

PROGRESS SOFTWARE CORP /MA

Form 10-Q

July 10, 2008

Table of Contents

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

FORM 10-Q

(Mark One)

☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended May 31, 2008

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)(Zip code)

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

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|--|--|--|---|
| Large accelerated filer <input checked="" type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |
|--|--|--|---|

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 June 30, 2008, there were 41,153,000 shares of the registrant's common stock, \$.01 par value per share, outstanding.

PROGRESS SOFTWARE CORPORATION
FORM 10-Q
FOR THE THREE MONTHS ENDED MAY 31, 2008
INDEX

PART

I

FINANCIAL INFORMATION

| | | |
|----------------|--|----|
| <u>Item 1.</u> | <u>Unaudited Consolidated Financial Statements</u> | 3 |
| | <u>Condensed Consolidated Balance Sheets as of May 31, 2008 and November 30, 2007</u> | 3 |
| | <u>Condensed Consolidated Statements of Operations for the three months and six months ended May 31, 2008 and 2007</u> | 4 |
| | <u>Condensed Consolidated Statements of Cash Flows for the six months ended May 31, 2008 and 2007</u> | 5 |
| | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 6 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 13 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 22 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 23 |

PART

II

OTHER INFORMATION

| | | |
|----------------|--|----|
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 23 |
| <u>Item</u> | | |
| <u>1A.</u> | <u>Risk Factors</u> | 24 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 25 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 26 |
| <u>Item 6.</u> | <u>Exhibits</u> | 26 |
| | <u>Signatures</u> | 28 |
| | <u>Ex-10.6 2008 Fiscal Year Director Compensation Program</u> | |
| | <u>Ex-31.1 Section 302 Certification of CEO</u> | |
| | <u>Ex-31.2 Section 302 Certification of CFO</u> | |
| | <u>Ex-32.1 Section 906 Certification of CEO & CFO</u> | |

Table of Contents**PART 1. FINANCIAL INFORMATION****Item 1. Unaudited Consolidated Financial Statements**
Condensed Consolidated Balance Sheets (unaudited)*(In thousands)*

| | May 31, 2008 | November 30, 2007 |
|--|-----------------|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and equivalents | \$216,613 | \$ 53,879 |
| Short-term investments | 42,413 | 285,646 |
| Total cash and short-term investments | 259,026 | 339,525 |
| Accounts receivable, net | 88,041 | 93,998 |
| Other current assets | 24,384 | 17,891 |
| Deferred income taxes | 12,124 | 13,009 |
| Total current assets | 383,575 | 464,423 |
| Property and equipment, net | 63,916 | 64,949 |
| Acquired intangible assets, net | 55,159 | 59,931 |
| Goodwill | 153,289 | 149,057 |
| Deferred income taxes | 19,074 | 17,617 |
| Investments | 67,691 | |
| Other assets | 12,298 | 5,851 |
| Total | \$755,002 | \$ 761,828 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current portion, long-term debt | \$ 317 | \$ 305 |
| Accounts payable | 12,524 | 12,684 |
| Accrued compensation and related taxes | 35,502 | 50,092 |
| Income taxes payable | 416 | 3,409 |
| Other accrued liabilities | 26,490 | 26,493 |
| Short-term deferred revenue | 148,402 | 135,487 |
| Total current liabilities | 223,651 | 228,470 |
| Long-term debt, less current portion | 1,190 | 1,352 |
| Long-term deferred revenue | 10,981 | 11,200 |
| Deferred income taxes | 4,507 | 2,817 |

Edgar Filing: PROGRESS SOFTWARE CORP /MA - Form 10-Q

| | | |
|--|-----------|------------|
| Other non-current liabilities | 5,129 | 115 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock and additional paid-in capital; authorized, 100,000 shares; issued and outstanding, 41,269 shares in 2008 and 42,380 shares in 2007 | 230,466 | 240,647 |
| Retained earnings and accumulated other comprehensive gains of \$3,731 in 2008 and \$4,833 in 2007 | 279,078 | 277,227 |
| Total shareholders' equity | 509,544 | 517,874 |
| Total | \$755,002 | \$ 761,828 |

See notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended May 31, | | Six Months Ended May 31, | |
|---|----------------------------|-----------|--------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenue: | | | | |
| Software licenses | \$ 45,015 | \$ 44,555 | \$ 90,117 | \$ 89,284 |
| Maintenance and services | 82,927 | 75,087 | 159,392 | 145,587 |
| Total revenue | 127,942 | 119,642 | 249,509 | 234,871 |
| Costs of revenue: | | | | |
| Cost of software licenses | 2,164 | 1,880 | 4,460 | 3,552 |
| Cost of maintenance and services | 17,715 | 16,871 | 35,356 | 33,133 |
| Amortization of acquired intangibles for purchased technology | 2,817 | 2,493 | 5,490 | 4,984 |
| Total costs of revenue | 22,696 | 21,244 | 45,306 | 41,669 |
| Gross profit | 105,246 | 98,398 | 204,203 | 193,202 |
| Operating expenses: | | | | |
| Sales and marketing | 48,158 | 45,745 | 94,000 | 90,390 |
| Product development | 20,530 | 20,389 | 41,223 | 41,184 |
| General and administrative | 14,605 | 19,029 | 28,505 | 34,060 |
| Amortization of other acquired intangibles | 1,349 | 1,946 | 2,723 | 3,926 |
| Total operating expenses | 84,642 | 87,109 | 166,451 | 169,560 |
| Income from operations | 20,604 | 11,289 | 37,752 | 23,642 |
| Other income (expense): | | | | |
| Interest income and other | 2,659 | 2,331 | 5,814 | 4,249 |
| Foreign currency loss | (474) | (710) | (563) | (1,538) |
| Total other income, net | 2,185 | 1,621 | 5,251 | 2,711 |
| Income before provision for income taxes | 22,789 | 12,910 | 43,003 | 26,353 |
| Provision for income taxes | 8,318 | 4,519 | 15,696 | 9,224 |
| Net income | \$ 14,471 | \$ 8,391 | \$ 27,307 | \$ 17,129 |
| Earnings per share: | | | | |
| Basic | \$ 0.35 | \$ 0.20 | \$ 0.65 | \$ 0.42 |
| Diluted | \$ 0.33 | \$ 0.19 | \$ 0.62 | \$ 0.39 |

Weighted average shares outstanding:

| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 41,483 | 41,178 | 41,861 | 41,123 |
| Diluted | 43,238 | 43,636 | 43,706 | 43,537 |

See notes to unaudited condensed consolidated financial statements.

4

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

| | Six Months Ended May 31, | |
|---|--------------------------|-----------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | \$ 27,307 | \$ 17,129 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of property and equipment | 5,275 | 4,849 |
| Write-down for asset impairment | | 2,388 |
| Amortization of capitalized software costs | | 87 |
| Amortization of acquired intangible assets | 8,213 | 8,910 |
| Stock-based compensation | 8,080 | 12,408 |
| Deferred income taxes | 2,256 | (1,477) |
| Tax benefit from stock options | 2,294 | 230 |
| Excess tax benefit from stock options | (1,417) | |
| Changes in operating assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable, net | 8,625 | (925) |
| Other current assets | (562) | (879) |
| Accounts payable and accrued expenses | (17,582) | (17,927) |
| Income taxes payable | (4,442) | 1,178 |
| Deferred revenue | 8,784 | 13,047 |
| Net cash provided by operating activities | 46,831 | 39,018 |
| Cash flows from investing activities: | | |
| Purchases of investments available for sale | (140,806) | (108,061) |
| Sales and maturities of investments available for sale | 312,484 | 80,557 |
| Purchases of property and equipment | (3,935) | (9,622) |
| Acquisition, net of cash acquired | (5,728) | |
| Investment in IONA Technologies | (6,668) | |
| Increase in other non-current assets | (411) | (827) |
| Net cash provided by (used for) investing activities | 154,936 | (37,953) |
| Cash flows from financing activities: | | |
| Issuance of common stock | 18,024 | 17,359 |
| Excess tax benefit from stock options | 1,417 | 1,039 |
| Payment of long-term debt | (149) | (138) |
| Repurchase of common stock | (62,921) | (19,529) |
| Net cash used for financing activities | (43,629) | (1,269) |
| Effect of exchange rate changes on cash | 4,596 | 2,162 |
| Net increase in cash and equivalents | 162,734 | 1,958 |

Edgar Filing: PROGRESS SOFTWARE CORP /MA - Form 10-Q

| | | |
|---|------------|-----------|
| Cash and equivalents, beginning of period | 53,879 | 46,449 |
| Cash and equivalents, end of period | \$ 216,613 | \$ 48,407 |

See notes to unaudited condensed consolidated financial statements.

5

Table of Contents

Notes to Unaudited Condensed Consolidated Financial Statements

Note 1: Basis of Presentation

We have prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and these unaudited financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2007.

In our opinion, we have prepared the accompanying unaudited condensed consolidated financial statements on the same basis as the audited financial statements, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full fiscal year.

On December 1, 2007, we adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) and have not elected to use fair value measurement on any assets or liabilities under this statement.

New Accounting Pronouncements

In June 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 141R, Business Combinations (SFAS 141R). SFAS 141R establishes a framework to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply SFAS 141R to any acquisition after the date of adoption.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161) as an amendment to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. We are currently evaluating whether adoption of SFAS 161 will have an impact on our consolidated financial statements.

Note 2: Revenue Recognition

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 consider software license arrangements with payment terms greater than ninety days beyond our standard payment terms to be fixed and determinable and therefore such software license fees are recognized upon due date. 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.

Table of Contents

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 generally recognize both the software license and consulting fees using the percentage of completion 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.

Note 3: Earnings Per Share

We calculate basic earnings per share using the weighted average number of common shares outstanding. We compute diluted earnings per share on the basis of the weighted average number of common shares outstanding plus the effects of outstanding stock options using the treasury stock method. The following table provides the calculation of basic and diluted earnings per share on an interim basis:

(In thousands, except per share data)

| | Three Months Ended May 31, | | Six Months Ended May 31, | |
|--|----------------------------|----------|--------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 14,471 | \$ 8,391 | \$ 27,307 | \$ 17,129 |
| Weighted average shares outstanding | 41,483 | 41,178 | 41,861 | 41,123 |
| Dilutive impact from outstanding stock Options | 1,755 | 2,458 | 1,845 | 2,414 |
| Diluted weighted average shares outstanding | 43,238 | 43,636 | 43,706 | 43,537 |
| Earnings per share: | | | | |
| Basic | \$ 0.35 | \$ 0.20 | \$ 0.65 | \$ 0.42 |
| Diluted | \$ 0.33 | \$ 0.19 | \$ 0.62 | \$ 0.39 |

Stock options to purchase approximately 2,865,000 shares and 2,156,000 shares of common stock were excluded from the calculation of diluted earnings per share in the second quarter of fiscal years 2008 and 2007, respectively, because these options were anti-dilutive. Stock options to purchase approximately 2,715,000 shares and 2,561,000 shares of common stock were excluded from the calculation of diluted earnings per share in the first six months of fiscal years 2008 and 2007, respectively, because these options were anti-dilutive.

Note 4: Stock-based Compensation

Our stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We estimate the fair value of each stock-based award on the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield.

Table of Contents

The following table provides the classification of stock-based compensation as reflected in our consolidated statements of operations:

(In thousands)

| | Three Months Ended May 31, | | Six Months Ended May 31, | |
|--|-------------------------------|---------|--------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Cost of software licenses | \$ 13 | \$ 44 | \$ 35 | \$ 74 |
| Cost of maintenance and services | 226 | 515 | 493 | 862 |
| Sales and marketing | 1,419 | 2,702 | 2,850 | 4,498 |
| Product development | 937 | 1,731 | 1,856 | 2,850 |
| General and administrative | 1,515 | 2,539 | 2,846 | 4,124 |
| Total stock-based compensation expense | \$4,110 | \$7,531 | \$8,080 | \$12,408 |

Note 5: Income Taxes

We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year. We record cumulative adjustments to the tax provision in an interim period in which a change in the estimated annual effective rate is determined. 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. On December 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with Statement 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

The total amount of gross unrecognized tax benefits as of December 1, 2007 (the date of adoption of FIN 48) was \$4.4 million which was reclassified to non-current liabilities. In addition, as of the date of adoption, \$4.3 million of unrecognized benefits would affect our effective tax rate if realized. The adoption of FIN 48 resulted in a nominal decrease to our retained earnings. We recognize interest and penalties related to uncertain tax positions as a component of our provision for income taxes and the gross amount of interest and penalties accrued as of the date of adoption was \$0.3 million.

Domestically, U.S. federal and state taxing authorities are currently examining our income tax returns for years through fiscal 2005. Many issues are at an advanced stage in the examination process, the most significant of which relates to research and development credits. With all domestic audit issues considered in the aggregate, we believe it was reasonably possible that, as of December 1, 2007, the unrecognized tax benefits related to these audits could decrease (whether by payment, release, or a combination of both) in the next 12 months by as much as \$1.5 million. Our U.S. federal and, with some exceptions, our state income tax returns have been examined or are closed by statute for all years prior to fiscal 2003, and we are no longer subject to audit for those periods.

Internationally, tax authorities for certain non-U.S. jurisdictions are also examining returns affecting unrecognized tax benefits. With some exceptions, we are generally no longer subject to tax examinations in non-U.S. jurisdictions for years prior to fiscal 2001.

We believe that we have adequately provided for any reasonably foreseeable outcomes related to our tax audits and that any settlement will not have a material adverse effect on our consolidated financial position or results of

operations. However, there can be no assurances as to the possible outcomes.

Table of Contents**Note 6: Adoption of SFAS 157 Fair Value Measurements**

On December 1, 2007, we adopted SFAS No. 157 Fair Value Measurements (SFAS 157). In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157, which provides a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, we only have adopted the provisions of SFAS 157 with respect to our financial assets and liabilities. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The following table details the fair value measurements within the fair value hierarchy of our financial assets:

(In thousands)

| Description | May 31, 2008 | Fair Value Measurements at the Reporting Date Using | | |
|-------------------------------|-----------------|---|---|--|
| | | Quoted Prices in Active Markets Using Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Available-for-sale securities | \$ 110,104 | \$ 42,413 | | \$ 67,691 |
| Investment in IONA | 6,534 | 6,534 | | |
| Foreign exchange derivatives | 565 | | \$ 565 | |
| Total | \$ 117,203 | \$ 48,947 | \$ 565 | \$ 67,691 |

Since the end of the first quarter, we have reclassified our investments related to auction rate securities (ARS) to the Level 3 category, which total \$67.7 million and are classified as non-current. Previously, such investments were classified in the Level 2 category. We reclassified our ARS to the Level 3 category as some of the inputs used in the trinomial discount model (described below) included unobservable inputs. Our ARS are floating rate securities with longer-term maturities which are marketed by financial institutions with auction reset dates at primarily 28 or 35 day intervals to provide short-term liquidity. The underlying collateral of the ARS consist primarily of municipal bonds, which are insured by monoline insurance companies, with the remainder consisting of student loans, which are supported by the federal government as part of the Federal Family Education Loan Program (FFELP) and by the monoline insurance companies. Beginning in February, auctions for these securities began to fail, and the interest rates for these ARS reset to the maximum rate per the applicable investment offering document. As of February 29, 2008, our ARS investments totaled \$109.8 million. During the second quarter, investments totaling \$38.2 million were either redeemed at par by the issuer or sold at a successful auction, reducing the par value of our ARS investments to \$71.6 million. We will not be able to access these remaining funds until a future auction for these ARS is successful, we sell the securities in a secondary market which currently is not active, or they are redeemed by the issuer. As such, these remaining investments currently lack short-term liquidity and were therefore reclassified as non-current on our balance sheet.

The following table reflects the activity for our major classes of assets measured at fair value using level 3 inputs:

(In thousands)

Available
For-sale

Securities

| | |
|--|-----------|
| Balance, December 1, 2007 | \$ |
| Transfers from Level 2 | 109,800 |
| Redemptions and sales | (38,245) |
| Unrealized losses included in accumulated other comprehensive loss | (3,864) |
| Balance, May 31, 2008 | \$ 67,691 |

For each of our ARS, we evaluated the risks related to the structure, collateral and liquidity of the investment, and forecasted the probability of issuer default, auction failure and a successful auction at par or a redemption at par for

Table of Contents

each future auction period. Using a trinomial discount model, the weighted average cash flow for each period was then discounted back to present value for each security. Based on this methodology, we determined that the fair value of our ARS investments is \$67.7 million, and we recorded a temporary impairment charge of \$3.9 million to reduce the value of our ARS. Based on our cash and short-term investments balance of \$259.0 million and expected operating cash flows, we do not anticipate the lack of liquidity associated with our ARS to adversely affect our ability to conduct business and believe we have the ability to hold the remaining securities throughout the currently estimated recovery period, therefore the impairment was only temporary in nature.

Note 7: Comprehensive Income

The components of comprehensive income include net income, foreign currency translation adjustments and unrealized gains and losses on investments. The following table provides the composition of comprehensive income on an interim basis:

(In thousands)

| | Three Months Ended May 31, | | Six Months Ended May 31, | |
|--|-------------------------------|---------|--------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income, as reported | \$14,471 | \$8,391 | \$27,307 | \$17,129 |
| Foreign currency translation adjustments, net of tax | 879 | 1,386 | 1,299 | 1,218 |
| Unrealized gains (losses) on investments, net of tax | (2,465) | (17) | (2,401) | (34) |
| Total comprehensive income | \$12,885 | \$9,760 | \$26,205 | \$18,313 |

Note 8: Common Stock Repurchases

In September 2007, the Board of Directors authorized, for the period from October 1, 2007 through September 30, 2008, the purchase of up to 10,000,000 shares of our common stock, at such times that management deems such purchases to be an effective use of cash. We purchased and retired approximately 2,088,000 shares of our common stock for \$62.9 million in the first six months of fiscal 2008 as compared to approximately 705,000 shares of our common stock for \$19.5 million in the first six months of fiscal 2007.

Note 9: Goodwill

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. Goodwill in certain jurisdictions changes each period due to changes in foreign currency exchange rates. During the first quarter of fiscal 2008, 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, 2007. For purposes of the annual impairment test, we assigned goodwill of \$30.3 million to the OpenEdge and SOA operating segment, \$88.2 million to the DataDirect Technologies operating segment, excluding a preliminary allocation of \$4.2 million of goodwill related to the Xcalia acquisition which occurred in February 2008, and \$30.6 million to the other operating segment. See Note 10 for a description of each operating segment.

Note 10: Segment Information

At the beginning of fiscal 2008, we reorganized our business into five operating segments. The reorganization resulted in the separation of the DataXtend Division as its own separate operating segment from the Enterprise Infrastructure Division and the combination of the remainder of the Enterprise Infrastructure Division with the OpenEdge Division, which created the OpenEdge and SOA Group. Our principal operating segment conducts business as the OpenEdge and SOA Group. The OpenEdge and SOA Group provides the Progress® OpenEdge platform and the Sonic and Actional product sets, interoperable, best-in-class service infrastructure products used to build, deploy and manage a service-oriented architecture. Another significant operating segment, DataDirect Technologies, provides

standards-based data connectivity software. Our other three operating segments include the DataXtend Division, the Apama Division and the EasyAsk Division.

Table of Contents

Segment information 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.

Our chief decision maker (CDM) is our Chief Executive Officer.

For fiscal 2008, we have two operating segments which met the requirements for separate disclosure: OpenEdge and SOA Group and DataDirect Technologies. The other three operating segments are below the threshold for separate disclosure and are included in the Other segment. We do not manage our assets, capital expenditures, total other income or provision for income taxes by segment. We managed such items on a company basis.

The following table provides revenue and income from operations from our reportable segments on an interim basis:

| <i>(In thousands)</i> | Three months ended, May 31, 2008 | Six months ended, May 31, 2008 |
|---------------------------------|--|--------------------------------------|
| Revenue: | | |
| OpenEdge and SOA segment | \$ 102,654 | \$ 201,866 |
| DataDirect Technologies segment | 17,512 | 34,610 |
| Other segment | 9,363 | 16,054 |
| Reconciling items | (1,587) | (3,021) |
| Total | \$ 127,942 | \$ 249,509 |
| Income (loss) from operations: | | |
| OpenEdge and SOA segment | \$ 31,052 | \$ 60,213 |
| DataDirect Technologies segment | 241 | 2,569 |
| Other segment | (1,517) | (5,054) |
| Reconciling items | (9,172) | (19,976) |
| Total | \$ 20,604 | \$ 37,752 |

We did not include prior year comparisons as it is not practical to restate the fiscal 2007 data into the fiscal 2008 structure or the fiscal 2008 data into the fiscal 2007 structure.

The reconciling items within revenue primarily represent intersegment sales, which are accounted for as if sold under an equivalent arms-length basis arrangement. Amounts included under reconciling items within income from operations represent amortization of acquired intangibles, stock-based compensation and certain unallocated administrative expenses.

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

| <i>(In thousands)</i> | Three Months Ended May 31, | | Six Months Ended May 31, | |
|-----------------------------|----------------------------|------------|--------------------------|------------|
| | 2008 | 2007 | 2008 | 2007 |
| DataDirect | \$ 17,512 | \$ 16,892 | \$ 34,610 | \$ 33,197 |
| Enterprise Infrastructure | 23,316 | 20,894 | 44,796 | 38,016 |
| Progress OpenEdge and other | 87,114 | 81,856 | 170,103 | 163,658 |
| Total revenue | \$ 127,942 | \$ 119,642 | \$ 249,509 | \$ 234,871 |

Note 11: Acquisition of Xcalia

On February 5, 2008, we acquired, through a wholly-owned subsidiary, the stock of Xcalia SA (Xcalia) for an aggregate purchase price of \$5.7 million, net of cash acquired. Xcalia is a leader in the development and adoption of service data objects standard and data integration technologies. The purpose of the acquisition was to expand the product offerings within the DataDirect product line. Upon the closing of the transaction, Xcalia became part of our DataDirect Technologies operating segment. We accounted for the acquisition as a purchase, and accordingly, we

Table of Contents

included the results of operations of Xcalia in our operating results from February 5, 2008, the date of acquisition. Transaction costs related to this acquisition included \$0.9 million of direct acquisition costs. We paid the purchase price in cash from available funds.

For this acquisition, we obtained a valuation from an independent appraiser for the amounts assigned to intangible assets. The preliminary allocation of the purchase price as of February 29, 2008 was as follows:

(In thousands)

| | Total | Life (in years) |
|--|----------|-----------------|
| Assets and liabilities, including cash | \$ (440) | |
| Acquired intangible assets | 3,700 | 3 to 4 years |
| Goodwill (not deductible for tax purposes) | 4,204 | |
| Deferred tax liabilities | (1,258) | |
| Total purchase price | 6,206 | |
| Less: cash acquired | (478) | |
| Net cash paid | \$ 5,728 | |

Pro forma financial information has not been presented, as the historical operations of Xcalia are not significant to our consolidated financial statements.

Note 12: Contingencies

On June 23, 2006, we received written notice that the Enforcement Staff in the Boston, Massachusetts office of the SEC had begun an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. On December 19, 2006, the SEC informed us that it had issued a formal order of investigation into our option-granting practices during the period December 1, 1995 through the present. We are unable to predict with certainty what consequences may arise from the SEC investigation. We have already incurred, and expect to continue to incur, significant legal expenses arising from the investigation. 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 did not resolve the pending SEC inquiry. The SEC has not indicated to us whether it has reviewed our restated financial statements, and any SEC 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*, Civ. Act. No. 06-CA-11459 RCL 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 were also named as a nominal defendant. The complaint alleged 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 the allegedly improper backdating of certain stock option grants. The complaint sought monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. A Special Litigation Committee was formed by our Board of Directors to investigate and determine our response to the complaint. On September 25, 2007, the Court, in response to our motion, dismissed the *Arkansas Teacher Retirement System* complaint on the grounds that the Plaintiff failed to make a proper pre-filing demand upon our Board of Directors, and entered judgment for Defendants. On May 5, 2008, the Plaintiff filed a second derivative complaint, largely identical to the first, in the same court. By agreement of the parties, the court has stayed all proceedings while the Special Litigation Committee's investigation is ongoing.

On January 16, 2007, another party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *Acuna, Derivatively on Behalf of Progress Software Corporation v. Joseph Alsop et al.*, Civ. Act. No. 07-0157 against our directors and certain of our present and former officers in Massachusetts Superior Court. We are named as a nominal defendant in this action as well. The complaint alleges breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from the allegedly

Table of Contents

improper backdating of certain stock option grants. The complaint seeks monetary damages and disgorgement, among other forms of relief.

Further, on March 28, 2007, an additional party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *White, Derivatively on Behalf Of Nominal Defendant Progress v. Progress Software Corporation et al.*, Civ 07-01172, in Massachusetts Superior Court. This complaint involves substantially the same defendants, allegations and demands for relief as the *Acuna* complaint described above. On June 26, 2007, the *White* and *Acuna* cases were consolidated. The consolidated case has been stayed while the Special Litigation Committee's investigation is ongoing.

The ultimate outcome of any of these matters could have a material adverse effect on our results of operations. These matters could divert the attention of our management and harm our business. In addition, we have incurred, and expect to continue to incur legal expenses arising from these matters, which may be significant, including the advancement of legal expenses to our directors and officers. We have certain indemnification obligations to our directors and officers, and the outcome of 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.

Note 13: Subsequent Events

On June 13, 2008, we acquired substantially all of the assets and assumed certain liabilities of Mindreef, Inc. (Mindreef) for an aggregate purchase price of approximately \$6 million, net of cash acquired. The purpose of the acquisition is to expand the capabilities of our Actional product-line. The Mindreef assets will be combined into our OpenEdge and SOA segment. The purchase price was paid in cash from available funds.

On June 25, 2008, we signed a definitive agreement under which we have agreed to acquire IONA Technologies plc (IONA) for \$4.05 per share in cash. This represents a total equity value of approximately \$162 million and approximately \$106 million net of cash and marketable securities reported by IONA on March 31, 2008. The IONA Technologies Board of Directors has unanimously approved the transaction and each IONA Technologies director has entered into an agreement to vote their IONA shares in favor of the transaction. The acquisition will be effected by means of a scheme of arrangement under Irish law. The acquisition will be subject to the terms and conditions to be set forth in the scheme of arrangement document to be delivered to IONA shareholders. To become effective, the scheme of arrangement requires, among other things, the approval of a majority in number of IONA shareholders, present and voting either in person or by proxy, representing 75% or more in value of the IONA shares held by such holders. We own 362,000 shares of IONA common stock and have an economic interest, through contracts for difference, in 1,443,000 shares of IONA common stock. Such equity was purchased in the second quarter and represents approximately 5% of the issued share capital of IONA. The acquisition is also subject to regulatory approval in the U.S. and the approval of the Irish High Court. Assuming the necessary approvals are obtained and all conditions have been satisfied, the acquisition will become effective upon delivery to the Registrar of Companies in Ireland of the court order of the Irish High Court sanctioning the scheme. Upon the acquisition becoming effective, it will be binding on all IONA shareholders. The acquisition is expected to close in September 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This Form 10-Q, 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

Table of Contents

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 referenced in Part II, Item 1A of this Form 10-Q 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.

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 users. 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 all of fiscal 2007 and the first six months of fiscal 2008, the weakening of the U.S. dollar against most major currencies, primarily the euro and the British pound, positively affected the translation of our results into U.S. dollars.

Critical Accounting Policies

Our 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 we believe 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 in the Notes to Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the fiscal year ended November 30, 2007, as well as the notes to our Consolidated Financial Statements included in Item 1 of this Form 10-Q.

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.

Table of Contents

Goodwill and Intangible Assets We had goodwill and net intangible assets of approximately \$208 million at May 31, 2008. 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, 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 cash flow models 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 our models. 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 approximately \$27 million at May 31, 2008. 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 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. On a quarterly basis we provide for income taxes based on the estimated effective tax rate for the full fiscal year.

On December 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with Statement 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position taken or expected to be taken in a tax return by determining if the weight of available evidence indicates that it is more likely than not that, on an evaluation of the technical merits, the tax position will be sustained on audit, including resolution of any related appeals or litigation processes. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. Management judgment is required for each step. If management made different estimates or judgments, material differences in the amount accrued for uncertain tax positions could have occurred.

Stock-Based Compensation We account for stock-based compensation expense in accordance with Statement of Financial Accounting Standards (SFAS) No. 123, *Share-based Payments*, (SFAS 123R). Under SFAS 123R, stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We estimate the fair value of each stock-based award on the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. Many of these assumptions are highly subjective and require the exercise of management judgment. Our management must also apply judgment in developing an estimate of awards that may be forfeited. If our actual experience differs significantly from our estimates and we choose to employ different assumptions in the future, the stock-based compensation expense that we record in future periods may differ materially from that recorded in the current period.

Investments in Debt Securities As of May 31, 2008, we had approximately \$67.7 million in investments related to auction rate securities (ARS), all of which are classified as non-current. This balance is after recording a temporary reduction in value of \$3.9 million. Our ARS are floating rate securities with longer-term maturities which are marketed by financial institutions with auction reset dates at primarily 28 or 35 day intervals to provide short-term liquidity. The underlying collateral of the ARS consist primarily of municipal bonds, which are insured by monoline insurance companies, with the remainder consisting of student loans, which are supported by the federal government as part of the Federal Family Education Loan Program (FFELP) and by the monoline insurance companies. Beginning in February, auctions for certain of these securities began to fail, which has resulted in higher interest rates being earned on these securities and less certainty around the short-term liquidity of these securities. As of February 29,

2008, our ARS investments totaled \$109.8 million. During the second quarter, investments totaling \$38.2 million were either redeemed at par by the issuer or sold at a successful auction, reducing the par

Table of Contents

value of our ARS investments to \$71.6 million. We will not be able to access these funds until a future auction for these ARS is successful or until we sell the securities in a secondary market which currently is not active, although there have been instances of redemptions at par by municipalities through refinance of new debt to date. As such, certain of these investments currently lack short-term liquidity and were therefore reclassified as non-current on our balance sheet. If the credit rating of either the security issuer or the third-party insurer underlying the investments deteriorates, we may be required to adjust the carrying value of the ARS through an impairment charge.

Results of Operations

The following table provides 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:

| | Percentage of Total Revenue | | | | Period-to-Period Change | |
|---|-----------------------------|------|------------------|------|-------------------------|--------|
| | Three Months Ended | | Six Months Ended | | Three | Six |
| | May | May | May | May | Month | Month |
| | 31, | 31, | 31, | 31, | Month | Month |
| | 2008 | 2007 | 2008 | 2007 | Period | Period |
| Revenue: | | | | | | |
| Software licenses | 35% | 37% | 36% | 38% | 1% | 1% |
| Maintenance and services | 65 | 63 | 64 | 62 | 10 | 9 |
| Total revenue | 100 | 100 | 100 | 100 | 7 | 6 |
| Costs of revenue: | | | | | | |
| Cost of software licenses | 2 | 2 | 2 | 2 | 15 | 26 |
| Cost of maintenance and services | 14 | 14 | 14 | 14 | 5 | 7 |
| Amortization of acquired intangibles for purchased technology | 2 | 2 | 2 | 2 | 13 | 10 |
| Total costs of revenue | 18 | 18 | 18 | 18 | 7 | 9 |
| Gross profit | 82 | 82 | 82 | 82 | 7 | 6 |
| Operating expenses: | | | | | | |
| Sales and marketing | 38 | 38 | 38 | 38 | 5 | 4 |
| Product development | 16 | 17 | 17 | 18 | 1 | 1 |
| General and administrative | 11 | 16 | 11 | 14 | (23) | (16) |
| Amortization of other acquired intangibles | 1 | 2 | 1 | 2 | (31) | (31) |
| Total operating expenses | 66 | 73 | 67 | 72 | (3) | (2) |
| Income from operations | 16 | 9 | 15 | 10 | 83 | 60 |
| Other income | 2 | 2 | 2 | 1 | 35 | 94 |
| | 18 | 11 | 17 | 11 | 77 | 63 |

Income before provision for
taxes

| | | | | | | |
|----------------------------|-----|----|-----|----|-----|-----|
| Provision for income taxes | 7 | 4 | 6 | 4 | 84 | 70 |
| Net income | 11% | 7% | 11% | 7% | 72% | 59% |

Revenue. Our total revenue increased 7% from \$119.6 million in the second quarter of fiscal 2007 to \$127.9 million in the second quarter of fiscal 2008. Total revenue would have increased by 1% if exchange rates had been constant in the second quarter of fiscal 2008 as compared to exchange rates in effect in the second quarter of fiscal 2007. Total revenue increased 6% from \$234.9 million in the first six months of fiscal 2007 to \$249.5 million in the first six months of fiscal 2008. Total revenue would have increased by 1% if exchange rates had been constant in the first six months of fiscal 2008 as compared to exchange rates in effect in the first six months of fiscal 2007.

Revenue from our Progress OpenEdge product line increased 6% from \$81.9 million in the second quarter of fiscal 2007 to \$87.1 million in the second quarter of fiscal 2008 and increased 4% from \$163.7 million in the first six months of fiscal 2007 to \$170.1 million in the first six months of fiscal 2008. Revenue derived from our Enterprise Infrastructure product lines increased 12% from \$20.9 million in the second quarter of fiscal 2007 to \$23.3 million in the second quarter of fiscal 2008 and increased 18% from \$38.0 million in the first six months of fiscal 2007 to \$44.8 million in the first six months of fiscal 2008. Revenue from our DataDirect product line increased 4% from

Table of Contents

\$16.9 million in the second quarter of fiscal 2007 to \$17.5 million in the second quarter of fiscal 2008 and increased 4% from \$33.2 million in the first six months of fiscal 2007 to \$34.6 million in the first six months of fiscal 2008. Software license revenue increased 1% from \$44.6 million in the second quarter of fiscal 2007 to \$45.0 million in the second quarter of fiscal 2008. Software license revenue would have decreased by 4% if exchange rates had been constant in the second quarter of fiscal 2008 as compared to exchange rates in effect in the second quarter of fiscal 2007. Software license revenue increased 1% from \$89.3 million in the first six months of fiscal 2007 to \$90.1 million in the first six months of fiscal 2008. Software license revenue would have decreased by 4% if exchange rates had been constant in the first six months of fiscal 2008 as compared to exchange rates in effect in the first six months of fiscal 2007. Excluding the impact of changes in exchange rates, the decrease in software license revenue was due to decreases in our OpenEdge and DataDirect product lines partially offset by an increase in our Enterprise Infrastructure product line.

Maintenance and services revenue increased 10% from \$75.1 million in the second quarter of fiscal 2007 to \$82.9 million in the second quarter of fiscal 2008. Maintenance and services revenue would have increased by 3% if exchange rates had been constant in the second quarter of fiscal 2008 as compared to exchange rates in effect in the second quarter of fiscal 2007. Maintenance and services revenue increased 9% from \$145.6 million in the first six months of fiscal 2007 to \$159.4 million in the first six months of fiscal 2008. Maintenance and services revenue would have increased by 3% if exchange rates had been constant in the first six months of fiscal 2008 as compared to exchange rates in effect in the first six months of fiscal 2007. Excluding the impact of changes in exchange rates, the increase in maintenance and services revenue was primarily the result of growth in our installed customer base and renewal of maintenance agreements.

Total revenue generated in markets outside North America increased 12% from \$68.0 million in the second quarter of fiscal 2007 to \$76.5 million in the second quarter of fiscal 2008 and represented 57% of total revenue in the second quarter of fiscal 2007 and 60% of total revenue in the second quarter of fiscal 2008. Revenue from the three major regions outside North America, consisting of EMEA, Latin America and Asia Pacific, each increased in the second quarter of fiscal 2008 as compared to the second quarter of fiscal 2007. Total revenue generated in markets outside North America would have represented 57% of total revenue if exchange rates had been constant in the second quarter of fiscal 2008 as compared to the exchange rates in effect in the second quarter of fiscal 2007.

Total revenue generated in markets outside North America increased 11% from \$133.1 million in the first six months of fiscal 2007 to \$147.7 million in the first six months of fiscal 2008 and represented 57% of total revenue in the first six months of fiscal 2007 and 59% of total revenue in the first six months of fiscal 2008. Revenue from the three major regions outside North America, consisting of EMEA, Latin America and Asia Pacific, each increased in fiscal 2008 as compared to fiscal 2007. Total revenue generated in markets outside North America would have represented 57% of total revenue if exchange rates had been constant in the first six months of fiscal 2008 as compared to the exchange rates in effect in the first six months of fiscal 2007.

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 increased 15% from \$1.9 million in the second quarter of fiscal 2007 to \$2.2 million in the second quarter of fiscal 2008, and increased as a percentage of software license revenue from 4% in the first quarter of fiscal 2007 to 5% in the first quarter of fiscal 2008. Cost of software licenses increased 26% from \$3.6 million in the first six months of fiscal 2007 to \$4.5 million in the first six months of fiscal 2008, and increased as a percentage of software licenses revenue from 4% in the first six months of fiscal 2007 to 5% in the first six months of fiscal 2008. The dollar increase for the second quarter and for the first six months was primarily due to higher royalty expense for products and technologies licensed or resold from third parties. Cost of software licenses as a percentage of software license revenue may vary from period to period depending upon the relative product mix.

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 5% from \$16.9 million in the second quarter of fiscal 2007 to \$17.7 million in the second quarter of fiscal 2008, and decreased as a percentage of maintenance and services revenue from 22% in the first quarter of fiscal 2007 to 21% in the first quarter of fiscal 2008. Cost of maintenance and services increased 7% from \$33.1 million in the first six months of fiscal 2007 to

\$35.4 million in the first six months of fiscal 2008, and decreased as a percentage of maintenance and

Table of Contents

services revenue from 23% to 22%. The total dollar amount in the second quarter of fiscal 2008 and in the first six months of fiscal 2008 increased primarily due to higher usage of third-party contractors for service engagements. Our technical support, education and consulting headcount decreased by 1% from the end of the second quarter of fiscal 2007 to the end of the second quarter of fiscal 2008.

Amortization of Acquired Intangibles for Purchased Technology. Amortization of acquired intangibles for purchased technology primarily represents the amortization of the value assigned to technology-related intangible assets obtained in business combinations. Amortization of acquired intangibles for purchased technology increased 13% from \$2.5 million in the second quarter of fiscal 2007 to \$2.8 million in the second quarter of fiscal 2008. Amortization of acquired intangibles for purchased technology increased 10% from \$5.0 million in the first six months of fiscal 2007 to \$5.5 million in the first six months of fiscal 2008. The increase was due to amortization expense associated with the acquisition of Xcalia in the first quarter of fiscal 2008.

Gross Profit. Our gross profit increased 7% from \$98.4 million in the second quarter of fiscal 2007 to \$105.2 million in the second quarter of fiscal 2008. Our gross profit percentage of total revenue remained the same at 82% in the second quarter of fiscal 2007 compared to the second quarter of fiscal 2008. Our gross profit increased 6% from \$193.2 million in the first six months of fiscal 2007 to \$204.2 million in the first six months of fiscal 2008. Our gross profit percentage of total revenue remained the same at 82% in the first six months of fiscal 2007 compared to the first six months of fiscal 2008.

Sales and Marketing. Sales and marketing expenses increased 5% from \$45.7 million in the second quarter of fiscal 2007 to \$48.2 million in the second quarter of fiscal 2008, and remained the same as a percentage of total revenue at 38%. Sales and marketing expenses increased 4% from \$90.4 million in the first six months of fiscal 2007 to \$94.0 million in the first six months of fiscal 2008, and remained the same as a percentage of total revenue at 38%. The increase in sales and marketing expenses was due to higher average selling costs per head, partially offset by a decrease in marketing program expenses. Our sales support and marketing headcount decreased by 2% from the end of the second quarter of fiscal 2007 to the end of the second quarter of fiscal 2008.

Product Development. Product development expenses increased 1% from \$20.4 million in the second quarter of fiscal 2007 to \$20.5 million in the second quarter of fiscal 2008, and decreased as a percentage of revenue from 17% to 16%. Product development expenses remained the same at \$41.2 million in the first six months of fiscal 2007 and the first six months of fiscal 2008, and decreased as a percentage of revenue from 18% to 17%. The dollar increase in the first six months of fiscal 2008 as compared to the first six months of fiscal 2007 was primarily due to expenses related to the development team associated with the acquisition of Xcalia at the end of the first quarter of fiscal 2008, partially offset by a decrease in stock-based compensation expense included in product development in fiscal 2008 as compared to fiscal 2007. Our product development headcount increased 3% from the end of the second quarter of fiscal 2007 to the end of the second quarter of fiscal 2008.

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 decreased 23% from \$19.0 million in the second quarter of fiscal 2007 to \$14.6 million in the second quarter of fiscal 2008, and decreased as a percentage of revenue from 16% to 11%. General and administrative expenses decreased 16% from \$34.1 million in the first six months of fiscal 2007 to \$28.5 million in the first six months of fiscal 2008, and decreased as a percentage of revenue from 14% to 11%. The dollar decrease was primarily due to a write-down associated with a portion of the implementation of a new ERP system of \$2.4 million in the second quarter of fiscal 2007, payments made to compensation committee members for cancelled options of \$1.3 million, and professional services fees associated with the investigation and shareholder derivative lawsuits related to our historical stock option grant practices of \$0.8 million in the second quarter of fiscal 2007 and \$2.4 million in the first six months of fiscal 2007. Our administrative headcount decreased 4% from the end of the second quarter of fiscal 2007 to the end of the second quarter of fiscal 2008.

Amortization of Other Acquired Intangibles. Amortization of other acquired intangibles primarily represents the amortization of value assigned to non-technology-related intangible assets obtained in business combinations. Amortization of other acquired intangibles decreased from \$1.9 million in the second quarter of fiscal 2007 to \$1.3 million in the second quarter of fiscal 2008. Amortization of other acquired intangibles decreased from

\$3.9 million in the first six months of fiscal 2007 to \$2.7 million in the first six months of fiscal 2008. The decrease in both

Table of Contents

periods was related to certain intangibles becoming fully amortized partially offset by amortization expense related to intangible assets acquired in the Xcalia acquisition.

Income From Operations. Income from operations increased 83% from \$11.3 million in the second quarter of fiscal 2007 to \$20.6 million in the second quarter of fiscal 2008 and increased as a percentage of total revenue from 9% in the second quarter of fiscal 2007 to 16% in the second quarter of fiscal 2008. Income from operations increased 60% from \$23.6 million in the first six months of fiscal 2007 to \$37.8 million in the first six months of fiscal 2008 and increased as a percentage of total revenue from 10% in the first six months of fiscal 2007 to 15% in the first six months of fiscal 2008.

The increase in the second quarter of fiscal 2008 as compared to the second quarter of fiscal 2007 was driven by the expense decrease which was due to lower stock-based compensation, lower professional services fees related to the derivative lawsuits and investigation of our historical stock option grant practices, partially offset by an increase in headcount related expense. Our total headcount increased 1% from the end of the second quarter of fiscal 2007 to the end of the second quarter of fiscal 2008.

Other Income. Other income increased 35% from \$1.6 million in the second quarter of fiscal 2007 to \$2.2 million in the second quarter of fiscal 2008. Other income increased 94% from \$2.7 million in the first six months of fiscal 2007 to \$5.3 million in the first six months of fiscal 2008. The increase in both periods was primarily due to an increase in interest income resulting from higher interest rates earlier in the year, including higher interest rates earned on ARS, higher average cash and short-term investment balances, and lower foreign exchange losses.

Provision for Income Taxes. Our effective tax rate was 36.5% in the first six months of fiscal 2008 as compared to 35% in the first six months of fiscal 2007. The increase in our effective tax rate was due to the expiration of the research and development credit provisions in the federal tax code which have not been renewed. We estimate that our effective tax rate will be approximately 36% for all of fiscal 2008.

Liquidity and Capital Resources

At the end of the second quarter of fiscal 2008, our cash and short-term investments totaled \$259.0 million. The decrease of \$80.5 million since the end of fiscal 2007 resulted primarily from the reclassification of approximately \$67.7 million of auction rate securities to non-current investments (see below), purchases of our common stock, and cash used for acquisitions, offset by cash generated from operations and proceeds from issuances of common stock. In addition to the \$259.0 million of cash and short-term investments, we had \$67.7 million in investments related to ARS that are classified as non-current. Our ARS are floating rate securities with longer-term maturities which are marketed by financial institutions with auction reset dates at primarily 28 or 35 day intervals to provide short-term liquidity. The underlying collateral of the ARS consist primarily of municipal bonds, which are insured by monoline insurance companies, with the remainder consisting of student loans, which are supported by the federal government as part of the Federal Family Education Loan Program (FFELP) and by the monoline insurance companies. Beginning in February, auctions for these securities began to fail, and the interest rates for these ARS reset to the maximum rate per the applicable investment offering document. As of February 29, 2008, our ARS investments totaled \$109.8 million. During the second quarter, investments totaling \$38.2 million were either redeemed at par by the issuer or sold at a successful auction, reducing the par value of our ARS investments to \$71.6 million. We will not be able to access these remaining funds until a future auction for these ARS is successful, we sell the securities in a secondary market which currently is not active, or they are redeemed by the issuer. As such, these remaining investments currently lack short-term liquidity and were therefore reclassified as non-current on the balance sheet. For each of our ARS, we evaluated the risks related to the structure, collateral and liquidity of the investment, and forecasted the probability of issuer default, auction failure and a successful auction at par or a redemption at par for each future auction period. Using a trinomial discount model, the weighted average cash flow for each period was then discounted back to present value for each security. Based on this methodology, we determined that the fair value of our ARS investments is \$67.7 million, and we recorded a temporary impairment charge of \$3.9 million to reduce the value of our ARS. Based on our cash and short-term investments balance of \$259.0 million and expected operating cash flows, we do not anticipate the lack of liquidity associated with our ARS to adversely affect our

Table of Contents

ability to conduct business and believe we have the ability to hold the remaining securities throughout the currently estimated recovery period, therefore the impairment was only temporary in nature.

We generated \$46.8 million in cash from operations in the first six months of fiscal 2008 as compared to \$39.0 million in the first six months of fiscal 2007. The increase in cash generated from operations in the second quarter of fiscal 2008 over the second quarter of fiscal 2007 was primarily due to increased profitability.

A summary of our cash flows from operations for the first six months of fiscal years 2008 and 2007 is as follows:

| <i>(In thousands)</i> | Six Months Ended May 31, | |
|--|--------------------------|-----------|
| | 2008 | 2007 |
| Net income | \$ 27,307 | \$ 17,129 |
| Depreciation, amortization and other noncash charges | 21,568 | 28,642 |
| Tax benefit from stock plans | 877 | 230 |
| Changes in operating assets and liabilities | (2,921) | (6,983) |
| Total | \$ 46,831 | \$ 39,018 |

Accounts receivable decreased by \$6.0 million from the end of fiscal 2007. Accounts receivable days sales outstanding, or DSO, remained the same at 62 days at the end of the second quarter of fiscal 2008 as compared to the end of fiscal 2007 and decreased by 2 days from 64 days at the end of the second quarter of fiscal 2007. We target a DSO range of 60 to 80 days.

We purchased property and equipment totaling \$3.9 million in the first six months of fiscal 2008 as compared to \$9.6 million in the first six months of fiscal 2007. The purchases consisted primarily of computer equipment and software and building and leasehold improvements. The decrease primarily related to higher costs associated with our ongoing ERP implementation in the first six months of fiscal 2007 as compared to the first six months of fiscal 2008. On February 5, 2008, we acquired, through a wholly-owned subsidiary, the stock of Xcalia SA (Xcalia) for an aggregate purchase price of \$5.7 million, net of cash acquired. Xcalia is a leader in the development and adoption of service data objects standard and data integration technologies. The purpose of the acquisition was to expand the product offerings within the DataDirect product line. Upon the closing of the transaction, Xcalia became part of our DataDirect Technologies operating segment. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations of Xcalia in our operating results from February 5, 2008, the date of acquisition. Transaction costs related to this acquisition included \$0.9 million of direct acquisition costs. We paid the purchase price in cash from available funds.

In September 2007, the Board of Directors authorized, for the period from October 1, 2007 through September 30, 2008, 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. We purchased and retired approximately 2,088,000 shares of our common stock for \$62.9 million in the first six months of fiscal 2008 as compared to approximately 705,000 shares of our common stock for \$19.5 million in the first six months of fiscal 2007.

We received \$18.0 million in the first six months of fiscal 2008 from the exercise of stock options and the issuance of shares under our Employee Stock Purchase Plan as compared to \$17.4 million in the first six months of fiscal 2007. On June 25, 2008, we signed a definitive agreement under which we have agreed to acquire IONA Technologies plc (IONA) for \$4.05 per share in cash. This represents a total equity value of approximately \$162 million and approximately \$106 million net of cash and marketable securities reported by IONA on March 31, 2008. The IONA Technologies Board of Directors has unanimously approved the transaction and each IONA Technologies director has entered into an agreement to vote their IONA shares in favor of the transaction. The acquisition will be effected by means of a scheme of arrangement under Irish law. The acquisition will be subject to the terms and conditions to be set forth in the scheme of arrangement document to be delivered to IONA shareholders. To become effective, the scheme of arrangement requires, among other things, the approval of a majority in number of IONA

Table of Contents

shareholders, present and voting either in person or by proxy, representing 75% or more in value of the IONA shares held by such holders. We own 362,000 shares of IONA common stock and have an economic interest, through contracts for difference, in 1,443,000 shares of IONA common stock. Such equity was purchased in the second quarter and represents approximately 5% of the issued share capital of IONA. The acquisition is also subject to regulatory approval in the U.S. and the approval of the Irish High Court. Assuming the necessary approvals are obtained and all conditions have been satisfied, the acquisition will become effective upon delivery to the Registrar of Companies in Ireland of the court order of the Irish High Court sanctioning the scheme. Upon the acquisition becoming effective, it will be binding on all IONA shareholders. The acquisition is expected to close in September 2008.

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, cash acquisitions and other long-term obligations) through at least the next twelve months.

Revenue Backlog Our aggregate revenue backlog at May 31, 2008 was approximately \$184 million of which \$159 million was included on our balance sheet as deferred revenue, primarily related to unexpired maintenance and support contracts. At May 31, 2008, the remaining amount of backlog of approximately \$25 million was composed of multi-year licensing arrangements of approximately \$23 million and open software license orders received but not shipped of approximately \$2 million. Our backlog of orders not included on the balance sheet is not subject to our normal accounting controls for information that is either reported in or derived from our basic financial statements. Our aggregate revenue backlog at May 31, 2007 was approximately \$167 million of which \$142 million was included on our balance sheet as deferred revenue, primarily related to unexpired maintenance and support contracts. At May 31, 2007, the remaining amount of backlog of approximately \$25 million was composed of multi-year licensing arrangements of approximately \$21 million and open software license orders received but not shipped of approximately \$4 million. Our backlog of orders not included on the balance sheet is not subject to our normal accounting controls for information that is either reported in or derived from our basic financial statements.

We typically fulfill most of our software license orders within 30 days of acceptance of a purchase order. Assuming all other revenue recognition criteria have been met, we recognize software license revenue upon shipment of the product, or if delivered electronically, when the customer has the right to access the software. Because there are many elements governing when revenue is recognized, including when orders are shipped, credit approval, completion of internal control processes over revenue recognition and other factors, management has some control in determining the period in which certain revenue is recognized. We frequently have open software license orders at the end of the quarter which have not shipped or have otherwise not met all the required criteria for revenue recognition. Although the amount of open software license orders may vary at any time, we generally do not believe that the amount, if any, of such software license orders at the end of a particular quarter is a reliable indicator of future performance. In addition, there is no industry standard for the definition of backlog and there may be an element of estimation in determining the amount. As such, direct comparisons with other companies may be difficult or potentially misleading.

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.

Legal and Other Regulatory Matters

See discussion regarding legal and other regulatory matters in Part II, Item 1. Legal Proceedings.

Table of Contents

Off-Balance Sheet Arrangements

Our only significant off-balance sheet commitments relate to operating lease obligations. We have no off-balance sheet arrangements within the meaning of Item 303(a)(4) of Regulation S-K. Future annual minimum rental lease payments are detailed in Note 10 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended November 30, 2007.

New Accounting Pronouncements

In June 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 141R, Business Combinations (SFAS 141R). SFAS 141R establishes a framework to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply SFAS 141R to any acquisition after the date of adoption.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161) as an amendment to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS 161 requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008. We are currently evaluating whether adoption of SFAS 161 will have an impact on our consolidated financial statements.

Item 3. 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. 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 because changes in fair value due to market changes in interest rates are recorded on the balance sheet in accumulated other comprehensive income. 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. See discussion concerning ARS Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in Liquidity and Capital Resources.

We use derivative instruments to manage exposures to fluctuations in the value of foreign currencies, which exist as part of our on-going business operations. Certain assets and forecasted transactions 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, Brazilian real, Japanese yen and Australian dollar. We do not enter into derivative instruments for speculative purposes, nor do we hold or issue any derivative instruments for trading purposes. We enter into certain derivative instruments that may not be designated as hedges under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). Although these derivatives do not qualify for hedge accounting, we believe that such instruments are closely correlated with the underlying exposure, thus managing the associated risk. The gains or losses from changes in the fair value of such derivative instruments that are not accounted for as hedges are recognized in earnings.

We use foreign currency option contracts that are not designated as hedging instruments under SFAS 133, to hedge a portion of forecasted international intercompany revenue for up to one year in the future. There were outstanding foreign currency option contracts with a fair value of \$0.3 million (and a notional value of \$129.6 million) at May

Table of Contents

31, 2008. Major U.S. multinational banks are counterparties to the option contracts. We also use forward contracts that are 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. We generally do not hedge the net assets of our international subsidiaries. The unrealized gains (losses) of our outstanding foreign currency forward contracts were \$0.3 million and \$0.2 million at May 31, 2008 and May 31, 2007, respectively.

The foreign exchange exposure from a 10% movement of currency exchange rates would have a material impact on our revenue and net income. Based on a hypothetical 10% adverse movement in all foreign currency exchange rates, our revenue would be adversely affected by approximately 5% 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 May 31, 2008 where the notional amount is determined using contract exchange rates:

(In thousands)

| Functional Currency: | Exchange Foreign Currency For U.S. Dollars (Notional Amount) | Exchange U.S. Dollars For Foreign Currency (Notional Amount) | Notional Weighted Average Exchange Rate* |
|----------------------|--|---|--|
| Australian dollar | | \$ 8,731 | 1.05 |
| Brazilian real | \$ 6,117 | | 1.67 |
| Euro | | 48,401 | 0.64 |
| Japanese yen | 3,902 | | 105.07 |
| South African rand | 1,108 | | 7.67 |
| U.K. pound | | 34,990 | 0.51 |
| | \$ 11,127 | \$ 92,122 | |

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

Item 4. Controls and Procedures

(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 of the end of the period covered by this report. 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.

(b) *Changes in internal control over financial reporting.* No changes in our internal control over financial reporting occurred during the quarter ended May 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

On June 23, 2006, we received written notice that the Enforcement Staff in the Boston, Massachusetts office of the SEC had begun an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. On December 19, 2006, the SEC informed us that it had issued a formal order of investigation into our option-granting practices during the period December 1, 1995 through the present. We are unable to predict with certainty what consequences may arise from the SEC investigation. We have already incurred, and expect to continue to incur, significant legal expenses arising from the investigation. 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 did not resolve the pending SEC

Table of Contents

inquiry. The SEC has not indicated to us whether it has reviewed our restated financial statements, and any SEC 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*, Civ. Act. No. 06-CA-11459 RCL 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 were also named as a nominal defendant. The complaint alleged 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 the allegedly improper backdating of certain stock option grants. The complaint sought monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. A Special Litigation Committee was formed by our Board of Directors to investigate and determine our response to the complaint. On September 25, 2007, the Court, in response to our motion, dismissed the *Arkansas Teacher Retirement System* complaint on the grounds that the Plaintiff failed to make a proper pre-filing demand upon our Board of Directors, and entered judgment for Defendants. On May 5, 2008, the Plaintiff filed a second derivative complaint, largely identical to the first, in the same court. By agreement of the parties, the court has stayed all proceedings while the Special Litigation Committee's investigation is ongoing.

On January 16, 2007, another party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *Acuna, Derivatively on Behalf of Progress Software Corporation v. Joseph Alsop et al*, Civ. Act. No. 07-0157 against our directors and certain of our present and former officers in Massachusetts Superior Court. We are named as a nominal defendant in this action as well. The complaint alleges breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from the allegedly improper backdating of certain stock option grants. The complaint seeks monetary damages and disgorgement, among other forms of relief. Further, on March 28, 2007, an additional party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *White, Derivatively on Behalf Of Nominal Defendant Progress v. Progress Software Corporation et al*, Civ 07-01172, in Massachusetts Superior Court. This complaint involves substantially the same defendants, allegations and demands for relief as the *Acuna* complaint described above. On June 26, 2007, the *White* and *Acuna* cases were consolidated. The consolidated case has been stayed while the Special Litigation Committee's investigation is ongoing.

The ultimate outcome of any of these matters could have a material adverse effect on our results of operations. These matters could divert the attention of our management and harm our business. In addition, we have incurred, and expect to continue to incur legal expenses arising from these matters, which may be significant, including the advancement of legal expenses to our directors and officers. We have certain indemnification obligations to our directors and officers, and the outcome of 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.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond our control. You should carefully review and consider the information regarding certain factors that could materially affect our business, financial condition or future results set forth under Part II, Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended November 30, 2007. No material changes have occurred since the fiscal year ended November 30, 2007 to the risk factors previously presented, other than the addition of the following: ***Funds associated with certain of our auction rate securities may not be accessible in the short term, and we may be required to adjust the carrying value of these securities through an impairment charge.*** As of May 31, 2008,

Table of Contents

we had approximately \$67.7 million in investments related to auction rate securities (ARS) that are classified as non-current. Our ARS are floating rate securities with longer-term maturities which are marketed by financial institutions with auction reset dates at primarily 28 or 35 day intervals to provide short-term liquidity. Beginning in February 2008, auctions for these securities began to fail, which has resulted in higher interest rates being earned on these securities, but the investments lack short-term liquidity. While we do not currently anticipate the lack of liquidity of the ARS to adversely affect our ability to conduct business, we will not be able to access these funds until a future auction for these ARS is successful or until we sell the securities in a secondary market, which currently is not active. In the second quarter of fiscal 2008, we recorded a temporary impairment charge in accumulated other comprehensive losses of \$3.9 million. In addition, if the credit rating of either the security issuer or the third-party insurer underlying the investments deteriorates, we may be required to further adjust the carrying value of the ARS through an other than temporary impairment charge.

We face various risks in connection with our proposed acquisition of IONA Technologies, plc. On June 25, 2008, we entered into a definitive agreement with IONA Technologies, plc under which we agreed to acquire IONA. We face various risks in connection with our proposed acquisition of IONA, including uncertainties as to the timing of the closing of our acquisition of IONA, uncertainties as to whether the shareholders of IONA will vote in favor of the acquisition, the risk that competing offers to acquire IONA will be made, the possibility that various closing conditions for the transaction may not be satisfied or waived, including that a governmental entity may prohibit, delay or refuse to grant approval for the consummation of the transaction, the effects of disruption from the transaction making it more difficult to maintain relationships with employees, licensees, other business partners or governmental entities, other business effects, including the effects of industry, economic or political conditions outside of our or IONA's control, transaction costs, actual or contingent liabilities, uncertainties as to whether anticipated synergies will be realized and uncertainties as to whether IONA's business will be successfully integrated with our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Items 2(a) and 2(b) are not applicable.

(c) Stock Repurchases

(In thousands, except per share data)

| Period: | | Total Number Of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased As Part of Publicly Announced Plans Or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1) |
|--------------|---------------|--|---------------------------------------|--|--|
| Mar. 1, 2008 | Mar. 31, 2008 | 33 | \$ 29.78 | 33 | 7,867 |
| Apr. 1, 2008 | Apr. 30, 2008 | 244 | \$ 29.58 | 244 | 7,623 |
| May 1, 2008 | May 31, 2008 | 287 | \$ 29.88 | 287 | 7,336 |
| Total | | 564 | \$ 29.74 | 564 | 7,336 |

(1) In
September 2007,
our Board of
Directors
authorized, for

the period from
October 1, 2007
through
September 30,
2008, the
purchase of up to
10,000,000
shares of our
common stock.

This
authorization
superseded the
previous
authorization that
expired on
September 30,
2007.

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

At the annual meeting of our shareholders held on April 24, 2008, the shareholders voted on the items described below:

To fix the number of directors constituting the full board at six:

| For | Against | Abstain |
|---|---------|---------|
| 37,645,100 | 641,541 | 27,428 |
| To elect the following six directors: Joseph W. Alsop, Barry N. Bycoff, Roger J. Heinen, Jr., Charles F. Kane, David A. Krall, and Michael L. Mark: | | |

| Nominee | For | Withhold Authority |
|---|------------|--------------------|
| Joseph W. Alsop | 38,027,467 | 286,604 |
| Barry N. Bycoff | 37,948,885 | 365,186 |
| Roger J. Heinen, Jr. | 34,993,469 | 3,320,602 |
| Charles F. Kane | 37,965,444 | 348,627 |
| David A. Krall | 35,775,027 | 2,539,044 |
| Michael L. Mark | 36,312,912 | 2,001,159 |
| To act upon a proposal to adopt and approve the Company's 2008 Stock Option and Incentive Plan: | | |

| For | Against | Abstain | Broker Non-Vote |
|--|------------|---------|-----------------|
| 23,896,657 | 10,445,558 | 70,523 | 3,901,333 |
| To act upon a proposal to ratify the selection of Deloitte & Touche LLP as the Company's independent registered public accounting firm for fiscal year 2008: | | | |

| For | Against | Abstain | Broker Non-Vote |
|------------|---------|---------|-----------------|
| 38,012,150 | 288,482 | 13,439 | 0 |

Item 6. Exhibits

The following exhibits are filed or furnished as part of this quarterly report on Form 10-Q:

| Exhibit No. | Description |
|-------------|---|
| 10.1 | Progress Software Corporation 2008 Stock Option and Incentive Plan (incorporated herein by reference to Exhibit 4.3 to our Registration Statement on Form S-8, Registration No. 333-150555) |
| 10.2 | Form of Notice of Grant of Stock Options and Grant Agreement (incorporated herein by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on April 28, 2008) |
| 10.3 | Form of Non-Qualified Stock Option Agreement for Non-Employee Directors under the Progress Software Corporation 2008 Stock Option and Incentive Plan (Initial Grant) (incorporated herein by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on April 28, 2008) |
| 10.4 | Form of Non-Qualified Stock Option Agreement for Non-Employee Directors under the Progress Software Corporation 2008 Stock Option and Incentive Plan (Annual Grant) (incorporated herein by reference to Exhibit 10.4 to our Current Report on Form 8-K filed on April 28, 2008) |

Table of Contents

| Exhibit No. | Description |
|--------------------|---|
| 10.5 | Form of Deferred Stock Unit Agreement under the Progress Software Corporation 2008 Stock Option and Incentive Plan (incorporated herein by reference to Exhibit 10.5 to our Current Report on Form 8-K filed on April 28, 2008) |
| 10.6* | Progress Software Corporation 2008 Fiscal Year Director Compensation Program |
| 31.1* | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act Joseph W. Alsop |
| 31.2* | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act Norman R. Robertson |
| 32.1* | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act |

* Filed herewith

Table of Contents

SIGNATURES

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

PROGRESS SOFTWARE CORPORATION

(Registrant)

Dated: July 10, 2008

/s/ Joseph W. Alsop
Joseph W. Alsop
Chief Executive Officer
(Principal Executive Officer)

Dated: July 10, 2008

/s/ Norman R. Robertson
Norman R. Robertson
Senior Vice President, Finance and
Administration and Chief Financial Officer
(Principal Financial Officer)

Dated: July 10, 2008

/s/ David H. Benton, Jr.
David H. Benton, Jr.
Vice President and Corporate Controller
(Principal Accounting Officer)