. The foreign exchange exposure from a 10% movement of currency exchange rates on our financial position is not significant. Based on a hypothetical 10% adverse movement in all foreign currency exchange rates, our revenue would be adversely affected by approximately 6% and our net income would be adversely affected by approximately 20% (excluding any offsetting positive impact from our ongoing hedging programs), although the actual effects may differ materially from the hypothetical analysis.

The table below details outstanding forward contracts, which mature in ninety days or less, at November 30, 2005 where the notional amount is determined using contract exchange rates:

*(In thousands, except exchange rate data)*

| Functional Currency: | Exchange<br>Foreign<br>Currency<br>for U.S.<br>Dollars<br>(Notional<br>Amount) | Exchange<br>U.S. Dollars<br>for Foreign<br>Currency<br>(Notional<br>Amount) | Notional<br>Weighted<br>Average<br>Exchange<br>Rate* |
|----------------------|--|---|--|
| Australian dollar    |  | \$ 799  | 1.35   |
| Brazilian real       | \$ 1,617   |   | 2.23   |
| Euro                 |  | 17,306  | 0.85   |
| Japanese yen         | 3,366  |   | 118.85   |
| South African rand   | 2,004  |   | 6.54   |
| U.K. pound           |  | 1,874   | 0.58   |
|                      | \$ 6,987   | \$ 19,979   |  |

\* expressed as  
local currency  
unit per U.S.  
dollar

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**  
**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Progress Software Corporation:

We have audited the accompanying consolidated balance sheets of Progress Software Corporation and subsidiaries (the Company) as of November 30, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 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, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of November 30, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended November 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 14, the consolidated financial statements have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of November 30, 2005, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 10, 2006 (December 18, 2006 as to the effect of the material weakness described in Management's Annual Report on Internal Control over Financial Reporting (as revised)) expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Boston, Massachusetts

February 10, 2006 (December 18, 2006 as to the effect of the matters discussed in the third, fourth and fifth paragraphs of Note 13 and the effect of the restatement discussed in Note 14)



**Table of Contents****Consolidated Financial Statements****Consolidated Balance Sheets***(In thousands, except share data)*

| November 30,   | 2005<br>(as restated,<br>see Note 14) | 2004<br>(as restated,<br>see Note 14) |
|--|---------------------------------------|---------------------------------------|
| Assets   |                                       |                                       |
| Current assets:  |                                       |                                       |
| Cash and equivalents   | \$ 40,398                             | \$ 58,439                             |
| Short-term investments   | 226,022                               | 132,828                               |
| Total cash and short-term investments  | 266,420                               | 191,267                               |
| Accounts receivable (less allowances of \$8,639 in 2005 and \$8,710 in 2004) | 66,592                                | 63,503                                |
| Other current assets   | 11,813                                | 11,909                                |
| Deferred income taxes  | 16,379                                | 11,576                                |
| Total current assets   | 361,204                               | 278,255                               |
| Property and equipment, net  | 42,816                                | 40,658                                |
| Intangible assets, net   | 47,213                                | 40,233                                |
| Goodwill   | 84,974                                | 67,130                                |
| Deferred income taxes  | 20,442                                | 17,176                                |
| Other assets   | 5,066                                 | 3,362                                 |
| Total  | \$561,715                             | \$446,814                             |
| Liabilities and Shareholders' Equity   |                                       |                                       |
| Current liabilities:   |                                       |                                       |
| Current portion, long-term debt  | \$ 262                                | \$ 238                                |
| Accounts payable   | 11,654                                | 11,953                                |
| Accrued compensation and related taxes                                       | 41,653                                | 36,097                                |
| Income taxes payable   | 1,122                                 | 3,489                                 |
| Other accrued liabilities  | 22,737                                | 20,553                                |
| Short-term deferred revenue  | 99,697                                | 101,106                               |
| Total current liabilities  | 177,125                               | 173,436                               |
| Long-term debt, less current portion   | 1,938                                 | 2,200                                 |
| Long-term deferred revenue   | 5,068                                 | 5,861                                 |
| Deferred income taxes  | 3,580                                 |                                       |
| Commitments and contingencies (note 10)                                      |                                       |                                       |
| Shareholders' equity:  |                                       |                                       |
| Preferred stock, \$.01 par value; authorized, 1,000,000 shares; issued, none | 160,911                               | 87,725                                |

|  |           |           |
|--|-----------|-----------|
| Common stock, \$.01 par value, and additional paid-in capital; authorized, 100,000,000 shares; issued and outstanding, 40,435,918 in 2005 and 36,421,700 in 2004 |           |           |
| Deferred compensation  | (5,706)   |           |
| Retained earnings, including accumulated other comprehensive loss of \$2,181 in 2005 and \$1,913 in 2004   | 218,799   | 177,592   |
| Total shareholders' equity   | 374,004   | 265,317   |
| Total  | \$561,715 | \$446,814 |

See notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Operations***(In thousands, except per share data)*

| Year Ended November 30,  | 2005<br>(as restated,<br>see Note 14) | 2004<br>(as restated,<br>see Note 14) | 2003<br>(as restated,<br>see Note 14) |
|--|---------------------------------------|---------------------------------------|---------------------------------------|
| Revenue:   |                                       |                                       |                                       |
| Software licenses  | \$ 156,846                            | \$ 140,462                            | \$ 109,666                            |
| Maintenance and services   | 248,530                               | 222,200                               | 199,394                               |
| Total revenue  | 405,376                               | 362,662                               | 309,060                               |
| Costs of revenue:  |                                       |                                       |                                       |
| Cost of software licenses  | 8,170                                 | 9,000                                 | 8,463                                 |
| Cost of maintenance and services                                 | 55,752                                | 52,692                                | 52,991                                |
| Amortization of acquired intangibles for purchased technology    | 5,122                                 | 4,099                                 | 1,108                                 |
| Total costs of revenue   | 69,044                                | 65,791                                | 62,562                                |
| Gross profit   | 336,332                               | 296,871                               | 246,498                               |
| Operating expenses:  |                                       |                                       |                                       |
| Sales and marketing  | 158,544                               | 147,701                               | 127,344                               |
| Product development  | 64,010                                | 61,172                                | 50,864                                |
| General and administrative                                       | 43,345                                | 40,007                                | 34,487                                |
| Amortization of other acquired intangibles                       | 4,277                                 | 2,977                                 | 1,182                                 |
| Compensation expense from repurchase of subsidiary stock options | 2,803                                 |                                       |                                       |
| Acquisition-related expenses, net                                | 3,403                                 | 2,600                                 | 200                                   |
| Total operating expenses   | 276,382                               | 254,457                               | 214,077                               |
| Income from operations   | 59,950                                | 42,414                                | 32,421                                |
| Other income (expense):  |                                       |                                       |                                       |
| Interest income and other  | 5,257                                 | 2,785                                 | 3,358                                 |
| Foreign currency loss  | (2,158)                               | (1,942)                               | (1,433)                               |
| Total other income, net  | 3,099                                 | 843                                   | 1,925                                 |
| Income before provision for income taxes                         | 63,049                                | 43,257                                | 34,346                                |
| Provision for income taxes                                       | 16,792                                | 13,889                                | 10,198                                |
| Net income   | \$ 46,257                             | \$ 29,368                             | \$ 24,148                             |

Earnings per share:

|         |         |         |         |
|---------|---------|---------|---------|
| Basic   | \$ 1.21 | \$ 0.82 | \$ 0.71 |
| Diluted | \$ 1.12 | \$ 0.76 | \$ 0.65 |

Weighted average shares outstanding:

|         |        |        |        |
|---------|--------|--------|--------|
| Basic   | 38,227 | 36,031 | 34,217 |
| Diluted | 41,424 | 38,807 | 36,930 |

See notes to consolidated financial statements.

**Table of Contents****Consolidated Statements of Shareholders' Equity***(In thousands)*

| Year Ended November 30,   | 2005<br>(as restated,<br>see Note 14) | 2004<br>(as restated,<br>see Note 14) | 2003<br>(as restated,<br>see Note 14) |
|---|---------------------------------------|---------------------------------------|---------------------------------------|
| Common stock and additional paid-in capital:  |                                       |                                       |                                       |
| Balance, beginning of year (as reported)  |                                       |                                       | \$ 27,743                             |
| Adjustments to beginning common stock and additional paid-in capital in connection with the restatement |                                       |                                       | 13,642                                |
| Balance, beginning of year (as restated)  | 87,725                                | 68,389                                | 41,385                                |
| Exercise of employee stock options  | 49,822                                | 16,173                                | 23,209                                |
| Issuance of stock under the employee stock purchase plan  | 5,373                                 | 4,932                                 | 3,496                                 |
| Repurchase of common stock  | (6,932)                               | (8,907)                               | (8,330)                               |
| Issuance (repurchase) of stock in subsidiary, net   | (467)                                 | 40                                    | 56                                    |
| Stock-based compensation (as restated)  | 2,611                                 | 3,468                                 | 3,623                                 |
| Issuance of restricted stock  | 5,840                                 |                                       |                                       |
| Tax benefit from stock plans (as restated)  | 16,939                                | 3,630                                 | 4,950                                 |
| Balance, end of year (as restated)  | 160,911                               | 87,725                                | 68,389                                |
| Deferred compensation:  |                                       |                                       |                                       |
| Balance, beginning of year  |                                       |                                       |                                       |
| Issuance of restricted stock  | (5,840)                               |                                       |                                       |
| Recognition of compensation expense   | 134                                   |                                       |                                       |
| Balance, end of year  | (5,706)                               |                                       |                                       |
| Retained earnings:  |                                       |                                       |                                       |
| Balance, beginning of year (as reported)  |                                       |                                       | 145,220                               |
| Adjustments to beginning retained earnings in connection with the restatement                           |                                       |                                       | (13,642)                              |
| Balance, beginning of year (as restated)  | 177,592                               | 152,371                               | 131,578                               |
| Net income (as restated)  | 46,257                                | 29,368                                | 24,148                                |
| Other comprehensive income:   |                                       |                                       |                                       |
| Unrealized losses on investments, net of tax  | (100)                                 | (418)                                 | (254)                                 |
| Unrealized gains (losses) on foreign exchange hedging contracts, net of tax                             | 593                                   | (332)                                 | (261)                                 |
| Translation adjustments, net of tax   | (761)                                 | 662                                   | 946                                   |
| Comprehensive income (as restated)  | 45,989                                | 29,280                                | 24,579                                |
| Repurchase of common stock  | (4,782)                               | (4,059)                               | (3,786)                               |
| Balance, end of year (as restated)  | 218,799                               | 177,592                               | 152,371                               |

|                           |           |           |           |
|---------------------------|-----------|-----------|-----------|
| Total shareholders equity | \$374,004 | \$265,317 | \$220,760 |
|---------------------------|-----------|-----------|-----------|

See notes to consolidated financial statements.

40

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**Table of Contents****Consolidated Statements of Cash Flows***(In thousands)*

| Year Ended November 30,   | 2005<br>(as restated,<br>see Note 14) | 2004<br>(as restated,<br>see Note 14) | 2003<br>(as restated,<br>see Note 14) |
|---|---------------------------------------|---------------------------------------|---------------------------------------|
| Cash flows from operating activities:   |                                       |                                       |                                       |
| Net income  | \$ 46,257                             | \$ 29,368                             | \$ 24,148                             |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                       |                                       |                                       |
| Depreciation and amortization of property and equipment                           | 8,547                                 | 9,134                                 | 8,389                                 |
| Amortization of capitalized software costs  | 243                                   | 313                                   | 318                                   |
| Amortization of intangible assets   | 9,399                                 | 7,076                                 | 2,290                                 |
| Stock-based compensation  | 2,745                                 | 3,468                                 | 3,623                                 |
| Allowances for accounts receivable  | 648                                   | 922                                   | 1,725                                 |
| Deferred income taxes   | (5,896)                               | 1,481                                 | (3,067)                               |
| In-process research and development   |                                       | 2,600                                 | 200                                   |
| Tax benefit from stock plans  | 17,745                                | 4,745                                 | 6,112                                 |
| Changes in operating assets and liabilities, net of effects from acquisitions:    |                                       |                                       |                                       |
| Accounts receivable   | (5,141)                               | (5,516)                               | 5,233                                 |
| Other assets  | 1,628                                 | 2,105                                 | 1,400                                 |
| Accounts payable and accrued expenses   | 6,281                                 | 1,339                                 | 3,416                                 |
| Income taxes payable  | (2,898)                               | (1,010)                               | (822)                                 |
| Deferred revenue  | 1,072                                 | 16,163                                | 4,715                                 |
| Net cash provided by operating activities   | 80,630                                | 72,188                                | 57,680                                |
| Cash flows from investing activities:   |                                       |                                       |                                       |
| Purchases of investments available for sale                                       | (373,963)                             | (204,777)                             | (200,496)                             |
| Sales and maturities of investments available for sale                            | 280,765                               | 228,017                               | 170,557                               |
| Purchases of property and equipment   | (10,909)                              | (10,716)                              | (7,134)                               |
| Capitalized software costs  |                                       | (300)                                 | (400)                                 |
| Acquisitions, net of cash acquired and purchase price settlements                 | (31,488)                              | (99,320)                              | (24,255)                              |
| Increase in other noncurrent assets   | (2,390)                               | (88)                                  | (463)                                 |
| Net cash used for investing activities  | (137,985)                             | (87,184)                              | (62,191)                              |
| Cash flows from financing activities:   |                                       |                                       |                                       |
| Issuance of common stock  | 55,195                                | 21,105                                | 26,705                                |
| Issuance (repurchase) of stock in subsidiary, net                                 | (467)                                 | 40                                    | 56                                    |
| Payment of long-term debt   | (238)                                 |                                       |                                       |
| Repurchase of common stock  | (11,714)                              | (12,966)                              | (12,116)                              |
| Net cash provided by financing activities   | 42,776                                | 8,179                                 | 14,645                                |
| Effect of exchange rate changes on cash   | (3,462)                               | 2,579                                 | 2,118                                 |

|   |           |           |           |
|---|-----------|-----------|-----------|
| Net increase (decrease) in cash and equivalents | (18,041)  | (4,238)   | 12,252    |
| Cash and equivalents, beginning of year         | 58,439    | 62,677    | 50,425    |
| Cash and equivalents, end of year               | \$ 40,398 | \$ 58,439 | \$ 62,677 |

See notes to consolidated financial statements.

41

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**Table of Contents**

**Notes to Consolidated Financial Statements**

**Note 1: Nature of Business and Summary of Significant Accounting Policies**

**The Company**

We are a global supplier of software and services for the development, deployment, integration and management of business applications deployed in a distributed, Web-based or client/server environment. We develop, market and distribute our products to business, industry and governments worldwide. We also provide consulting, education and technical support services.

**Accounting Principles**

We prepare our consolidated financial statements and accompanying notes in conformity with accounting principles generally accepted in the United States of America.

**Use of Estimates**

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Basis of Consolidation**

The consolidated financial statements include our accounts and those of our subsidiaries. All intercompany balances and transactions have been eliminated.

**Foreign Currency Translation**

For foreign operations with the local currency as the functional currency, we translate assets and liabilities into U.S. dollars at the exchange rate on the balance sheet date. We translate income and expense items at average rates of exchange prevailing during each period. We accumulate translation adjustments in other comprehensive income (loss), a component of shareholders' equity.

For foreign operations with the U.S. dollar as the functional currency, we translate monetary assets and liabilities into U.S. dollars at the exchange rate on the balance sheet date. We re-measure non-monetary assets and liabilities into U.S. dollars at historical exchange rates. We translate income and expense items at average rates of exchange prevailing during each period. We recognize translation adjustments currently as a component of foreign currency gain or loss.

**Table of Contents****Revenue Recognition**

We recognize revenue when earned. We recognize software license revenue upon shipment of the product or, if delivered electronically, when the customer has the right to access the software, provided that the license fee is fixed or determinable, persuasive evidence of an arrangement exists and collection is probable. We do not license our software with a right of return and generally do not license our software with conditions of acceptance. If an arrangement does contain conditions of acceptance, we defer recognition of the revenue until the acceptance criteria are met or the period of acceptance has passed. We generally recognize revenue for products distributed through application partners and distributors when sold through to the end user.

We generally sell our software licenses with maintenance services and, in some cases, also with consulting services. For the undelivered elements, we determine vendor-specific objective evidence (VSOE) of fair value to be the price charged when the undelivered element is sold separately. We determine VSOE for maintenance sold in connection with a software license based on the amount that will be separately charged for the maintenance renewal period. We determine VSOE for consulting services by reference to the amount charged for similar engagements when a software license sale is not involved.

We generally recognize revenue from software licenses sold together with maintenance and/or consulting services upon shipment using the residual method, provided that the above criteria have been met. If VSOE of fair value for the undelivered elements cannot be established, we defer all revenue from the arrangement until the earlier of the point at which such sufficient VSOE does exist or all elements of the arrangement have been delivered, or if the only undelivered element is maintenance, then we recognize the entire fee ratably. If payment of the software license fees is dependent upon the performance of consulting services or the consulting services are essential to the functionality of the licensed software, then we recognize both the software license and consulting fees using the proportional performance method.

We recognize maintenance revenue ratably over the term of the applicable agreement. We generally recognize revenue from services, primarily consulting and customer education, as the related services are performed.

**Warranty Costs**

We make periodic provisions for expected warranty costs. Historically, warranty costs have been insignificant.

**Allowance for Doubtful Accounts**

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. We establish this allowance using estimates that we make based on factors such as the composition of the accounts receivable aging, historical bad debts, changes in payment patterns, changes to customer creditworthiness and current economic trends.

A summary of activity in the allowances against accounts receivable is as follows:

*(In thousands)*

| Year Ended November 30,       | 2005     | 2004     | 2003     |
|-------------------------------|----------|----------|----------|
| Beginning balance             | \$ 8,710 | \$ 8,561 | \$ 7,763 |
| Charged to costs and expenses | 648      | 922      | 1,725    |
| Write-offs and other          | (719)    | (773)    | (927)    |
| Ending balance                | \$ 8,639 | \$ 8,710 | \$ 8,561 |

**Cash Equivalents and Short-Term Investments**

Cash equivalents include short-term, highly liquid investments purchased with remaining maturities of three months or less. We classify short-term investments, which consist primarily of state and municipal obligations and auction rate securities, as investments available for sale and stated at fair value. We include aggregate unrealized holding gains and losses as a component of accumulated other comprehensive income (loss) in shareholders' equity.

**Table of Contents**

**Supplemental Cash Flow Information**

In fiscal 2004, we purchased a building adjacent to our headquarters and assumed an existing mortgage of \$2.4 million as part of the total purchase price of \$4.7 million.

In fiscal years 2005, 2004 and 2003, we paid \$8.4 million, \$7.9 million and \$8.0 million in income taxes, respectively. In fiscal 2005, we received a refund from the IRS of \$1.7 million related to the filing of amended tax returns from prior years. Refunds in other years were insignificant.

In fiscal 2005, cash paid for interest on the mortgage totaled \$0.2 million. Such amounts were insignificant in all other years.

**Concentration of Credit Risk**

Our financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash, short-term investments and trade receivables. We have cash investment policies which, among other things, limit investments to investment-grade securities. We perform ongoing credit evaluations of our customers, and the risk with respect to trade receivables is further mitigated by the diversity, both by geography and by industry, of the customer base.

**Fair Value of Financial Instruments**

The carrying amount of our cash, accounts receivable and accounts payable approximates fair value due to the short-term nature of these instruments. We base the fair value of investments available for sale on current market value (Note 2). The carrying value of long-term debt approximates its fair value.

**Property and Equipment**

We record property and equipment at cost. We record property and equipment purchased in business combinations at fair values which are then treated as the current cost. We provide for depreciation and amortization on the straight-line method over the estimated useful lives of the related assets or the remaining initial or current terms of leases, whichever is shorter. Useful lives by major asset class are as follows: computer equipment and software, three to five years; buildings and improvements, five to thirty-nine years; and furniture and fixtures, five to seven years.

**Product Development Costs**

We expense product development costs, other than certain software-related costs, as incurred. We capitalize certain internally generated software development costs after technological feasibility of the product has been established. We amortize such costs as a component of cost of software licenses over the estimated life of the product (generally four years) in an amount equal to the greater of the amount computed using the ratio of current revenue to total expected revenue in the product's life or the amount computed using the straight-line method. We periodically compare the unamortized costs of capitalized software to the expected future revenues for the products. If the unamortized costs exceed the expected future net realizable value, we write off the excess amount. Capitalized software costs, included in other assets, totaled \$0.4 million (net of accumulated amortization of \$13.4 million and \$13.2 million, respectively) at November 30, 2005 and 2004.

**Goodwill, Other Intangible Assets and Long-lived Assets**

Goodwill is the amount by which the cost of acquired net assets in a business acquisition exceeded the fair value of net identifiable assets on the date of purchase. For purposes of the annual impairment test, we assigned goodwill of \$59.7 million to the Application Development and Deployment operating segment and goodwill of \$25.3 million to the Enterprise SOA Infrastructure operating segment.

**Table of Contents**

Under Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, we evaluate goodwill or other intangible assets with indefinite useful lives for impairment annually. To conduct these impairment tests of goodwill, we compare the fair value of the reporting unit to its carrying value. If the reporting unit's carrying value exceeds its fair value, we record an impairment loss to the extent that the carrying value of goodwill exceeds its implied fair value. We estimate the fair values of our reporting units using discounted cash flow valuation models and third-party valuation reports. During fiscal 2005 and fiscal 2004, we completed our annual testing for impairment of goodwill and, based on those tests, concluded that no impairment of goodwill existed as of December 15, 2004 and December 15, 2003, the goodwill impairment measurement dates for fiscal 2005 and fiscal 2004, respectively.

Long-lived assets primarily include property and equipment and intangible assets with finite lives (purchased software, capitalized software and customer-related intangibles). In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we periodically review long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of those assets are no longer appropriate. We base each impairment test on a comparison of the undiscounted cash flows to the recorded value of the asset. If impairment is indicated, we write down the asset to its estimated fair value based on a discounted cash flow analysis.

**Stock-Based Compensation Plans**

At November 30, 2005, we had three stock-based employee compensation plans, which are described more fully in Note 7. We account for those plans under the recognition and measurement principles of APB Opinion No. 25,

Accounting for Stock Issued to Employees (APB 25), and related interpretations. Stock-based employee compensation cost generally has been reflected in net income using the intrinsic value method. It is our practice, where there is compensation expense to record, to only give recognition to the expense as incurred. We do not establish deferred compensation accounts in equity. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), to stock-based employee compensation.

*(In thousands, except per share data)*

| Year Ended November 30,  | 2005      | 2004      | 2003      |
|--|-----------|-----------|-----------|
| Net income, as currently reported  | \$ 46,257 | \$ 29,368 | \$ 24,148 |
| Add: stock-based compensation included above, net of tax   | 1,805     | 2,353     | 2,461     |
| Less: stock-based compensation expense determined under fair value method for all awards, net of tax | (27,888)  | (11,824)  | (10,613)  |
| Pro forma net income   | \$ 20,174 | \$ 19,897 | \$ 15,996 |
| Earnings per share:  |           |           |           |
| Basic, as reported   | \$ 1.21   | \$ 0.82   | \$ 0.71   |
| Basic, pro forma   | \$ 0.53   | \$ 0.55   | \$ 0.47   |
| Diluted, as reported   | \$ 1.12   | \$ 0.76   | \$ 0.65   |
| Diluted, pro forma   | \$ 0.49   | \$ 0.51   | \$ 0.43   |

In fiscal 2005, we determined that the estimated forfeiture rate for unvested options required an adjustment due to changes in retention rates, increases in the stock price and other factors which generally increased an employee's expected length of service. The impact of the estimated forfeiture rate change during fiscal 2005 from approximately

50% to approximately 22% was to increase pro forma stock-based compensation expense determined under the fair value method for all awards, net of tax, by approximately \$17 million.

45

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**Table of Contents**

We estimated the fair value of options and Employee Stock Purchase Plan (ESPP) shares granted in fiscal years 2005, 2004 and 2003 at the date of grant using the Black-Scholes option valuation model with the following weighted average assumptions:

| Year Ended November 30,     | 2005  | 2004  | 2003  |
|-----------------------------|-------|-------|-------|
| <b>Stock Purchase Plan:</b> |       |       |       |
| Expected volatility         | 32.6% | 35.0% | 33.0% |
| Risk-free interest rate     | 2.4%  | 1.7%  | 1.5%  |
| Expected life in years      | 1.5   | 1.7   | 0.9   |
| Expected dividend yield     | None  | None  | None  |
| <b>Stock Options:</b>       |       |       |       |
| Expected volatility         | 32.2% | 43.7% | 45.7% |
| Risk-free interest rate     | 4.3%  | 3.6%  | 3.5%  |
| Expected life in years      | 4.8   | 6.4   | 6.5   |
| Expected dividend yield     | None  | None  | None  |

Based on the above assumptions, the weighted average estimated fair value of options granted in fiscal years 2005, 2004 and 2003 was \$11.05, \$10.06 and \$9.73 per share, respectively. The weighted average estimated fair value for shares issued under the ESPP in fiscal years 2005, 2004 and 2003 was \$6.33, \$5.22 and \$4.18 per share, respectively. For purposes of the pro forma disclosure above, we amortize the estimated fair value of options to expense over the vesting period.

**Income Taxes**

We provide for deferred income taxes resulting from temporary differences between financial and taxable income. Such differences arise primarily from depreciation, accruals, goodwill, deferred revenue, capitalized software costs, tax carryforwards and allowances for accounts receivable. We record valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. We have not provided for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries, as these earnings have been permanently reinvested or would be principally offset by foreign tax credits. Cumulative undistributed foreign earnings were approximately \$37.4 million at November 30, 2005.

**Comprehensive Income (Loss)**

The components of comprehensive income include, in addition to net income, unrealized gains and losses on investments, unrealized gains and losses on foreign exchange hedging contracts and foreign currency translation adjustments.

Accumulated other comprehensive loss is made up of the following components:

*(In thousands)*

| November 30,  | 2005       | 2004       |
|---|------------|------------|
| Cumulative translation adjustment, net of tax                                   | \$ (1,986) | \$ (1,225) |
| Accumulated unrealized losses on foreign exchange hedging contracts, net of tax |            | (593)      |
| Accumulated unrealized losses on investments, net of tax                        | (195)      | (95)       |
| Total accumulated comprehensive loss  | \$ (2,181) | \$ (1,913) |

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), Share-Based Payment (SFAS 123R). This Statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related

implementation guidance. SFAS 123R requires a company to measure the grant date fair value of equity

**Table of Contents**

awards given to employees in exchange for services and recognize that cost over the period that such services are performed. In April 2005, the SEC announced that the SFAS 123R effective transition date will be extended to the annual period beginning after June 15, 2005. We adopted SFAS 123R on December 1, 2005 using the modified-prospective transition method.

Adoption of SFAS 123R will materially increase our stock compensation expense and decrease our net income and basic and diluted earnings per share. However, adoption of SFAS 123R will have no impact on our financial position. For fiscal 2006, total stock-based compensation expense, including amounts from the issuance of restricted shares in fiscal 2005 and amounts from stock options using the fair value provisions of SFAS 123R, is estimated to be approximately \$23 million. In order to develop the fiscal 2006 stock-based compensation expense estimate, we utilized assumptions, including, among other items, projected option grants, expected life and volatility, which were similar to the amounts in fiscal 2005. SFAS 123R also requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations.

Total gross unrecognized stock-based compensation expense related to unvested stock options and unvested restricted stock awards amounted to \$47.4 million at November 30, 2005. The shares associated with this unrecognized expense have a weighted average remaining vest period of 2.8 years.

**Note 2: Cash and Short-Term Investments**

A summary of our investments available for sale by major security type at November 30, 2005 is as follows:

*(In thousands)*

| Security Type                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Auction rate securities              | \$ 183,250        | \$                           | \$                            | \$ 183,250    |
| State and municipal bond obligations | 43,073            |                              | (301)                         | 42,772        |
| Total                                | \$ 226,323        | \$                           | \$ (301)                      | \$ 226,022    |

The fair value of debt securities at November 30, 2005, by contractual maturity, is as follows:

*(In thousands)*

|                            |           |
|----------------------------|-----------|
| Due in one year or less(1) | \$210,690 |
| Due after one year         | 15,332    |
| Total                      | \$226,022 |

(1) Includes auction rate securities which are tendered for interest-rate setting purposes periodically throughout the year

A summary of our investments available for sale by major security type (including \$1.0 million classified as cash equivalents) at November 30, 2004 is as follows:

*(In thousands)*



| Security Type                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Auction rate securities              | \$ 87,298         | \$                           | \$                            | \$ 87,298     |
| State and municipal bond obligations | 46,692            | 28                           | (175)                         | 46,545        |
| Total                                | \$ 133,990        | \$ 28                        | \$ (175)                      | \$ 133,843    |

In fiscal 2004, realized losses from the sale of available-for-sale securities totaled \$0.1 million. The cost basis used to determine the realized losses was the amortized cost on the date of sale. Such amounts in all other years were insignificant. Unrealized gains and losses that were reclassified from accumulated other comprehensive income to income were insignificant for all years presented.

**Table of Contents****Note 3: Derivative Instruments**

We record all derivatives, whether designated in hedging relationships or not, on the balance sheet at fair value. If the derivative is designated as a cash flow hedge, we record the effective portions of changes in the fair value of the derivative in other comprehensive income and transfer such amounts to the income statement when the hedged item affects earnings. We immediately recognize ineffective portions of changes in the fair value of cash flow hedges in earnings.

We use derivative instruments to manage exposures to fluctuations in the value of foreign currencies. Certain forecasted transactions and assets are exposed to foreign currency risk. Our objective for holding derivatives is to eliminate or reduce the impact of these exposures. We periodically monitor our foreign currency exposures to enhance the overall effectiveness of our foreign currency hedge positions. Principal currencies hedged include the euro, British pound, and Australian dollar. Options used to hedge a portion of forecasted international intercompany revenue for up to one year in the future are designated as cash flow hedging instruments. We also use forward contracts not designated as hedging instruments under SFAS 133 to hedge the impact of the variability in exchange rates on accounts receivable and collections denominated in certain foreign currencies. There were no outstanding foreign exchange option contracts at November 30, 2005. In December 2005, we entered into foreign exchange option contracts with a notional principal amount of \$100.2 million. Major U.S. multinational banks are counterparties to the option contracts.

For options designated as cash flow hedges, we exclude changes in the time value from the assessment of hedge effectiveness. In fiscal years 2005, 2004 and 2003, foreign currency loss included a net loss of \$1.1 million, \$1.0 million and \$0.8 million, respectively, for changes in the time value of options designated as cash flow hedges. The table below details outstanding forward contracts, which mature in ninety days or less, at November 30, 2005 where the notional amount is determined using contract exchange rates:

(In thousands)

| Functional Currency: | Exchange<br>Foreign<br>Currency<br>For U.S.<br>Dollars<br>(Notional<br>Amount) | Exchange<br>U.S. Dollars<br>For Foreign<br>Currency<br>(Notional<br>Amount) | Notional<br>Weighted<br>Average<br>Exchange<br>Rate* |
|----------------------|--|---|--|
| Australian dollar    |  | \$ 799  | 1.35   |
| Brazilian real       | \$ 1,617   |   | 2.23   |
| Euro                 |  | 17,306  | 0.85   |
| Japanese yen         | 3,366  |   | 118.85   |
| South African rand   | 2,004  |   | 6.54   |
| U.K. pound           |  | 1,874   | 0.58   |
|                      | \$ 6,987   | \$ 19,979   |  |

\* expressed as local currency unit per U.S. dollar

**Table of Contents**

The table below details outstanding forward contracts, which mature in ninety days or less, at November 30, 2004 where the notional amount is determined using contract exchange rates:

(In thousands)

| Functional Currency: | Exchange<br>Foreign<br>Currency<br>For U.S.<br>Dollars<br>(Notional<br>Amount) | Exchange<br>U.S. Dollars<br>For Foreign<br>Currency<br>(Notional<br>Amount) | Notional<br>Weighted<br>Average<br>Exchange<br>Rate* |
|----------------------|--|---|--|
| Australian dollar    |  | \$ 78   | 1.28   |
| Brazilian real       | \$ 1,940   |   | 2.78   |
| Euro                 |  | 7,179   | 0.75   |
| Japanese yen         | 5,055  |   | 102.87   |
| South African rand   | 776  |   | 5.80   |
| U.K. pound           | 3,589  |   | 0.53   |
|                      | \$ 11,360  | \$ 7,257  |  |

\* expressed as local currency unit per U.S. dollar

**Note 4: Property and Equipment**

Property and equipment consists of the following:

(In thousands)

| November 30,                                   | 2005      | 2004      |
|--|-----------|-----------|
| Computer equipment and software                | \$ 57,051 | \$ 83,195 |
| Land, building and leasehold improvements      | 41,211    | 38,715    |
| Furniture and fixtures                         | 8,908     | 11,180    |
| Total  | 107,170   | 133,090   |
| Less accumulated depreciation and amortization | 64,354    | 92,432    |
| Property and equipment, net                    | \$ 42,816 | \$ 40,658 |

In the fourth quarter of fiscal 2005, we determined that certain fully-depreciated fixed assets were no longer in service or could not be located. The write-off of such assets totaled approximately \$28.8 million. There was no gain or loss on disposal of these assets.

**Note 5: Intangible Assets and Goodwill**

Intangible assets are composed of the following significant classes at November 30, 2005:

(In thousands)

|                            | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Book<br>Value |
|----------------------------|-----------------------------|-----------------------------|-------------------|
| Purchased technology       | \$ 37,023                   | \$ 11,393                   | \$ 25,630         |
| Customer-related and other | 30,078                      | 8,495                       | 21,583            |

|       |           |           |           |
|-------|-----------|-----------|-----------|
| Total | \$ 67,101 | \$ 19,888 | \$ 47,213 |
|-------|-----------|-----------|-----------|

**Table of Contents**

Intangible assets are composed of the following significant classes at November 30, 2004:

*(In thousands)*

|                            | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Book<br>Value |
|----------------------------|-----------------------------|-----------------------------|-------------------|
| Purchased technology       | \$ 30,183                   | \$ 6,268                    | \$ 23,915         |
| Customer-related and other | 20,477                      | 4,159                       | 16,318            |
| Total                      | \$ 50,660                   | \$ 10,427                   | \$ 40,233         |

We amortize intangible assets assuming no expected residual value. The weighted average amortization period for all intangible assets was 6.6 years, including 6.8 years for purchased technology and 6.4 years for customer-related and other intangible assets. Amortization expense related to these intangible assets was \$9.4 million, \$7.1 million and \$2.3 million in fiscal years 2005, 2004 and 2003, respectively. We estimate future amortization expense from intangible assets held as of November 30, 2005, to be approximately \$9.8 million, \$9.8 million, \$8.8 million, \$7.4 million and \$7.2 million in fiscal years 2006, 2007, 2008, 2009 and 2010, respectively.

A summary of activity in goodwill is as follows:

*(In thousands)*

| Year Ended November 30,                     | 2005      | 2004      | 2003      |
|---|-----------|-----------|-----------|
| Beginning balance                           | \$ 67,130 | \$ 14,313 | \$ 4,013  |
| Additions and adjustments from acquisitions | 17,900    | 52,453    | 9,417     |
| Write-offs and impairments                  |           |           |           |
| Translation adjustments                     | (56)      | 364       | 883       |
| Ending balance                              | \$ 84,974 | \$ 67,130 | \$ 14,313 |

**Note 6: Earnings Per Share**

We compute basic earnings per share using the weighted average number of common shares outstanding. We compute diluted earnings per share using the weighted average number of common shares outstanding plus the effect of outstanding dilutive stock options using the treasury stock method. The following table sets forth the calculation of basic and diluted earnings per share for each fiscal year:

*(In thousands, except per share data)*

| Year Ended November 30,                        | 2005      | 2004      | 2003      |
|--|-----------|-----------|-----------|
| Net income                                     | \$ 46,257 | \$ 29,368 | \$ 24,148 |
| Weighted average shares outstanding            | 38,227    | 36,031    | 34,217    |
| Dilutive impact from outstanding stock options | 3,197     | 2,776     | 2,713     |
| Diluted weighted average shares outstanding    | 41,424    | 38,807    | 36,930    |
| Basic earnings per share                       | \$ 1.21   | \$ 0.82   | \$ 0.71   |
| Diluted earnings per share                     | \$ 1.12   | \$ 0.76   | \$ 0.65   |

Stock options to purchase approximately 62,000 shares, 967,000 shares and 796,000 shares of common stock were excluded from the calculation of diluted earnings per share in fiscal years 2005, 2004 and 2003, respectively, because these options were anti-dilutive.

**Note 7: Shareholders Equity**

**Preferred Stock**

The Board of Directors is authorized to establish one or more series of preferred stock and to fix and determine the number and conditions of preferred shares, including dividend rates, redemption and/or conversion provisions, if any, preferences and voting rights. At November 30, 2005, the Board of Directors had not established any series of preferred stock.

**Table of Contents****Common Stock**

A summary of share activity is as follows:

(In thousands)

| Year Ended November 30, | 2005   | 2004   | 2003   |
|-------------------------|--------|--------|--------|
| Beginning balance       | 36,422 | 35,239 | 33,401 |
| Shares issued           | 4,475  | 1,830  | 2,524  |
| Shares repurchased      | (461)  | (647)  | (686)  |
| Ending balance          | 40,436 | 36,422 | 35,239 |

**Common Stock Repurchases**

In fiscal years 2005, 2004 and 2003, we purchased and retired 461,000 shares, 647,000 shares and 686,000 shares, respectively, of our common stock for \$11.7 million, \$13.0 million and \$12.1 million, respectively. Since beginning our stock repurchase program in 1996, we have purchased and retired 18,719,000 shares at a cost of \$202.5 million. In September 2005, the Board of Directors authorized, for the period from October 1, 2005 through September 30, 2006, the purchase of up to 10,000,000 shares of our common stock, at such times when we deem such purchases to be an effective use of cash. At November 30, 2005, approximately 9,900,000 shares of common stock remained available for repurchase under this authorization.

**Stock Options**

We have three shareholder-approved stock option plans: the 1992 Incentive and Nonqualified Stock Option Plan (1992 Plan), the 1994 Stock Incentive Plan (1994 Plan) and the 1997 Stock Incentive Plan (1997 Plan). These plans permit the granting of stock awards to officers, members of the Board of Directors, employees and consultants. Awards under the 1992, 1994 and 1997 Plans may include stock options (both incentive and nonqualified), grants of conditioned stock, unrestricted grants of stock, grants of stock contingent upon the attainment of performance goals and stock appreciation rights. Prior to fiscal 2005, no awards other than incentive and nonqualified stock options had been granted under the foregoing plans. The options granted prior to fiscal 2005 generally vest over five years and had terms of ten years. The options granted in fiscal 2005 generally vest over five years and have terms of seven years. A total of 19,540,000 shares are issuable under these plans, of which 301,000 shares were available for grant at November 30, 2005.

In 2002, the Board of Directors approved and adopted the 2002 Nonqualified Stock Plan (2002 Plan), for which the approval of shareholders was not required. Executive officers and members of the Board of Directors are not eligible for awards under the 2002 Plan. Awards under the 2002 Plan may include nonqualified stock options, grants of conditioned stock, unrestricted grants of stock, grants of stock contingent upon the attainment of performance goals and stock appreciation rights. Prior to fiscal 2005, no awards other than nonqualified stock options had been granted under the 2002 Plan. The options granted prior to fiscal 2005 generally vest over five years and had terms of ten years. The options granted in fiscal 2005 generally vest over five years and have terms of seven years. A total of 6,500,000 shares are issuable under the 2002 Plan, of which 374,000 shares were available for grant at November 30, 2005.

In 2004, the Board of Directors approved and adopted the 2004 Inducement Stock Plan (2004 Plan), for which approval of shareholders was not required. We intend that the 2004 Plan be reserved for persons to whom we may issue securities as an inducement to become employed by us pursuant to the rules and regulations of the Nasdaq Stock Market. Awards under the 2004 Plan may include nonqualified stock options, grants of conditioned stock, unrestricted grants of stock, grants of stock contingent upon the attainment of performance goals and stock appreciation rights. No awards other than nonqualified stock options have been granted under the 2004 Plan. The options granted prior to fiscal 2005 generally vest over five years and have terms of ten years. The options granted in fiscal 2005 generally vest over five years and have terms of seven years. A total of 500,000 shares are issuable under the 2004 Plan, of which 222,000 shares were available for grant at November 30, 2005.





**Table of Contents**

During fiscal 2005, we issued 190,000 shares of restricted stock under the 1997 Stock Incentive Plan and the 2002 Nonqualified Stock Plan. The restricted stock generally vests over two years. None of the restricted stock shares were forfeited and approximately 1,000 shares had vested as of November 30, 2005.

A summary of stock option activity under all plans is as follows:

*(In thousands, except per share data)*

|  | Number<br>Of Shares |    | Weighted<br>Average<br>Exercise Price<br>Per Share |
|--|---------------------|----|--|
| Options outstanding, December 1, 2002  | 11,549              | \$ | 11.67  |
| Granted                                | 3,129               |    | 18.42  |
| Exercised                              | (2,201)             |    | 10.55  |
| Canceled                               | (657)               |    | 13.49  |
| Options outstanding, November 30, 2003 | 11,820              |    | 13.57  |
| Granted                                | 2,466               |    | 18.91  |
| Exercised                              | (1,410)             |    | 11.47  |
| Canceled                               | (430)               |    | 16.28  |
| Options outstanding, November 30, 2004 | 12,446              |    | 14.77  |
| Granted                                | 1,427               |    | 29.34  |
| Exercised                              | (3,961)             |    | 12.58  |
| Canceled                               | (453)               |    | 17.50  |
| Options outstanding, November 30, 2005 | 9,459               | \$ | 17.75  |

For various exercise price ranges, characteristics of outstanding and exercisable stock options at November 30, 2005 are as follows:

*(Number of shares in thousands)*

| Range of<br>Exercise<br>Price: | Options Outstanding    |  |  | Options Exercisable    |  |  |
|--------------------------------|------------------------|--|--|------------------------|--|--|
|                                | Number<br>of<br>Shares | Weighted<br>Average<br>Remaining<br>Life (in<br>years) | Weighted<br>Average<br>Exercise<br>Price | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price |  |
| \$ 4.50- 7.23                  | 399                    | 1.86   | \$ 6.38                                  | 398                    | \$ 6.38                                  |  |
| 9.00-12.94                     | 1,355                  | 4.06   | 11.74                                    | 1,289                  | 11.71                                    |  |
| 13.00-16.87                    | 2,809                  | 6.69   | 13.85                                    | 1,710                  | 13.68                                    |  |
| 18.15-24.91                    | 3,706                  | 7.83   | 20.08                                    | 1,557                  | 20.04                                    |  |
| 27.91-30.81                    | 1,190                  | 6.97   | 30.39                                    | 192                    | 30.63                                    |  |
| \$ 4.50-30.81                  | 9,459                  | 6.59   | \$ 17.75                                 | 5,146                  | \$ 15.18                                 |  |

At the end of fiscal years 2004 and 2003, we had 6,951,000 shares and 6,035,000 shares subject to exercisable options, respectively, with weighted average exercise prices of \$13.02 and \$11.65 per share, respectively.

**Employee Stock Purchase Plan**

The 1991 Employee Stock Purchase Plan (ESPP), as amended in April 2004, April 2001 and April 1998, permits eligible employees to purchase up to a maximum of 3,200,000 shares of our common stock at 85% of the lesser of the market value of such shares at the beginning of a 27-month offering period or the end of each three-month segment within such offering period. During fiscal years 2005, 2004 and 2003, we issued 324,000 shares, 419,000 shares and 323,000 shares, respectively, with weighted average purchase prices of \$16.56, \$11.77 and \$10.82 per share, respectively, under the ESPP. At November 30, 2005, approximately 546,000 shares were available and reserved for issuance under the ESPP.

**Table of Contents****Repurchase of Outstanding Subsidiary Options**

In August 2005, we entered into an agreement and plan of merger with Sonic Software Corporation (Sonic), a Delaware corporation and our majority-owned subsidiary, and Sonic Merger Corporation, a Delaware corporation and our wholly-owned subsidiary (Merger Sub). The purpose of the merger was for us to purchase the minority-owned shares and the in-the-money, vested stock options of Sonic. The surviving corporation in the merger was Sonic, which is now a wholly-owned subsidiary. The merger agreement was unanimously approved by our board of directors as well as the boards of directors of Sonic and Merger Sub and was also approved by the requisite votes of the stockholders of Sonic and Merger Sub. We consummated the merger on August 31, 2005 immediately after execution of the merger agreement.

Pursuant to the merger agreement, we paid an aggregate of \$0.6 million, recorded as a reduction in shareholders equity on the balance sheet, to the holders of Sonic common stock (other than us) and paid an aggregate of \$2.8 million, recorded as compensation expense in the statement of operations, to Sonic employees who held vested, in-the-money options to purchase Sonic common stock. The price per share paid to the minority stockholders and the option holders of Sonic was determined by our board of directors and that of Sonic, based on a number of factors, including the receipt of a recent valuation analysis of Sonic by an independent third-party and our desire that Sonic employees perceive the merger as fair and reasonable under all of the circumstances.

**Note 8: Retirement Plan**

We maintain a retirement plan covering all U.S. employees under Section 401(k) of the Internal Revenue Code. Company contributions to the plan are at the discretion of the Board of Directors and totaled approximately \$4.7 million, \$4.2 million and \$3.5 million for fiscal years 2005, 2004 and 2003, respectively.

**Note 9: Income Taxes**

The components of pretax income are as follows:

*(In thousands)*

| Year Ended November 30, | 2005      | 2004      | 2003      |
|-------------------------|-----------|-----------|-----------|
| United States           | \$ 50,110 | \$ 33,336 | \$ 27,631 |
| Non-U.S.                | 12,939    | 9,921     | 6,715     |
| Total                   | \$ 63,049 | \$ 43,257 | \$ 34,346 |

The provisions for income taxes are comprised of the following:

*(In thousands)*

| Year Ended November 30, | 2005      | 2004     | 2003     |
|-------------------------|-----------|----------|----------|
| Current:                |           |          |          |
| Federal                 | \$ 20,829 | \$ 6,432 | \$ 8,040 |
| State                   | 1,876     | 1,567    | 1,753    |
| Foreign                 | 5,106     | 4,409    | 3,472    |
| Total current           | 27,811    | 12,408   | 13,265   |
| Deferred:               |           |          |          |
| Federal                 | (10,902)  | 1,341    | (2,337)  |
| State                   | 117       | 848      | (463)    |
| Foreign                 | (234)     | (708)    | (267)    |

|                |           |           |           |
|----------------|-----------|-----------|-----------|
| Total deferred | (11,019)  | 1,481     | (3,067)   |
| Total          | \$ 16,792 | \$ 13,889 | \$ 10,198 |

**Table of Contents**

The tax effects of significant items comprising our deferred taxes are as follows:

(In thousands)

| November 30,                      | 2005       | 2004       |
|-----------------------------------|------------|------------|
| Deferred tax liabilities:         |            |            |
| Goodwill                          | \$ (2,833) | \$ (1,488) |
| Depreciation and amortization     | (1,466)    | (187)      |
| Total deferred tax liabilities    | (4,299)    | (1,675)    |
| Deferred tax assets:              |            |            |
| Accounts receivable               | 2,133      | 2,586      |
| Capitalized research costs        | 8,065      | 4,584      |
| Other current assets              | 588        | 488        |
| Accrued compensation              | 1,009      | 1,478      |
| Deferred revenue                  | 1,893      | 1,877      |
| Tax credit and loss carryforwards | 23,110     | 14,810     |
| Accrued liabilities and other     | 6,085      | 5,468      |
| Total deferred tax assets         | 42,883     | 31,291     |
| Valuation allowance               | (5,343)    | (864)      |
| Total                             | \$ 33,241  | \$ 28,752  |

The valuation allowance primarily applies to net operating and capital loss carryforwards where realization is not assured. The change in the valuation allowance of (\$4.5) million and (\$0.3) million in fiscal years 2005 and 2004, respectively, primarily related to the creation or acquisition of net operating and capital loss carryforwards. Of the total valuation allowance, we would credit goodwill for \$4.7 million if we reversed such valuation allowances upon utilization of the balances related to net operating losses obtained in acquisitions.

At November 30, 2005, we had net operating loss carryforwards of \$33.1 million expiring on various dates through 2024 and \$18.7 million that may be carried forward indefinitely. The increase in net operating loss carryforwards in fiscal 2005 was primarily due to amounts acquired as part of the acquisition of Apama, Inc.

A reconciliation of the U.S. federal statutory rate to the effective tax rate is as follows:

| Year Ended November 30,                                  | 2005  | 2004  | 2003  |
|--|-------|-------|-------|
| Tax at U.S. federal statutory rate                       | 35.0% | 35.0% | 35.0% |
| Foreign rate differences                                 | 0.7   | 0.9   | 1.7   |
| Extraterritorial income exclusion                        | (3.4) | (5.2) | (5.8) |
| State income taxes, net                                  | 2.1   | 2.8   | 2.4   |
| Research credits   | (0.6) | (2.4) | (2.8) |
| Tax-exempt interest                                      | (2.3) | (1.5) | (2.1) |
| Adjustment related to previously established tax reserve | (6.0) |       |       |
| Other  | 1.1   | 2.5   | 1.3   |
| Total  | 26.6% | 32.1% | 29.7% |

During fiscal 2005, the IRS completed an examination of our United States income tax returns for fiscal years through 2002. The provision for taxes in fiscal 2005 included a tax benefit of \$3.8 million resulting from the reversal of accruals for estimated income tax liabilities that were no longer required.

**Table of Contents****Note 10: Long-term Debt, Commitments and Contingencies****Long-term Debt**

In connection with the purchase of a building adjacent to our headquarters building, we were required to assume the existing mortgage under the terms of the agreement. The mortgage, secured by the building, had a remaining principal balance of \$2.4 million with a fixed annual interest rate of 8.05% at the time of the purchase. We may repay the entire outstanding balance beginning in July 2006, subject to a potential penalty based on interest rates in effect at that time. The final payment is due in June 2012. Future principal and interest payments are as follows:

*(In thousands)*

|            | Principal | Interest |
|------------|-----------|----------|
| 2006       | \$ 262    | \$ 168   |
| 2007       | 281       | 146      |
| 2008       | 305       | 122      |
| 2009       | 330       | 97       |
| 2010       | 357       | 69       |
| Thereafter | 665       | 48       |
| Total      | \$ 2,200  | \$ 650   |

**Leasing Arrangements**

We lease certain facilities and equipment under non-cancelable operating lease arrangements. Future minimum rental payments under these leases are as follows at November 30, 2005:

*(In thousands)*

|            |           |
|------------|-----------|
| 2006       | \$ 8,074  |
| 2007       | 6,375     |
| 2008       | 2,908     |
| 2009       | 2,730     |
| 2010       | 1,284     |
| Thereafter | 3,381     |
| Total      | \$ 24,752 |

Total rent expense under operating lease arrangements was approximately \$9.4 million, \$9.5 million and \$8.0 million in fiscal years 2005, 2004 and 2003, respectively.

**Guarantees and Indemnification Obligations**

We include standard intellectual property indemnification provisions in our licensing agreements in the ordinary course of business. Pursuant to our product license agreements, we will indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally business partners or customers, in connection with certain patent, copyright or other intellectual property infringement claims by third parties with respect to our products. Other agreements with our customers provide indemnification for claims relating to property damage or personal injury resulting from the performance of services by us or our subcontractors. Historically, our costs to defend lawsuits or settle claims relating to such indemnity agreements have been insignificant. Accordingly, the estimated fair value of these indemnification provisions is immaterial.

**Table of Contents**

**Litigation**

We are subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on our consolidated financial position or results of operations.

See Note 13 for a discussion of regulatory and legal matters relating to our stock option practices.

**Note 11: Business Segments and International Operations**

During fiscal 2005, we conducted business through four primary operating units. Our principal operating unit conducts business as the Progress OpenEdge Division. The OpenEdge Division provides the Progress® OpenEdge® platform, a set of development and deployment technologies, including the OpenEdge RDBMS, one of the leading embedded databases, for building business applications. Another operating unit, Sonic Software Corporation, is focused on enterprise application integration and the emerging market for the enterprise service bus, or ESB, and operates as a subsidiary. Sonic provides distributed infrastructure products that integrate applications and orchestrate business processes across the extended enterprise. The third operating unit is the Progress Real Time Division (formerly ObjectStore). The Progress Real Time Division provides event stream processing, data management, data access and synchronization products to enable the real-time enterprise. The division includes the recent acquisitions of Persistence Software and Apama and the integration of PeerDirect, creating a comprehensive source of real-time enterprise products. The fourth operating unit, DataDirect, provides standards-based data connectivity software. In December 2005, we combined the sales and marketing organizations of Sonic and Real Time in order to provide more focus and market coverage as the target markets and customers of the two operating units are similar. As a result, we changed the composition of our reporting segments from previous annual disclosures. We restated the fiscal 2004 and fiscal 2003 segment disclosures to conform to the fiscal 2005 presentation.

Segment information, as restated, is presented in accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. This standard is based on a management approach, which requires segmentation based upon our internal organization and disclosure of revenue and operating income based upon internal accounting methods.

Based upon the aggregation criteria for segment reporting, we have two reportable segments: Application Development and Deployment, which primarily includes the OpenEdge Division and DataDirect Technologies, and Enterprise SOA Infrastructure, which includes Sonic Software, Real Time and, for fiscal 2003, certain Sonic-related international sales and marketing functions within the OpenEdge Division. We have aggregated our segment data based on similar utilization characteristics, such as deployment and integration, of the primary products in each operating unit. We do not manage our assets, capital expenditures, interest income or provision for income taxes by segment. We manage such items on a company basis.



**Table of Contents**

The following table sets forth our revenue and income from operations from our reportable segments for fiscal years 2005, 2004 and 2003:

*(In thousands)*

| Year Ended November 30,                | 2005       | 2004       | 2003       |
|--|------------|------------|------------|
| Revenue:                               |            |            |            |
| Application Development and Deployment | \$ 355,027 | \$ 325,198 | \$ 278,789 |
| Enterprise SOA Infrastructure          | 55,346     | 39,912     | 32,905     |
| Reconciling items                      | (4,997)    | (2,448)    | (2,634)    |
| Total                                  | \$ 405,376 | \$ 362,662 | \$ 309,060 |
| Income (loss) from operations:         |            |            |            |
| Application Development and Deployment | \$ 112,417 | \$ 96,259  | \$ 74,882  |
| Enterprise SOA Infrastructure          | (26,716)   | (29,049)   | (28,979)   |
| Reconciling items                      | (25,751)   | (24,796)   | (13,482)   |
| Total                                  | \$ 59,950  | \$ 42,414  | \$ 32,421  |

Amounts included under reconciling items represent intersegment sales, which are accounted for as if sold under an equivalent arms-length basis arrangement, amortization of acquired intangibles, compensation expenses for the repurchase of subsidiary stock options, stock-based compensation, acquisition-related expenses and certain unallocated administrative expenses.

Total revenue by significant product line, regardless of which segment generated the revenue, is as follows:

*(In thousands)*

| Year Ended November 30,     | 2005       | 2004       | 2003       |
|-----------------------------|------------|------------|------------|
| DataDirect                  | \$ 35,680  | \$ 28,243  | \$         |
| Real Time                   | 28,938     | 18,553     | 13,543     |
| Sonic                       | 32,515     | 26,211     | 22,980     |
| Progress OpenEdge and other | 308,243    | 289,655    | 272,537    |
| Total                       | \$ 405,376 | \$ 362,662 | \$ 309,060 |

Our revenues are derived from licensing our products, and from related services, which consist of maintenance and consulting and education. Information relating to revenue from external customers by revenue type is as follows:

*(In thousands)*

| Year Ended November 30,  | 2005       | 2004       | 2003       |
|--------------------------|------------|------------|------------|
| Software licenses        | \$ 156,846 | \$ 140,462 | \$ 109,666 |
| Maintenance              | 212,290    | 189,072    | 160,626    |
| Consulting and education | 36,240     | 33,128     | 38,768     |
| Total                    | \$ 405,376 | \$ 362,662 | \$ 309,060 |



**Table of Contents**

Revenue attributed to North America includes shipments to customers in the United States and Canada and licensing to certain multinational organizations. Revenue from Europe, Middle East and Africa (EMEA), Latin America and Asia Pacific includes shipments to customers in each region, not including certain multinational organizations, plus export shipments into each region that are billed from the United States. Information relating to revenue from external customers from different geographical areas is as follows:

*(In thousands)*

| Year Ended November 30, | 2005       | 2004       | 2003       |
|-------------------------|------------|------------|------------|
| North America           | \$ 176,015 | \$ 153,730 | \$ 122,046 |
| EMEA                    | 185,039    | 170,870    | 153,345    |
| Latin America           | 21,624     | 16,574     | 14,716     |
| Asia Pacific            | 22,698     | 21,488     | 18,953     |
| Total                   | \$ 405,376 | \$ 362,662 | \$ 309,060 |

Revenue from the United Kingdom totaled \$56.5 million, \$51.6 million and \$45.9 million for fiscal years 2005, 2004 and 2003, respectively. No other country outside of the United States exceeded 10% of our consolidated total revenue in any year presented. Long-lived assets totaled \$39.8 million, \$37.9 million and \$32.5 million in the United States and \$6.0 million, \$5.3 million and \$5.4 million outside of the United States at the end of fiscal years 2005, 2004 and 2003, respectively. No individual country outside of the United States exceeded 10% of our consolidated long-lived assets.

**Note 12: Business Combinations****Fiscal 2005 Transactions:**

In fiscal 2005, we paid a total of \$31.5 million for acquisitions, net of the cash acquired and net of a settlement related to a previous acquisition resulting in a purchase price adjustment and return of funds to us of approximately \$2 million. The settlement was recorded as a decrease to goodwill.

On May 12, 2005, we acquired, through a wholly-owned subsidiary, substantially all of the assets and assumed certain liabilities of EasyAsk, Inc. (EasyAsk) for an aggregate purchase price of approximately \$9.0 million, net of cash acquired. EasyAsk is a provider of natural language question/answer solutions. The purpose of the acquisition was to broaden our product offerings. Prior to the acquisition, we held a minority interest in EasyAsk, whose chairman was a member of our Board of Directors until the closing of the purchase agreement. EasyAsk is included within the Application Development and Deployment segment. Transaction costs related to this acquisition included \$0.4 million of expenses related to excess facilities space and \$0.2 million of direct acquisition costs. In addition, we have implemented an employee retention program by which payments will be made twelve months following the acquisition to EasyAsk employees who joined us, if the employees meet certain employment criteria. If all retention criteria are met, we will be obligated to pay a total of \$0.5 million in retention payments. We recognize compensation expense associated with these payments ratably over the twelve month service period. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations for EasyAsk in our operating results from the date of acquisition. We paid the purchase price in cash from available funds.

On April 6, 2005, we acquired the stock of Apama, Inc. (Apama) for an aggregate purchase price of approximately \$24.7 million, net of cash acquired. Apama is a provider of event stream processing software focused on the financial services industry. The purpose of the acquisition was to expand the product set of the Real Time operating unit. Upon the closing of the transaction, Apama became part of the Progress Real Time Division. Transaction costs related to this acquisition totaled \$0.6 million of direct acquisition costs. In addition, we have implemented an employee retention program by which payments will be made on certain dates over the twelve months following the acquisition to Apama employees who joined us, if the employees meet certain employment criteria. If all retention criteria are met, we will be obligated to pay a total of approximately \$4 million in retention payments. We recognize compensation expense ratably over the service period associated with each payment. We accounted for the acquisition

as a purchase, and accordingly, we included the results of operations for Apama in our operating results from the date of acquisition. We paid the purchase price in cash from available funds.

**Table of Contents**

Acquisition-related expenses for fiscal 2005 totaling \$3.4 million include expenses for retention bonuses to Apama and EasyAsk employees who joined us of \$4.0M, of which \$2.0 million is attributable to sales and marketing, \$1.6 million is attributable to product development, and \$0.4 million is attributable to general and administrative, partially offset by a credit of \$0.6 million for settlement of pre-acquisition assets and liabilities related to a previous acquisition.

For both acquisitions, we obtained valuations from independent appraisers for the amounts assigned to intangible assets. The preliminary allocation of the purchase prices as of November 30, 2005 is as follows:

*(In thousands)*

|   | Total         | Life (in years) |
|---|---------------|-----------------|
| Assets and liabilities, including cash              | \$ 560        |                 |
| Acquired intangible assets                          | 17,500        | 1 to 10 years   |
| Goodwill (\$16,087 not deductible for tax purposes) | 24,037        |                 |
| Deferred income taxes                               | (4,726)       |                 |
| <br>Total purchase price                            | <br>37,371    |                 |
| Less: cash acquired                                 | (3,383)       |                 |
| Less: existing investment in EasyAsk held by us     | (300)         |                 |
| <br>Net cash paid                                   | <br>\$ 33,688 |                 |

We have not presented pro forma financial information as the historical operations of Apama and EasyAsk were not material to our consolidated financial statements either individually or in the aggregate.

**Fiscal 2004 Transactions:**

On November 5, 2004, we acquired the stock of Persistence Software, Inc. (Persistence), a provider of data caching software for an aggregate purchase price, net of cash acquired, of approximately \$11.8 million. The acquisition was accounted for as a purchase, and accordingly, the results of operations of Persistence are included in our operating results from the date of acquisition. The purpose of the acquisition was to expand the product set of the Real Time operating unit. We structured the acquisition as a merger of a wholly owned subsidiary of ours with and into Persistence. Pursuant to the terms of the acquisition, each outstanding share of Persistence common stock was converted into the right to receive \$5.70 in cash, without interest. In addition, as a result of the acquisition, holders of exercisable options and warrants to purchase Persistence common stock with an exercise price of less than \$5.70 per share were entitled to receive a cash payment equal to the number of shares of Persistence common stock subject to such option or warrant multiplied by the amount by which \$5.70 exceeded the exercise price per share of such option or warrant. Direct transaction costs related to the acquisition totaled \$0.3 million. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations for Persistence in our operating results from the date of acquisition. We paid the purchase price in cash from available funds. In fiscal 2005, we adjusted the allocation of the purchase price by reducing goodwill by \$3.8 million to reflect an additional tax benefit not contemplated in the original allocation. The allocation of the purchase price is as follows:

*(In thousands)*

|  | Total    | Life (in years) |
|--|----------|-----------------|
| Assets and liabilities, including cash     | \$ 1,913 |                 |
| Deferred income taxes                      | 7,331    |                 |
| Acquired intangible assets                 | 4,207    | 1 to 6 years    |
| Goodwill (not deductible for tax purposes) | 2,557    |                 |

|                      |           |
|----------------------|-----------|
| Total purchase price | 16,008    |
| Less: cash acquired  | (4,208)   |
| Net cash paid        | \$ 11,800 |

**Table of Contents**

On December 23, 2003, we acquired, through a wholly owned subsidiary, substantially all of the assets and certain subsidiaries and assumed certain liabilities of DataDirect Technologies Limited (DataDirect), a private company incorporated under the laws of Ireland, for an aggregate purchase price of approximately \$87.5 million, net of cash acquired. The purpose of the acquisition was to expand the breadth of our product sets. DataDirect is a provider of standards-based software for data connectivity. Direct transaction costs related to the acquisition totaled \$0.7 million. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations of DataDirect in our operating results from the date of acquisition. We paid the purchase price in cash from available funds. We expensed acquired in-process research and development (IPR&D) of \$2.6 million when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. We used an independent appraiser to calculate the amounts allocated to assets and liabilities acquired, including intangible assets and IPR&D. The allocation of the purchase price is as follows:

*(In thousands)*

|  | Total     | Life (in years) |
|--|-----------|-----------------|
| Assets and liabilities, including cash | \$ 6,045  |                 |
| Acquired intangible assets             | 35,870    | 1 to 10 years   |
| Goodwill (deductible for tax purposes) | 48,817    |                 |
| In-process research and development    | 2,600     |                 |
| <br>                                   |           |                 |
| Total purchase price                   | 93,332    |                 |
| Less: cash acquired                    | (5,812)   |                 |
| <br>                                   |           |                 |
| Net cash paid                          | \$ 87,520 |                 |

**Fiscal 2003 Transactions:**

On December 19, 2002, we acquired, through a wholly-owned subsidiary, the stock of eXcelon Corporation (eXcelon), a provider of data management software, for an aggregate purchase price of \$24.3 million, net of cash acquired. The purpose of the acquisition was to expand the product set of the Sonic Software operating unit and, in addition, increase our size with the establishment of the Real Time product line. The acquisition was structured as a merger of a wholly owned subsidiary with and into eXcelon. Pursuant to the terms of the acquisition, each outstanding share of eXcelon common stock was converted into the right to receive \$3.19 in cash, without interest. In addition, as a result of the acquisition, holders of outstanding options to purchase eXcelon common stock with an exercise price of less than \$3.19 per share were entitled to receive a cash payment equal to the number of shares of eXcelon common stock subject to such option multiplied by the amount by which \$3.19 exceeded the exercise price per share of such option. Transaction costs related to this acquisition included \$9.1 million for facilities closures and employee severance and \$0.7 million for direct transaction costs. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations of eXcelon in our operating results from the date of acquisition. We paid the purchase price in cash from available funds.

We expensed acquired IPR&D of \$0.2 million when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. We used an independent appraiser to calculate the amounts allocated to assets and liabilities acquired including intangible assets, primarily customer-related and purchased technology, and IPR&D. In fiscal 2004, we adjusted the allocation of the purchase price by reducing goodwill by \$2.7 million to reflect an additional tax benefit not contemplated in the original allocation. The allocation of the purchase price is as follows:

**Table of Contents***(In thousands, except share data)*

|   | Total     | Life (in years) |
|---|-----------|-----------------|
| Assets and liabilities, including cash          | \$ 5,762  |                 |
| Deferred income taxes                           | 12,997    |                 |
| Intangible assets                               | 8,100     | 1 to 6 years    |
| Goodwill (not deductible for tax purposes)      | 6,696     |                 |
| In-process research and development             | 200       |                 |
| Total purchase price                            | 33,755    |                 |
| Less: cash acquired                             | (9,200)   |                 |
| Less: existing investment in eXcelon held by us | (300)     |                 |
| Net cash paid                                   | \$ 24,255 |                 |

In connection with certain of the above acquisitions, we established reserves for exit costs related to facilities closures and related costs and employee severance. The amounts included under cash disbursements are net of proceeds received from subrental agreements. A summary of activity is as follows:

*(In thousands)*

|  | Facilities<br>Closures<br>and Related<br>Costs | Employee<br>Severance<br>and Related<br>Benefits | Total    |
|--|--|--|----------|
| Balance, December 1, 2002                      |  |  |          |
| Establishment of reserve related to eXcelon    | \$ 6,955                                       | \$ 2,140   | \$ 9,095 |
| Cash disbursements                             | (2,580)  | (2,140)  | (4,720)  |
| Balance, November 30, 2003                     | 4,375  |  | 4,375    |
| Establishment of reserve related to DataDirect |  | 281  | 281      |
| Cash disbursements                             | (2,023)  | (281)  | (2,304)  |
| Balance, November 30, 2004                     | 2,352  |  | 2,352    |
| Establishment of reserve related to EasyAsk    | 376  |  | 376      |
| Cash disbursements                             | (930)  |  | (930)    |
| Balance, November 30, 2005                     | \$ 1,798                                       | \$   | \$ 1,798 |

**Note 13: Subsequent Events**

On January 30, 2006 we acquired, through a wholly-owned subsidiary, all of the outstanding shares of common stock of NEON Systems, Inc. (NEON) for an aggregate purchase price of approximately \$52 million, net of cash acquired. The purchase price also included the value of in-the-money stock options and warrants. NEON is a provider of mainframe integration products and services. The purpose of the acquisition was to broaden the product offerings of DataDirect. Upon the closing of the transaction, NEON became part of our DataDirect operating unit. We will account for the acquisition as a purchase, and accordingly, we will include the results of operations of NEON in our operating results from the date of acquisition. We paid the purchase price in cash from available funds.



On January 20, 2006, we acquired for a combination of cash and stock, through a wholly-owned subsidiary, the stock of Actional Corporation (Actional) for an aggregate purchase price of approximately \$32 million, net of cash acquired. Actional is a leading provider of Web services management software for visibility and run-time governance of distributed IT systems in a service-oriented architecture. The purpose of the acquisition was to broaden the Sonic product line. Upon the closing of the transaction, Actional became part of our Sonic operating unit. We will account for the acquisition as a purchase, and accordingly, we will include the results of operations of Actional in our operating results from the date of acquisition.

On June 23, 2006, we received written notice that the Boston, Massachusetts office of the Securities and Exchange Commission is conducting an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. The informal inquiry has been expanded to cover periods through the present. The SEC has requested testimony from certain of our officers and documents relating to our stock option practices for the period under investigation. We have produced responsive documents and are in the process of producing additional documents. We are unable to predict accurately what consequences may arise from the SEC inquiry. We have already incurred, and expect to continue to incur, significant legal and accounting expenses arising from the inquiry. The inquiry could also divert the attention of our management and harm our business. If the SEC institutes legal action, we could face significant fines and penalties and be required to take remedial actions determined by the SEC or a court. Although we have filed certain restated financial statements that we believe correct the accounting errors arising from our past option-granting practices, the filing of those financial statements will not resolve the pending SEC inquiry. The SEC has not reviewed our restated financial statements, and any future review could lead to further restatements or other modifications of our financial statements.

**Table of Contents**

On July 19, 2006, we received a staff determination letter from the Nasdaq Stock Market stating that our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended May 31, 2006 was a violation of Nasdaq rules and that our securities would be delisted unless we requested a hearing. We requested a hearing, and this request stayed the delisting pending the outcome of the hearing. On October 13, 2006, we received a similar staff determination letter with respect to our failure to timely file our quarterly report on Form 10-Q for the fiscal quarter ended August 31, 2006. The outcome of the hearing resulted in our delisting being deferred until November 30, 2006 based on our ability to meet certain conditions, including the filing of our delayed and restated financial statements by that date and providing Nasdaq with information regarding the results of our internal investigation. We have provided the Nasdaq Hearing Department with certain requested information. On November 29, 2006, we requested an extension of time until December 15, 2006 to file our delayed and restated financial statements. On December 15, 2006, we requested another such extension until December 18, 2006. The Nasdaq Listing Qualifications Panel has not granted us a formal written extension of the above conditions. If Nasdaq does not grant our requested extension, or if we do not meet any extended deadline for those filings or if Nasdaq is not satisfied with the result of our internal investigation, our common stock may be delisted.

On August 17, 2006, a derivative complaint styled *Arkansas Teacher Retirement System, Derivatively on Behalf of Progress Software Corporation, v. Joseph Alsop et al.* was filed in the United States District Court for the District of Massachusetts by a party identifying itself as one of our shareholders purporting to act on our behalf against our directors and certain of our present and former officers. We are also named as a nominal defendant. The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from an alleged option backdating scheme. The complaint seeks monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. A motion to dismiss the derivative complaint has been filed and is pending. We have also received derivative demands relating to substantially the same allegations from three purported shareholders, including the plaintiff that filed the derivative complaint. On November 30, 2006, the plaintiff filed an amended complaint. The ultimate outcome of these complaints could have a material adverse effect on our results of operations. We expect to incur additional legal expenses arising from the derivative action, including the advancement of legal expenses to our directors and officers in connection with the derivative action. We have indemnification obligations to our directors and officers, and the outcome of the derivative or any other litigation may require that we indemnify some or all of our directors and officers for expenses they may incur in defending the litigation and other losses.

**Table of Contents**

**Note 14: Restatement of Previously Issued Consolidated Financial Statements**

Accounting for Stock Options

On November 28, 2006, our Board of Directors concluded that our consolidated financial statements for each of the years during the three year period ended November 30, 2005 (as well as for certain prior periods not included in these financial statements) should be restated to record additional non-cash stock-based compensation expense resulting from stock options granted during fiscal years 1996 to 2005 that were incorrectly accounted for under GAAP. This decision was based on the determination that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements.

For this restatement, we determined the actual grant or measurement date for options by determining when the last step in the process necessary to complete a grant took place. We considered receipt of an executed unanimous written consent from each member of the Compensation Committee as the last required step. After comparing the grant or measurement dates that we historically used during fiscal years 1996 through 2005 to the actual grant dates identified by determining when the last step in the process necessary to complete a grant took place, we determined that certain options were granted at an exercise price below the fair market value of our common stock on the actual grant date. As a result of this determination, we recorded additional stock-based compensation charges of \$29.2 million for the years ended November 30, 1996 through November 30, 2005.

As a result of the errors in determining measurement dates, we also recorded payroll withholding tax-related adjustments for the exercise of certain options formerly classified as Incentive Stock Option (ISO) grants under Internal Revenue Service regulations. These options were determined to have been granted with an exercise price below the fair market value of our common stock on the actual grant date, and thus did not qualify for ISO tax treatment. Because these options did not qualify for ISO tax treatment, we should have withheld additional taxes on exercise of those options. Accordingly, we recorded estimated payroll withholding tax liabilities of \$2.4 million for the years ended November 30, 2003 through November 30, 2005 in connection with the disqualification of such ISO tax treatment. We have included in the estimated payroll withholding liabilities an estimate of a gross-up in income for any payments to be made on behalf of employees. The related reduction in the provision for income taxes associated with the additional stock-based compensation charges and the additional payroll withholding taxes expense totaled \$9.6 million for the years ended November 30, 1996 through November 30, 2005. The net effect of these amounts decreased net income by \$22.0 million for the fiscal years ended November 30, 1996 through November 30, 2005.

**Table of Contents**

In addition, the deductibility on our tax returns of the income on certain stock option exercises by the five most highly compensated executive officers is limited by Section 162(m) of the Internal Revenue Code. We recorded an adjustment of \$0.8 million and \$5.1 million to additional paid-in capital in fiscal 2003 and fiscal 2005, respectively, with a corresponding increase of \$0.8 million to income taxes payable and a reduction of \$5.1 million to deferred tax assets.

The following table reconciles as previously reported to as restated net income and retained earnings:

*(In thousands)*

|   | Net Income for Years Ended<br>November 30, |           |           | Retained<br>Earnings as of<br>December 1,<br>2002 | Retained<br>Earnings as of<br>November 30,<br>2005 |
|---|--|-----------|-----------|---|--|
|   | 2005                                       | 2004      | 2003      |   |  |
| As previously reported                                      | \$ 48,933                                  | \$ 32,101 | \$ 27,074 | \$ 145,220  | \$ 240,776   |
| Increase (decrease) to net income<br>and retained earnings: |  |           |           |   |  |
| Stock-based compensation<br>expense                         | (2,611)                                    | (3,468)   | (3,623)   | (19,541)  | (29,243)   |
| Payroll withholding expense                                 | (1,204)                                    | (482)     | (708)     |   | (2,394)  |
| Income tax benefit  | 1,139                                      | 1,217     | 1,405     | 5,899   | 9,660  |
| Total   | (2,676)                                    | (2,733)   | (2,926)   | (13,642)  | (21,977)   |
| As restated   | \$ 46,257                                  | \$ 29,368 | \$ 24,148 | \$ 131,578  | \$ 218,799   |

The following table details the components of the beginning retained earnings adjustment as of December 1, 2002 by fiscal year:

*(In thousands)*

| Year Ended November 30, | Stock-based<br>Compensation<br>Expense | Income<br>Tax<br>Benefit | Total     |
|-------------------------|--|--------------------------|-----------|
| 1996                    | \$ 431                                 | \$ 163                   | \$ 268    |
| 1997                    | 752                                    | 280                      | 472       |
| 1998                    | 2,400                                  | 726                      | 1,674     |
| 1999                    | 2,895                                  | 872                      | 2,023     |
| 2000                    | 3,922                                  | 1,181                    | 2,741     |
| 2001                    | 4,740                                  | 1,393                    | 3,347     |
| 2002                    | 4,401                                  | 1,284                    | 3,117     |
| Total                   | \$ 19,541(1)                           | \$ 5,899                 | \$ 13,642 |

(1) Stock-based  
compensation  
expense

previously  
reported by us  
was nominal  
during this  
period.

Accounting for Auction Rate Securities

In light of views expressed by the Securities and Exchange Commission with respect to accounting for auction rate securities (ARS), we restated the accompanying November 30, 2004 consolidated balance sheet to no longer report ARS as cash equivalents. We now report such investments within our short-term investments. In completing this restatement, additional ARS amounts totaling \$17.0 million and \$11.5 million at November 30, 2005 and 2004, respectively, of cash and equivalents were restated to reclassify such amounts to short-term investments. We also restated net cash used for investing activities within the consolidated statement of cash flows for each year.

**Table of Contents****Statement of Operations Adjustments**

The following is a summary of the adjustments to our previously issued consolidated statements of operations for the fiscal years ended November 30, 2005, 2004 and 2003.

*(In thousands, except per share data)*

| Year Ended November 30,  | 2005           |                |                | 2004           |                |                |
|--|----------------|----------------|----------------|----------------|----------------|----------------|
|  | (as reported)  | (adjustments)  | (as restated)  | (as reported)  | (adjustments)  | (as restated)  |
| <b>Revenue:</b>  |                |                |                |                |                |                |
| Software licenses  | \$ 156,846     |                | \$ 156,846     | \$ 140,462     |                | \$ 140,462     |
| Maintenance and services   | 248,530        |                | 248,530        | 222,200        |                | 222,200        |
| <b>Total revenue</b>   | <b>405,376</b> |                | <b>405,376</b> | <b>362,662</b> |                | <b>362,662</b> |
| <b>Costs of revenue:</b>   |                |                |                |                |                |                |
| Cost of software licenses  | 8,150          | 20             | 8,170          | 8,973          | 27             | 9,000          |
| Cost of maintenance and services                                 | 55,318         | 434            | 55,752         | 52,354         | 338            | 52,692         |
| Amortization of acquired intangibles for purchased technology    | 5,122          |                | 5,122          | 4,099          |                | 4,099          |
| <b>Total costs of revenue</b>                                    | <b>68,590</b>  | <b>454</b>     | <b>69,044</b>  | <b>65,426</b>  | <b>365</b>     | <b>65,791</b>  |
| <b>Gross profit</b>  | <b>336,786</b> | <b>(454)</b>   | <b>336,332</b> | <b>297,236</b> | <b>(365)</b>   | <b>296,871</b> |
| <b>Operating expenses:</b>                                       |                |                |                |                |                |                |
| Sales and marketing  | 157,145        | 1,399          | 158,544        | 146,171        | 1,530          | 147,701        |
| Product development  | 63,071         | 939            | 64,010         | 60,371         | 801            | 61,172         |
| General and administrative                                       | 42,322         | 1,023          | 43,345         | 38,753         | 1,254          | 40,007         |
| Amortization of other acquired intangibles                       | 4,277          |                | 4,277          | 2,977          |                | 2,977          |
| Compensation expense from repurchase of subsidiary stock options | 2,803          |                | 2,803          |                |                |                |
| Acquisition-related expenses, net                                | 3,403          |                | 3,403          | 2,600          |                | 2,600          |
| <b>Total operating expenses</b>                                  | <b>273,021</b> | <b>3,361</b>   | <b>276,382</b> | <b>250,872</b> | <b>3,585</b>   | <b>254,457</b> |
| <b>Income from operations</b>                                    | <b>63,765</b>  | <b>(3,815)</b> | <b>59,950</b>  | <b>46,364</b>  | <b>(3,950)</b> | <b>42,414</b>  |
| <b>Other income (expense):</b>                                   |                |                |                |                |                |                |
| Interest income and other  | 5,257          |                | 5,257          | 2,785          |                | 2,785          |
| Foreign currency loss  | (2,158)        |                | (2,158)        | (1,942)        |                | (1,942)        |
| <b>Total other income, net</b>                                   | <b>3,099</b>   |                | <b>3,099</b>   | <b>843</b>     |                | <b>843</b>     |

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|   |           |           |           |           |           |           |
|---|-----------|-----------|-----------|-----------|-----------|-----------|
| Income before provision for<br>income Taxes | 66,864    | (3,815)   | 63,049    | 47,207    | (3,950)   | 43,257    |
| Provision for income taxes                  | 17,931    | (1,139)   | 16,792    | 15,106    | (1,217)   | 13,889    |
| Net income                                  | \$ 48,933 | \$(2,676) | \$ 46,257 | \$ 32,101 | \$(2,733) | \$ 29,368 |
| Earnings per share:                         |           |           |           |           |           |           |
| Basic                                       | \$ 1.28   | \$ (0.07) | \$ 1.21   | \$ 0.89   | \$ (0.07) | \$ 0.82   |
| Diluted                                     | \$ 1.18   | \$ (0.06) | \$ 1.12   | \$ 0.82   | \$ (0.06) | \$ 0.76   |
| Weighted average shares<br>outstanding:     |           |           |           |           |           |           |
| Basic                                       | 38,227    |           | 38,227    | 36,031    |           | 36,031    |
| Diluted                                     | 41,571    | (147)     | 41,424    | 39,010    | (203)     | 38,807    |

**Table of Contents***(In thousands, except per share data)*

| Year Ended November 30,  | (as reported) | 2003<br>(adjustments) | (as restated) |
|--|---------------|-----------------------|---------------|
| Revenue:   |               |                       |               |
| Software licenses  | \$ 109,666    |                       | \$ 109,666    |
| Maintenance and services   | 199,394       |                       | 199,394       |
| Total revenue  | 309,060       |                       | 309,060       |
| Costs of revenue:  |               |                       |               |
| Cost of software licenses  | 8,435         | 28                    | 8,463         |
| Cost of maintenance and services                                 | 52,599        | 392                   | 52,991        |
| Amortization of acquired intangibles for purchased technology    | 1,108         |                       | 1,108         |
| Total costs of revenue   | 62,142        | 420                   | 62,562        |
| Gross profit   | 246,918       | (420)                 | 246,498       |
| Operating expenses:  |               |                       |               |
| Sales and marketing  | 125,650       | 1,694                 | 127,344       |
| Product development  | 50,054        | 810                   | 50,864        |
| General and administrative                                       | 33,080        | 1,407                 | 34,487        |
| Amortization of other acquired Intangibles                       | 1,182         |                       | 1,182         |
| Compensation expense from Repurchase of subsidiary stock options |               |                       |               |
| Acquisition-related expenses, net                                | 200           |                       | 200           |
| Total operating expenses   | 210,166       | 3,911                 | 214,077       |
| Income from operations   | 36,752        | (4,331)               | 32,421        |
| Other income (expense):  |               |                       |               |
| Interest income and other  | 3,358         |                       | 3,358         |
| Foreign currency loss  | (1,433)       |                       | (1,433)       |
| Total other income, net  | 1,925         |                       | 1,925         |
| Income before provision for income Taxes                         | 38,677        | (4,331)               | 34,346        |
| Provision for income taxes                                       | 11,603        | (1,405)               | 10,198        |
| Net income   | \$ 27,074     | \$ (2,926)            | \$ 24,148     |
| Earnings per share:  |               |                       |               |
| Basic  | \$ 0.79       | \$ (0.08)             | \$ 0.71       |
| Diluted  | \$ 0.72       | \$ (0.07)             | \$ 0.65       |



Weighted average shares outstanding:

|         |        |       |        |
|---------|--------|-------|--------|
| Basic   | 34,217 |       | 34,217 |
| Diluted | 37,554 | (624) | 36,930 |

**Table of Contents****Balance Sheet Adjustments**

The following is a summary of the adjustments to our previously issued consolidated balance sheets as of November 30, 2005 and 2004.

*(In thousands, except share data)*

| November 30,                                |               | 2005          |               | 2004          |               |               |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
|   | (as reported) | (adjustments) | (as restated) | (as reported) | (adjustments) | (as restated) |
| <b>Assets</b>                               |               |               |               |               |               |               |
| <b>Current assets:</b>                      |               |               |               |               |               |               |
| Cash and equivalents                        | \$ 57,399     | (17,001)      | \$ 40,398     | \$ 69,939     | (11,500)      | \$ 58,439     |
| Short-term investments                      | 209,021       | 17,001        | 226,022       | 121,328       | 11,500        | 132,828       |
| Total cash and short-term investments       | 266,420       |               | 266,420       | 191,267       |               | 191,267       |
| Accounts receivable                         | 66,592        |               | 66,592        | 63,503        |               | 63,503        |
| Other current assets                        | 11,813        |               | 11,813        | 11,909        |               | 11,909        |
| Deferred income taxes                       | 21,502        | (5,123)       | 16,379        | 11,576        |               | 11,576        |
| Total current assets                        | 366,327       | (5,123)       | 361,204       | 278,255       |               | 278,255       |
| <b>Property and equipment, net</b>          |               |               |               |               |               |               |
| Intangible assets, net                      | 42,816        |               | 42,816        | 40,658        |               | 40,658        |
| Goodwill                                    | 47,213        |               | 47,213        | 40,233        |               | 40,233        |
| Deferred income taxes                       | 84,974        |               | 84,974        | 67,130        |               | 67,130        |
| Other assets                                | 20,442        |               | 20,442        | 17,176        |               | 17,176        |
|   | 5,066         |               | 5,066         | 3,362         |               | 3,362         |
| Total                                       | \$566,838     | (5,123)       | \$561,715     | \$446,814     |               | \$446,814     |
| <b>Liabilities and Shareholders' Equity</b> |               |               |               |               |               |               |
| <b>Current liabilities:</b>                 |               |               |               |               |               |               |
| Current portion, long-term debt             | \$ 262        |               | \$ 262        | \$ 238        |               | \$ 238        |
| Accounts payable                            | 11,654        |               | 11,654        | 11,953        |               | 11,953        |
| Accrued compensation and related taxes      | 39,259        | 2,394         | 41,653        | 34,907        | 1,190         | 36,097        |
| Income taxes payable                        | 984           | 138           | 1,122         | 3,018         | 471           | 3,489         |
| Other accrued liabilities                   | 22,737        |               | 22,737        | 20,553        |               | 20,553        |
| Short-term deferred revenue                 | 99,697        |               | 99,697        | 101,106       |               | 101,106       |

|   |           |          |           |           |          |           |
|---|-----------|----------|-----------|-----------|----------|-----------|
| Total current liabilities                                     | 174,593   | 2,532    | 177,125   | 171,775   | 1,661    | 173,436   |
| Long-term debt, less current portion                          | 1,938     |          | 1,938     | 2,200     |          | 2,200     |
| Long-term deferred revenue                                    | 5,068     |          | 5,068     | 5,861     |          | 5,861     |
| Deferred income taxes   | 3,580     |          | 3,580     |           |          |           |
| Shareholders' equity:   |           |          |           |           |          |           |
| Common stock, \$.01 par value, and additional paid-in capital | 146,589   | 14,322   | 160,911   | 70,085    | 17,640   | 87,725    |
| Deferred compensation   | (5,706)   |          | (5,706)   |           |          |           |
| Retained earnings   | 240,776   | (21,977) | 218,799   | 196,893   | (19,301) | 177,592   |
| Total shareholders' equity                                    | 381,659   | (7,655)  | 374,004   | 266,978   | (1,661)  | 265,317   |
| Total   | \$566,838 | (5,123)  | \$561,715 | \$446,814 |          | \$446,814 |

**Table of Contents****Consolidated Statements of Cash Flows Adjustments**

The following is a summary of the adjustments to our previously issued consolidated statements of cash flows for the fiscal years ended November 30, 2005, 2004 and 2003.

(In thousands)

| Year Ended November 30,   | (as reported) | 2005<br>(adjustment) | (as restated) |
|---|---------------|----------------------|---------------|
| Cash flows from operating activities:   |               |                      |               |
| Net income  | \$ 48,933     | \$ (2,676)           | \$ 46,257     |
| Adjustments to reconcile net income to net cash provided by operating activities: |               |                      |               |
| Depreciation and amortization of property and equipment                           | 8,547         |                      | 8,547         |
| Amortization of capitalized software costs  | 243           |                      | 243           |
| Amortization of intangible assets   | 9,399         |                      | 9,399         |
| Stock-based compensation  | 134           | 2,611                | 2,745         |
| Allowances for accounts receivable  | 648           |                      | 648           |
| Deferred income taxes   | (10,213)      | 4,317                | (5,896)       |
| In-process research and development   |               |                      |               |
| Tax benefit from stock plans  | 22,868        | (5,123)              | 17,745        |
| Changes in operating assets and liabilities, net of effects from acquisitions:    |               |                      |               |
| Accounts receivable   | (5,141)       |                      | (5,141)       |
| Other assets  | 1,628         |                      | 1,628         |
| Accounts payable and accrued expenses   | 5,077         | 1,204                | 6,281         |
| Income taxes payable  | (2,565)       | (333)                | (2,898)       |
| Deferred revenue  | 1,072         |                      | 1,072         |
| Net cash provided by operating activities   | 80,630        |                      | 80,630        |
| Cash flows from investing activities:   |               |                      |               |
| Purchases of investments available for sale                                       | (368,463)     | (5,500)              | (373,963)     |
| Sales and maturities of investments available for sale                            | 280,765       |                      | 280,765       |
| Purchases of property and equipment   | (10,909)      |                      | (10,909)      |
| Capitalized software costs  |               |                      |               |
| Acquisitions, net of cash acquired and purchase price settlements                 | (31,488)      |                      | (31,488)      |
| Increase in other noncurrent assets   | (2,390)       |                      | (2,390)       |
| Net cash used for investing activities  | (132,485)     | (5,500)              | (137,985)     |
| Cash flows from financing activities:   |               |                      |               |
| Issuance of common stock  | 55,195        |                      | 55,195        |
| Issuance (repurchase) of stock in subsidiary, net                                 | (467)         |                      | (467)         |
| Payment of long-term debt   | (238)         |                      | (238)         |
| Repurchase of common stock  | (11,714)      |                      | (11,714)      |
| Net cash provided by financing activities   | 42,776        |                      | 42,776        |

|   |           |            |           |
|---|-----------|------------|-----------|
| Effect of exchange rate changes on cash         | (3,461)   | (1)        | (3,462)   |
| Net increase (decrease) in cash and equivalents | (12,540)  | (5,501)    | (18,041)  |
| Cash and equivalents, beginning of year         | 69,939    | (11,500)   | 58,439    |
| Cash and equivalents, end of year               | \$ 57,399 | \$(17,001) | \$ 40,398 |

**Table of Contents***(In thousands)*

| Year Ended November 30,   | (as reported) | 2004<br>(adjustment) | (as restated) |
|---|---------------|----------------------|---------------|
| Cash flows from operating activities:   |               |                      |               |
| Net income  | \$ 32,101     | \$ (2,733)           | \$ 29,368     |
| Adjustments to reconcile net income to net cash provided by operating activities: |               |                      |               |
| Depreciation and amortization of property and equipment                           | 9,134         |                      | 9,134         |
| Amortization of capitalized software costs  | 313           |                      | 313           |
| Amortization of intangible assets   | 7,076         |                      | 7,076         |
| Stock-based compensation  |               | 3,468                | 3,468         |
| Allowances for accounts receivable  | 922           |                      | 922           |
| Deferred income taxes   | 2,596         | (1,115)              | 1,481         |
| In-process research and development   | 2,600         |                      | 2,600         |
| Tax benefit from stock plans  | 4,745         |                      | 4,745         |
| Changes in operating assets and liabilities, net of effects from acquisitions:    |               |                      |               |
| Accounts receivable   | (5,516)       |                      | (5,516)       |
| Other assets  | 2,105         |                      | 2,105         |
| Accounts payable and accrued expenses   | 857           | 482                  | 1,339         |
| Income taxes payable  | (908)         | (102)                | (1,010)       |
| Deferred revenue  | 16,163        |                      | 16,163        |
| Net cash provided by operating activities   | 72,188        |                      | 72,188        |
| Cash flows from investing activities:   |               |                      |               |
| Purchases of investments available for sale                                       | (193,277)     | (11,500)             | (204,777)     |
| Sales and maturities of investments available for sale                            | 228,017       |                      | 228,017       |
| Purchases of property and equipment   | (10,716)      |                      | (10,716)      |
| Capitalized software costs  | (300)         |                      | (300)         |
| Acquisitions, net of cash acquired and purchase price settlements                 | (99,320)      |                      | (99,320)      |
| Increase in other noncurrent assets   | (88)          |                      | (88)          |
| Net cash used for investing activities  | (75,684)      | (11,500)             | (87,184)      |
| Cash flows from financing activities:   |               |                      |               |
| Issuance of common stock  | 21,105        |                      | 21,105        |
| Issuance (repurchase) of stock in subsidiary, net                                 | 40            |                      | 40            |
| Payment of long-term debt   |               |                      |               |
| Repurchase of common stock  | (12,966)      |                      | (12,966)      |
| Net cash provided by financing activities   | 8,179         |                      | 8,179         |
| Effect of exchange rate changes on cash   | 2,579         |                      | 2,579         |
| Net increase (decrease) in cash and equivalents                                   | 7,262         | (11,500)             | (4,238)       |

|   |           |            |           |
|---|-----------|------------|-----------|
| Cash and equivalents, beginning of year | 62,677    |            | 62,677    |
| Cash and equivalents, end of year       | \$ 69,939 | \$(11,500) | \$ 58,439 |

**Table of Contents***(In thousands)*

| Year Ended November 30,   | (as reported) | 2003<br>(adjustment) | (as restated) |
|---|---------------|----------------------|---------------|
| Cash flows from operating activities:   |               |                      |               |
| Net income  | \$ 27,074     | \$(2,926)            | \$ 24,148     |
| Adjustments to reconcile net income to net cash provided by operating activities: |               |                      |               |
| Depreciation and amortization of property and equipment                           | 8,389         |                      | 8,389         |
| Amortization of capitalized software costs  | 318           |                      | 318           |
| Amortization of intangible assets   | 2,290         |                      | 2,290         |
| Stock-based compensation  |               | 3,623                | 3,623         |
| Allowances for accounts receivable  | 1,725         |                      | 1,725         |
| Deferred income taxes   | (1,905)       | (1,162)              | (3,067)       |
| In-process research and development   | 200           |                      | 200           |
| Tax benefit from stock plans  | 6,928         | (816)                | 6,112         |
| Changes in operating assets and liabilities, net of effects from acquisitions:    |               |                      |               |
| Accounts receivable   | 5,233         |                      | 5,233         |
| Other assets  | 1,400         |                      | 1,400         |
| Accounts payable and accrued expenses   | 2,708         | 708                  | 3,416         |
| Income taxes payable  | (1,395)       | 573                  | (822)         |
| Deferred revenue  | 4,715         |                      | 4,715         |
| Net cash provided by operating activities   | 57,680        |                      | 57,680        |
| Cash flows from investing activities:   |               |                      |               |
| Purchases of investments available for sale                                       | (200,496)     |                      | (200,496)     |
| Sales and maturities of investments available for sale                            | 170,557       |                      | 170,557       |
| Purchases of property and equipment   | (7,134)       |                      | (7,134)       |
| Capitalized software costs  | (400)         |                      | (400)         |
| Acquisitions, net of cash acquired and purchase price settlements                 | (24,255)      |                      | (24,255)      |
| Increase in other noncurrent assets   | (463)         |                      | (463)         |
| Net cash used for investing activities  | (62,191)      |                      | (62,191)      |
| Cash flows from financing activities:   |               |                      |               |
| Issuance of common stock  | 26,705        |                      | 26,705        |
| Issuance (repurchase) of stock in subsidiary, net                                 | 56            |                      | 56            |
| Payment of long-term debt   |               |                      |               |
| Repurchase of common stock  | (12,116)      |                      | (12,116)      |
| Net cash provided by financing activities   | 14,645        |                      | 14,645        |
| Effect of exchange rate changes on cash   | 2,118         |                      | 2,118         |
| Net increase (decrease) in cash and equivalents                                   | 12,252        |                      | 12,252        |



|   |           |           |
|---|-----------|-----------|
| Cash and equivalents, beginning of year | 50,425    | 50,425    |
| Cash and equivalents, end of year       | \$ 62,677 | \$ 62,677 |

**Table of Contents****Note 15. Selected Quarterly Financial Data (Unaudited)**

The unaudited quarterly results presented below reflect the restatement of our previously issued consolidated financial statements as discussed above in Note 14. As a result, the quarterly data presented herein does not agree to previously issued quarterly statements. Selected quarterly financial data for the years ended November 30, 2005 and 2004 is as follows:

| <i>(In thousands, except per share data)</i>                  | Three Months Ended, Feb. 28, 2005 |                |               | Three Months Ended, May 31, 2005 |               |                |
|---|-----------------------------------|----------------|---------------|----------------------------------|---------------|----------------|
|   | (as reported)                     | (adjustments)  | (as restated) | (as reported)                    | (adjustments) | (as restated)  |
| <b>Revenue:</b>   |                                   |                |               |                                  |               |                |
| Software licenses   | \$37,555                          |                | \$37,555      | \$ 37,221                        |               | \$ 37,221      |
| Maintenance and services                                      | 60,167                            |                | 60,167        | 62,988                           |               | 62,988         |
| <b>Total revenue</b>  | <b>97,722</b>                     |                | <b>97,722</b> | <b>100,209</b>                   |               | <b>100,209</b> |
| <b>Costs of revenue:</b>                                      |                                   |                |               |                                  |               |                |
| Cost of software licenses                                     | 1,951                             | 6              | 1,957         | 1,855                            | 5             | 1,860          |
| Cost of maintenance and services                              | 14,036                            | 118            | 14,154        | 13,800                           | 117           | 13,917         |
| Amortization of acquired intangibles for purchased technology | 1,145                             |                | 1,145         | 1,260                            |               | 1,260          |
| <b>Total costs of revenue</b>                                 | <b>17,132</b>                     | <b>124</b>     | <b>17,256</b> | <b>16,915</b>                    | <b>122</b>    | <b>17,037</b>  |
| <b>Gross profit</b>   | <b>80,590</b>                     | <b>(124)</b>   | <b>80,466</b> | <b>83,294</b>                    | <b>(122)</b>  | <b>83,172</b>  |
| <b>Operating expenses:</b>                                    |                                   |                |               |                                  |               |                |
| Sales and marketing   | 38,329                            | 405            | 38,734        | 37,560                           | 352           | 37,912         |
| Product development   | 16,399                            | 262            | 16,661        | 15,393                           | 245           | 15,638         |
| General and administrative                                    | 10,652                            | 309            | 10,961        | 11,012                           | 245           | 11,257         |
| Amortization of other acquired intangibles                    | 852                               |                | 852           | 1,036                            |               | 1,036          |
| Acquisition-related expenses, net                             |                                   |                |               | 974                              |               | 974            |
| <b>Total operating expenses</b>                               | <b>66,232</b>                     | <b>976</b>     | <b>67,208</b> | <b>65,975</b>                    | <b>842</b>    | <b>66,817</b>  |
| <b>Income from operations</b>                                 | <b>14,358</b>                     | <b>(1,100)</b> | <b>13,258</b> | <b>17,319</b>                    | <b>(964)</b>  | <b>16,355</b>  |
| <b>Other income (expense):</b>                                |                                   |                |               |                                  |               |                |
| Interest income and other                                     | 890                               |                | 890           | 1,160                            |               | 1,160          |
| Foreign currency loss   | (1,551)                           |                | (1,551)       | (260)                            |               | (260)          |
| <b>Total other income, net</b>                                | <b>(661)</b>                      |                | <b>(661)</b>  | <b>900</b>                       |               | <b>900</b>     |
| <b>Income before provision for income taxes</b>               | <b>13,697</b>                     | <b>(1,100)</b> | <b>12,597</b> | <b>18,219</b>                    | <b>(964)</b>  | <b>17,255</b>  |

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|                                      |          |           |          |           |          |           |
|--------------------------------------|----------|-----------|----------|-----------|----------|-----------|
| Provision for income taxes           | 4,383    | (332)     | 4,051    | 5,990     | (293)    | 5,697     |
| Net income                           | \$ 9,314 | \$ (768)  | \$ 8,546 | \$ 12,229 | \$ (671) | \$ 11,558 |
| Earnings per share:                  |          |           |          |           |          |           |
| Basic                                | \$ 0.25  | \$ (0.02) | \$ 0.23  | \$ 0.33   | \$(0.02) | \$ 0.31   |
| Diluted                              | \$ 0.23  | \$ (0.01) | \$ 0.22  | \$ 0.30   | \$(0.02) | \$ 0.28   |
| Weighted average shares outstanding: |          |           |          |           |          |           |
| Basic                                | 36,573   |           | 36,573   | 37,433    |          | 37,433    |
| Diluted                              | 39,721   | (177)     | 39,544   | 40,979    | (147)    | 40,832    |

71

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**Table of Contents**

| <i>(In thousands, except per share data)</i>                     | Three Months Ended,<br>Aug. 31, 2005 |               |               | Three Months Ended,<br>Nov. 30, 2005 |               |               |
|--|--------------------------------------|---------------|---------------|--------------------------------------|---------------|---------------|
|  | (as reported)                        | (adjustments) | (as restated) | (as reported)                        | (adjustments) | (as restated) |
| Revenue:   |                                      |               |               |                                      |               |               |
| Software licenses  | \$ 37,986                            |               | \$ 37,986     | \$ 44,084                            |               | \$ 44,084     |
| Maintenance and services   | 61,502                               |               | 61,502        | 63,873                               |               | 63,873        |
| Total revenue  | 99,488                               |               | 99,488        | 107,957                              |               | 107,957       |
| Costs of revenue:  |                                      |               |               |                                      |               |               |
| Cost of software licenses  | 1,843                                | 5             | 1,848         | 2,501                                | 4             | 2,505         |
| Cost of maintenance and services                                 | 13,492                               | 141           | 13,633        | 13,990                               | 58            | 14,048        |
| Amortization of acquired intangibles for purchased technology    | 1,367                                |               | 1,367         | 1,350                                |               | 1,350         |
| Total costs of revenue   | 16,702                               | 146           | 16,848        | 17,841                               | 62            | 17,903        |
| Gross profit   | 82,786                               | (146)         | 82,640        | 90,116                               | (62)          | 90,054        |
| Operating expenses:  |                                      |               |               |                                      |               |               |
| Sales and marketing  | 37,910                               | 396           | 38,306        | 43,346                               | 246           | 43,592        |
| Product development  | 15,957                               | 289           | 16,246        | 15,322                               | 143           | 15,465        |
| General and administrative                                       | 10,284                               | 259           | 10,543        | 10,374                               | 210           | 10,584        |
| Amortization of other acquired intangibles                       | 1,201                                |               | 1,201         | 1,188                                |               | 1,188         |
| Compensation expense from repurchase of subsidiary stock options | 2,803                                |               | 2,803         |                                      |               |               |
| Acquisition-related expenses, net                                | 1,776                                |               | 1,776         | 653                                  |               | 653           |
| Total operating expenses   | 69,931                               | 944           | 70,875        | 70,833                               | 599           | 71,482        |
| Income from operations   | 12,855                               | (1,090)       | 11,765        | 19,233                               | (661)         | 18,572        |
| Other income (expense):  |                                      |               |               |                                      |               |               |
| Interest income and other  | 1,620                                |               | 1,620         | 1,587                                |               | 1,587         |
| Foreign currency loss  | (317)                                |               | (317)         | (30)                                 |               | (30)          |
| Total other income, net  | 1,303                                |               | 1,303         | 1,557                                |               | 1,557         |
| Income before provision for income taxes                         | 14,158                               | (1,090)       | 13,068        | 20,790                               | (661)         | 20,129        |
| Provision for income taxes                                       | 801                                  | (328)         | 473           | 6,757                                | (186)         | 6,571         |
| Net income   | \$ 13,357                            | \$ (762)      | \$ 12,595     | \$ 14,033                            | \$ (475)      | \$ 13,558     |

Earnings per share:

|         |         |           |         |         |           |         |
|---------|---------|-----------|---------|---------|-----------|---------|
| Basic   | \$ 0.34 | \$ (0.02) | \$ 0.32 | \$ 0.35 | \$ (0.01) | \$ 0.34 |
| Diluted | \$ 0.31 | \$ (0.01) | \$ 0.30 | \$ 0.33 | \$ (0.01) | \$ 0.32 |

Weighted average shares outstanding:

|         |        |       |        |        |       |        |
|---------|--------|-------|--------|--------|-------|--------|
| Basic   | 38,947 |       | 38,947 | 39,953 |       | 39,953 |
| Diluted | 42,501 | (144) | 42,357 | 43,083 | (121) | 42,962 |

**Table of Contents**

| <i>(In thousands, except per share data)</i>                  | Three Months Ended, Feb. 28, 2004 |                 |                 | Three Months Ended, May 31, 2004 |                 |                 |
|---|-----------------------------------|-----------------|-----------------|----------------------------------|-----------------|-----------------|
|   | (as reported)                     | (adjustments)   | (as restated)   | (as reported)                    | (adjustments)   | (as restated)   |
| <b>Revenue:</b>   |                                   |                 |                 |                                  |                 |                 |
| Software licenses   | \$ 33,895                         |                 | \$ 33,895       | \$ 36,905                        |                 | \$ 36,905       |
| Maintenance and services                                      | 52,480                            |                 | 52,480          | 53,872                           |                 | 53,872          |
| <b>Total revenue</b>  | <b>86,375</b>                     |                 | <b>86,375</b>   | <b>90,777</b>                    |                 | <b>90,777</b>   |
| <b>Costs of revenue:</b>                                      |                                   |                 |                 |                                  |                 |                 |
| Cost of software licenses                                     | 2,592                             | 6               | 2,598           | 2,299                            | 6               | 2,305           |
| Cost of maintenance and services                              | 12,826                            | 100             | 12,926          | 13,959                           | 78              | 14,037          |
| Amortization of acquired intangibles for purchased technology | 898                               |                 | 898             | 1,087                            |                 | 1,087           |
| <b>Total costs of revenue</b>                                 | <b>16,316</b>                     | <b>106</b>      | <b>16,422</b>   | <b>17,345</b>                    | <b>84</b>       | <b>17,429</b>   |
| <b>Gross profit</b>   | <b>70,059</b>                     | <b>(106)</b>    | <b>69,953</b>   | <b>73,432</b>                    | <b>(84)</b>     | <b>73,348</b>   |
| <b>Operating expenses:</b>                                    |                                   |                 |                 |                                  |                 |                 |
| Sales and marketing   | 36,180                            | 384             | 36,564          | 36,100                           | 355             | 36,455          |
| Product development   | 14,609                            | 222             | 14,831          | 15,275                           | 185             | 15,460          |
| General and administrative                                    | 9,676                             | 290             | 9,966           | 9,837                            | 291             | 10,128          |
| Amortization of other acquired intangibles                    | 661                               |                 | 661             | 750                              |                 | 750             |
| Acquisition-related expenses, net                             | 2,600                             |                 | 2,600           |                                  |                 |                 |
| <b>Total operating expenses</b>                               | <b>63,726</b>                     | <b>896</b>      | <b>64,622</b>   | <b>61,962</b>                    | <b>831</b>      | <b>62,793</b>   |
| <b>Income from operations</b>                                 | <b>6,333</b>                      | <b>(1,002)</b>  | <b>5,331</b>    | <b>11,470</b>                    | <b>(915)</b>    | <b>10,555</b>   |
| <b>Other income (expense):</b>                                |                                   |                 |                 |                                  |                 |                 |
| Interest income and other                                     | 771                               |                 | 771             | 650                              |                 | 650             |
| Foreign currency loss   | (379)                             |                 | (379)           | (403)                            |                 | (403)           |
| <b>Total other income, net</b>                                | <b>392</b>                        |                 | <b>392</b>      | <b>247</b>                       |                 | <b>247</b>      |
| <b>Income before provision for income taxes</b>               | <b>6,725</b>                      | <b>(1,002)</b>  | <b>5,723</b>    | <b>11,717</b>                    | <b>(915)</b>    | <b>10,802</b>   |
| <b>Provision for income taxes</b>                             | <b>2,085</b>                      | <b>(311)</b>    | <b>1,774</b>    | <b>3,632</b>                     | <b>(276)</b>    | <b>3,356</b>    |
| <b>Net income</b>   | <b>\$ 4,640</b>                   | <b>\$ (691)</b> | <b>\$ 3,949</b> | <b>\$ 8,085</b>                  | <b>\$ (639)</b> | <b>\$ 7,446</b> |

Earnings per share:

|         |         |           |         |         |           |         |
|---------|---------|-----------|---------|---------|-----------|---------|
| Basic   | \$ 0.13 | \$ (0.02) | \$ 0.11 | \$ 0.22 | \$ (0.01) | \$ 0.21 |
| Diluted | \$ 0.12 | \$ (0.02) | \$ 0.10 | \$ 0.21 | \$ (0.02) | \$ 0.19 |

Weighted average shares outstanding:

|         |        |       |        |        |       |        |
|---------|--------|-------|--------|--------|-------|--------|
| Basic   | 35,644 |       | 35,644 | 36,046 |       | 36,046 |
| Diluted | 38,955 | (294) | 38,661 | 39,233 | (216) | 39,017 |

**Table of Contents**

| <i>(In thousands, except per share data)</i>                  | Three Months Ended,<br>Aug. 31, 2004 |               |               | Three Months Ended,<br>Nov. 30, 2004 |               |               |
|---|--------------------------------------|---------------|---------------|--------------------------------------|---------------|---------------|
|   | (as reported)                        | (adjustments) | (as restated) | (as reported)                        | (adjustments) | (as restated) |
| Revenue:  |                                      |               |               |                                      |               |               |
| Software licenses   | \$ 32,864                            |               | \$ 32,864     | \$ 36,798                            |               | \$ 36,798     |
| Maintenance and services                                      | 56,452                               |               | 56,452        | 59,396                               |               | 59,396        |
| Total revenue   | 89,316                               |               | 89,316        | 96,194                               |               | 96,194        |
| Costs of revenue:   |                                      |               |               |                                      |               |               |
| Cost of software licenses                                     | 2,092                                | 6             | 2,098         | 1,990                                | 9             | 1,999         |
| Cost of maintenance and services                              | 12,826                               | 65            | 12,891        | 12,743                               | 95            | 12,838        |
| Amortization of acquired intangibles for purchased technology | 1,045                                |               | 1,045         | 1,070                                |               | 1,070         |
| Total costs of revenue  | 15,963                               | 71            | 16,034        | 15,803                               | 104           | 15,907        |
| Gross profit  | 73,353                               | (71)          | 73,282        | 80,391                               | (104)         | 80,287        |
| Operating expenses:   |                                      |               |               |                                      |               |               |
| Sales and marketing   | 35,310                               | 305           | 35,615        | 38,581                               | 486           | 39,067        |
| Product development   | 14,907                               | 156           | 15,063        | 15,580                               | 238           | 15,818        |
| General and administrative                                    | 9,674                                | 256           | 9,930         | 9,566                                | 417           | 9,983         |
| Amortization of other acquired intangibles                    | 764                                  |               | 764           | 801                                  |               | 801           |
| Acquisition-related expenses, net                             |                                      |               |               |                                      |               |               |
| Total operating expenses                                      | 60,655                               | 717           | 61,372        | 64,528                               | 1,141         | 65,669        |
| Income from operations  | 12,698                               | (788)         | 11,910        | 15,863                               | (1,245)       | 14,618        |
| Other income (expense):                                       |                                      |               |               |                                      |               |               |
| Interest income and other                                     | 606                                  |               | 606           | 758                                  |               | 758           |
| Foreign currency loss   | (503)                                |               | (503)         | (657)                                |               | (657)         |
| Total other income, net                                       | 103                                  |               | 103           | 101                                  |               | 101           |
| Income before provision for income taxes                      | 12,801                               | (788)         | 12,013        | 15,964                               | (1,245)       | 14,719        |
| Provision for income taxes                                    | 4,281                                | (233)         | 4,048         | 5,108                                | (397)         | 4,711         |
| Net income  | \$ 8,520                             | \$ (555)      | \$ 7,965      | \$ 10,856                            | \$ (848)      | \$ 10,008     |



## Earnings per share:

|         |         |           |         |         |           |         |
|---------|---------|-----------|---------|---------|-----------|---------|
| Basic   | \$ 0.24 | \$ (0.02) | \$ 0.22 | \$ 0.30 | \$ (0.02) | \$ 0.28 |
| Diluted | \$ 0.22 | \$ (0.01) | \$ 0.21 | \$ 0.28 | \$ (0.02) | \$ 0.26 |

## Weighted average shares outstanding:

|         |        |       |        |        |       |        |
|---------|--------|-------|--------|--------|-------|--------|
| Basic   | 36,220 |       | 36,220 | 36,212 |       | 36,212 |
| Diluted | 38,853 | (153) | 38,700 | 38,997 | (149) | 38,848 |

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures****Background of Restatement**

On August 29, 2006, the Audit Committee of our Board of Directors concluded that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements, and that our consolidated financial statements, including the reports of our independent registered public accounting firm thereon, and our earnings releases and similar communications for the year ended November 30, 1996 and subsequent periods, should no longer be relied upon.

On November 28, 2006, our Board of Directors concluded that our consolidated financial statements for each of the years during the three year period ended November 30, 2005 and for the three months ended February 28, 2006, as well as the selected financial data for the years ended November 30, 2002 and 2001 (as well as for certain prior periods not included in these financial statements) should be restated to record additional non-cash stock-based

**Table of Contents**

compensation expense, and related tax effects, resulting from stock options granted during fiscal years 1996 to 2005 that were incorrectly accounted for under GAAP. This decision was based on the determination that the actual measurement dates for determining the accounting treatment of certain stock option grants differed from the measurement dates we used in preparing our consolidated financial statements.

Our decision to restate our financial statements was based on the facts obtained by an internal investigation into our stock option accounting, conducted initially by the Audit Committee of our Board of Directors, and subsequently by a Special Committee of our Board consisting entirely of non-employee directors who had not served on the Compensation Committee of our Board. The Special Committee, advised by our outside legal counsel and special legal counsel, in consultation with management, concluded that nearly all option grants from December 1995 through July 2005 were accounted for improperly, and concluded that stock-based compensation associated with nearly all grants was misstated in fiscal years 1996 through 2005 and in the first quarter of fiscal 2006. The Special Committee identified several practices, including the retrospective selection of grant dates and the completion subsequent to the grant date of the allocation of individual awards, which caused errors related to stock option grant measurement dates and stock-based compensation. The Special Committee concluded, based on its review of the facts and circumstances surrounding our option grant practices, that management knew that relevant accounting rules required us to record stock-based compensation charges when we made below fair market value option grants, but did not apply those rules correctly or assure that they were being applied correctly and therefore failed to record necessary accounting charges. The Special Committee further concluded that there was no evidence to indicate that the practices that caused errors related to stock option grant measurement dates and stock-based compensation resulted from willful misconduct. During the second half of fiscal 2005, prior to the commencement of the investigation by the Audit Committee and the Special Committee, we revised our stock option grant practices. The revised grant process includes, among other things, fixed grant dates during the year, review by the Compensation Committee of a preliminary grant list in advance of the fixed grant date and a final approval by the Compensation Committee of the final list of grant recipients on the fixed grant date.

**(a) Evaluation of disclosure controls and procedures**

Our management, including the chief executive officer and the chief financial officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended) as of November 30, 2005 in connection with the filing of our original Form 10-K in February 2006. Based on this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to provide a reasonable level of assurance that the information required to be disclosed in the reports filed or submitted by us under the Securities Exchange Act of 1934 was recorded, processed, summarized and reported within the requisite time periods.

Subsequent to the evaluation made in connection with the Original Filing for the year ended November 30, 2005 and in connection with the restatement and the filing of this Form 10-K/A, our management, including the chief executive officer and chief financial officer, re-evaluated the effectiveness of the design and operation of our disclosure controls and procedures and concluded that, because of the material weakness in our internal control over financial reporting discussed below, our disclosure controls and procedures were not effective as of November 30, 2005. Notwithstanding the material weakness discussed below, our management, including the chief executive officer and chief financial officer, has concluded that the consolidated financial statements included in this Form 10-K/A present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States.

**(b) Management's Annual Report on Internal Control Over Financial Reporting (as revised)**

The management of Progress Software Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Our internal control system was designed to provide reasonable assurance to our management and board of directors regarding the preparation and fair presentation of published financial statements.

In connection with the filing of the original Form 10-K in February 2006, our management included Management's Annual Report on Internal Control over Financial Reporting therein, which expressed a conclusion by management



**Table of Contents**

that management believed that our internal control over financial reporting was effective as of November 30, 2005. In connection with filing this amended Form 10-K/A for the year ended November 30, 2005, our management reassessed the effectiveness of our internal control over financial reporting as of November 30, 2005. In making each of these assessments, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework. As a result of the restatement of our consolidated financial statements, our management has determined that a material weakness in our internal control over financial reporting existed as of November 30, 2005, and, based on the criteria noted above, has now concluded that our internal control over financial reporting was not effective as of November 30, 2005.

Specifically, our management determined that we had a material weakness resulting from the failure to design and implement controls necessary to provide reasonable assurance that historical measurement dates for stock option grants to employees were appropriately determined; accordingly, the measurement dates used for certain option grants were not appropriate, and the Company's accounting for those grants was not in accordance with Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*. This material weakness resulted in the restatement described in Note 14 to the restated consolidated financial statements included in this Form 10-K/A. Our management determined that this control deficiency was a material weakness, based upon the actual misstatements identified, the potential for additional material misstatements to have occurred as a result of the deficiency, and the lack of other mitigating controls.

Management's revised assessment of the effectiveness of its internal control over financial reporting as of November 30, 2005, as included in this Form 10-K/A, has been attested to by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which is included herein.

**(c) Changes in internal control over financial reporting**

No changes in our internal control over financial reporting occurred during the quarter ended November 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We believe that subsequent to November 30, 2005, we completed our remediation of the material weakness in our internal control over financial reporting relating to the proper measurement of expense under Accounting Principles Board Opinion 25 that existed at November 30, 2005. During the second half of fiscal 2005, prior to the commencement of the investigation by the Audit Committee and the Special Committee, we revised our stock option grant practices. The revised grant process includes, among other things, fixed grant dates during the year, review by the Compensation Committee of a preliminary grant list in advance of the fixed grant date and a final approval by the Compensation Committee of the final list of grant recipients on the fixed grant date. Additionally, during fiscal 2006 our management has corrected its understanding of the accounting principles included in APB 25 and as a result, our previous accounting for stock-based compensation has been corrected in the restated selected financial data appearing in Item 6 and the restated consolidated financial statements appearing in Item 8 of this Form 10-K/A.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
Progress Software Corporation  
Bedford, Massachusetts

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting (as revised), that Progress Software Corporation and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of November 30, 2005, because of the effect of the material weakness identified in management's assessment based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit



**Table of Contents**

included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our report dated February 10, 2006, we expressed an unqualified opinion on management's assessment that the Company maintained effective internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting as of November 30, 2005. As described in the following paragraph, the Company subsequently identified material misstatements in its annual financial statements, which caused such annual financial statements to be restated. Management subsequently revised its assessment due to the identification of the material weakness described in the following paragraph. Accordingly, our opinion on the effectiveness of the Company's internal control over financial reporting as of November 30, 2005 expressed herein is different from that expressed in our previous report.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's revised assessment. The Company did not design and implement controls necessary to provide reasonable assurance that historical measurement dates for stock option grants to employees were appropriately determined; accordingly, the measurement dates used for certain option grants were not appropriate, and the Company's accounting for those grants was not in accordance with Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees*. This material weakness resulted in the restatement described in Note 14 to the consolidated financial statements. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the Company's consolidated financial statements as of and for the year ended November 30, 2005 (as restated), and this report does not affect our report on such restated financial statements.

In our opinion, management's revised assessment that the Company did not maintain effective internal control over financial reporting as of November 30, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over

**Table of Contents**

financial reporting as of November 30, 2005, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended November 30, 2005 (as restated), and our report dated February 10, 2006 (December 18, 2006 as to the effect of the matters discussed in the third, fourth and fifth paragraphs of Note 13 and the effect of the restatement discussed in Note 14) expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

Boston, Massachusetts

February 10, 2006 (December 18, 2006 as to the effect of the material weakness described in Management's Annual Report on Internal Control over Financial Reporting (as revised))

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

The information regarding executive officers set forth under the caption "Executive Officers of the Registrant" in Item 1 of this Annual Report is incorporated herein by reference.

The information regarding directors set forth under the caption "Election of Directors" appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the Securities and Exchange Commission (SEC) not later than 120 days after November 30, 2005, is incorporated herein by reference.

The information regarding our code of ethics and audit committee set forth under the caption "Board of Directors and Committees of the Board" appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the SEC not later than 120 days after November 30, 2005, is incorporated herein by reference.

**Item 11. Executive Compensation**

The information set forth under the caption "Executive Compensation" appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the SEC not later than 120 days after November 30, 2005, is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management**

The information set forth under the caption "Security Ownership of Certain Holders and Management" appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the SEC not later than 120 days after November 30, 2005, is incorporated herein by reference.

**Table of Contents**

Information related to securities authorized for issuance under equity compensation plans as of November 30, 2005 is as follows:

*(In thousands, except per share data)*

| Plan Category  | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted-average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available For Future Issuance |
|--|---|---|--|
| Equity compensation plans approved by shareholders     | 4,842   | \$ 15.26  | 301  |
| Equity compensation plans not approved by shareholders | 4,617   | 20.37   | 596  |
| Total  | 9,459   | \$ 17.75  | 897  |

We have adopted two equity compensation plans, the 2002 Nonqualified Stock Plan (2002 Plan) and the 2004 Inducement Stock Plan (2004 Plan), for which the approval of shareholders was not required. We intend that the 2004 Plan be reserved for persons to whom we may issue securities as an inducement to become employed by us pursuant to the rules and regulations of the Nasdaq Stock Market. Executive officers and members of the Board of Directors are not eligible for awards under the 2002 Plan. An executive officer or director would be eligible to receive an award under the 2004 Plan only as an inducement to join us. Awards under the 2002 Plan and the 2004 Plan may include nonqualified stock options, grants of conditioned stock, unrestricted grants of stock, grants of stock contingent upon the attainment of performance goals and stock appreciation rights. A total of 7,000,000 shares are issuable under the two plans.

**Item 13. Certain Relationships and Related Transactions**

The information set forth under the caption **Certain Relationships and Related Transactions** appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the SEC not later than 120 days after November 30, 2005, is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services**

The information set forth under the caption **Principal Accounting Fees and Services** appearing in our definitive Proxy Statement for the Annual Meeting of Shareholders to be held on April 20, 2006, which will be filed with the SEC not later than 120 days after November 30, 2005, is incorporated herein by reference.

**PART IV****Item 15. Exhibits, Financial Statement Schedules****(a) Documents Filed as Part of this Form 10-K/A**

## 1. Financial Statements (included in Item 8 of this report on Form 10-K/A):

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of November 30, 2005 and 2004

Consolidated Statements of Operations for the years ending November 30, 2005, 2004 and 2003

Consolidated Statements of Shareholders' Equity for the years ending November 30, 2005, 2004 and 2003

Consolidated Statements of Cash Flows for the years ending November 30, 2005, 2004 and 2003



Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Financial statement schedules are omitted as they are either not required or the information is otherwise included.

**(b) Exhibits**

Documents listed below, except for documents followed by parenthetical numbers, are being filed as exhibits. Documents followed by parenthetical numbers are not being filed herewith and, pursuant to Rule 12b-32 of the General Rules and Regulations promulgated by the SEC under the Securities Exchange Act of 1934 (the Act), reference is made to such documents as previously filed as exhibits with the SEC. Our file number under the Act is 0-19417.

**Table of Contents**

|       |  |
|-------|--|
| 2.1   | Agreement and Plan of Merger Among Progress Software Corporation, Chopin Merger Sub, Inc. and eXcelon Corporation (1)  |
| 2.2   | Purchase Agreement Dated as of December 5, 2003 By and Among Progress Software Corporation, Diamond Acquisition Corp. and DataDirect Technologies Limited (2)  |
| 2.3   | Agreement and Plan of Merger dated as of April 6, 2005 by and among Progress Software Corporation, PSC Merger Corp., Apama Inc., and certain stockholders of Apama Inc. (3)  |
| 2.4   | Agreement and Plan of Merger dated August 31, 2005 by and among Progress Software Corporation, Sonic Software Corporation and Sonic Merger Corporation (4)   |
| 2.5   | Agreement and Plan of Merger dated December 19, 2005 by and among Progress Software Corporation, Noble Acquisition Corporation and NEON Systems, Inc. (5)  |
| 2.6   | Agreement and Plan of Merger dated January 18, 2006 by and among Progress Software Corporation, ACTC Acquisition Corp., Actional Corporation, Certain Stockholders of Actional Corporation and Standish O Grady, as the Company Stockholder Representative (6) |
| 3.1   | Restated Articles of Organization (7)  |
| 3.1.1 | Articles of Amendment to Restated Articles of Organization filed on January 19, 1995 (8)   |
| 3.1.2 | Articles of Amendment to Restated Articles of Organization filed on November 17, 1997 (9)  |
| 3.1.3 | Articles of Amendment to Restated Articles of Organization filed on May 6, 1999 (10)   |
| 3.1.4 | Articles of Amendment to Restated Articles of Organization filed on June 17, 2000 (11)   |
| 3.2   | By-Laws, as amended and restated (12)  |
| 4.1   | Specimen certificate for the Common Stock (13)   |
| 10.1* | Amended and Restated 1984 Incentive Stock Option Plan (14)   |
| 10.2* | 1991 Employee Stock Purchase Plan, as amended (15)   |
| 10.3* | 1992 Incentive and Nonqualified Stock Option Plan (16)   |
| 10.4* | 1994 Stock Incentive Plan (17)   |
| 10.5* | 1993 Directors Stock Option Plan (18)  |
| 10.6* | 1997 Stock Incentive Plan, as amended (19)   |
| 10.7* | Employee Retention and Motivation Agreement executed by each of the Executive Officers (20)  |
| 10.8* |  |

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First amendment to Employee Retention and Motivation Agreement executed by each of the Executive Officers (21)

- 10.9\* 2002 Nonqualified Stock Plan (22)
- 10.10\* 2004 Inducement Stock Plan (23)
- 10.12 Written offer of employment with Larry R. Harris dated April 29, 2005 (24)
- 21.1\*\* List of Subsidiaries of the Registrant
- 23.1 Consent of Deloitte & Touche LLP
- 31.1 Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 Joseph W. Alsop
- 31.2 Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 Norman R. Robertson
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 99.1 Agreement and Plan of Merger By and Among Progress Software Corporation, PSI Acquisition Sub, Inc. and Persistence Software, Inc. (25)
- 99.1 Asset Purchase Agreement dated April 29, 2005 by and among Progress Development Corporation, EasyAsk, Inc. and Sigma Partners LLP, as indemnification representative (26)

(1) Incorporated by reference to Exhibit 1 of Schedule 13D filed October 28, 2002.

(2) Incorporated by reference to Exhibit 2.1 of Form 8-K filed January 7, 2004.

(3) Incorporated by reference to Exhibit 2.1 of Form 8-K filed April 12, 2005.

(4) Incorporated by reference to Exhibit 2.1 of Form 8-K filed September 7, 2005.

- (5) Incorporated by reference to Exhibit 2.1 of Form 8-K filed December 22, 2005.
- (6) Incorporated by reference to Exhibit 2.1 of Form 8-K filed January 23, 2006.
- (7) Incorporated by reference to Exhibit 3.1 to our Annual Report on Form 10-K for the fiscal year ended November 30, 1997.

**Table of Contents**

- (8) Incorporated by reference to Exhibit 3.1.1 to our Annual Report on Form 10-K for the fiscal year ended November 30, 1994.
  
- (9) Incorporated by reference to Exhibit 3.1.2 to our Annual Report on Form 10-K for the fiscal year ended November 30, 1997.
  
- (10) Incorporated by reference to Exhibit 3.1.3 to our Annual Report on Form 10-K for the fiscal year ended November 30, 1999.
  
- (11) Incorporated by reference to Exhibit 3.1.4 to our Annual Report on Form 10-K for the fiscal year ended November 30, 2000.
  
- (12) Incorporated by reference to Exhibit 3.2 to our Annual Report on Form

10-K for the  
fiscal year  
ended  
November 30,  
1991.

- (13) Incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-1, File No. 33-41223, as amended.
- (14) Incorporated by reference to Exhibit 10.12 to our Registration Statement on Form S-1, File No. 33-41223, as amended.
- (15) Incorporated by reference to Exhibit 10.8 to our Quarterly Report on Form 10-Q for the quarter ended May 31, 1998.
- (16) Incorporated by reference to Exhibit 10.12 to our Quarterly Report on Form 10-Q for the quarter ended May 31, 1992.
- (17) Incorporated by reference to Exhibit 10.16 to our Quarterly Report on Form 10-Q for the quarter ended August 31, 1994.

- (18) Incorporated by reference to Exhibit 10.17 to our Quarterly Report on Form 10-Q for the quarter ended August 31, 1994.
- (19) Incorporated by reference to Exhibit 10.7 to our Annual Report on Form 10-K for the fiscal year ended November 30, 2000.
- (20) Incorporated by reference to Exhibit 10.10 to our Annual Report on Form 10-K for the fiscal year ended November 30, 1998.
- (21) Incorporated by reference to Exhibit 10.10.1 to our Quarterly Report on Form 10-Q for the quarter ended August 31, 1999.
- (22) Incorporated by reference to Exhibit 10.10 to our Quarterly Report on Form 10-Q for the quarter ended May 31, 2002.

(23) Incorporated by reference to Exhibit 10.12 to our Annual Report on Form 10-K for the fiscal year ended November 30, 2004.

(24) Incorporated by reference to Exhibit 10.1 of Form 8-K filed May 5, 2005.

(25) Incorporated by reference to Exhibit 99.1 of Form 8-K filed September 27, 2004.

(26) Incorporated by reference to Exhibit 99.1 of Form 8-K filed May 5, 2005.

\* Management contract or compensatory plan or arrangement in which an executive officer or director of PSC participates



**Table of Contents**

\*\* Previously filed

**(c) Financial Statement Schedules**

All schedules are omitted because they are not applicable or the required information is shown on the financial statements or notes thereto.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 18th day of December, 2006.

PROGRESS SOFTWARE  
CORPORATION

By: /s/ JOSEPH W. ALSOP

Joseph W. Alsop  
*Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature  | Title  | Date              |
|--|--|-------------------|
| /s/ JOSEPH W. ALSOP<br>Joseph W. Alsop           | Chief Executive Officer and<br>Director (Principal Executive<br>Officer)   | December 18, 2006 |
| /s/ NORMAN R. ROBERTSON<br>Norman R. Robertson   | Senior Vice President, Finance<br>and Administration and Chief<br>Financial Officer (Principal<br>Financial Officer) | December 18, 2006 |
| /s/ DAVID H. BENTON, JR.<br>David H. Benton, Jr. | Vice President and Corporate<br>Controller (Principal Accounting<br>Officer)   | December 18, 2006 |
| /s/ ROGER J. HEINEN, JR.<br>Roger J. Heinen, Jr. | Director   | December 18, 2006 |
| /s/ CHARLES F. KANE<br>Charles F. Kane           | Director   | December 18, 2006 |
| /s/ MICHAEL L. MARK<br>Michael L. Mark           | Director   | December 18, 2006 |
| /s/ SCOTT A. MCGREGOR<br>Scott A. McGregor       | Director   | December 18, 2006 |
| /s/ AMRAM RASIEL                                 | Director   | December 18, 2006 |

