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 August 31, 2004

OR

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: **0-19417**

PROGRESS SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

MASSACHUSETTS (State or other jurisdiction of incorporation or organization)	**04-2746201** (I.R.S. Employer Identification No.)

14 Oak Park
Bedford, Massachusetts 01730
(Address of principal executive offices)
Telephone Number: (781) 280-4000

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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act): Yes ☒ No o

As of September 28, 2004, there were 36,095,000 shares of the registrant's Common Stock, $.01 par value per share, outstanding.

PROGRESS SOFTWARE CORPORATION

FORM 10-Q

FOR THE THREE MONTHS ENDED AUGUST 31, 2004

INDEX

Table of Contents

PART 1. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Condensed Consolidated Balance Sheets (unaudited)

(In thousands)

	August 31, 2004	November 30, 2003
Assets		
Current assets:		
Cash and equivalents	$141,495	$152,117
Short-term investments	43,895	67,014
Accounts receivable, net	50,307	52,065
Other current assets	22,900	22,534
Total current assets	258,597	293,730
Property and equipment, net	35,299	35,572
Acquired intangible assets, net	37,876	7,217
Goodwill	60,243	14,313
Other assets	16,886	16,938
Total	$408,901	$367,770
Liabilities and Shareholders’ Equity		
Current liabilities:		
Accounts payable	$ 9,161	$ 11,593
Accrued compensation and related taxes	29,230	28,773
Income taxes payable	1,762	5,001
Other accrued liabilities	17,955	17,748
Deferred revenue	99,475	82,614
Total current liabilities	157,583	145,729
Commitments and contingent liabilities		
Shareholders’ equity:		
Common stock and additional paid-in capital; authorized, 100,000 shares; issued and outstanding, 36,085 shares in 2004 and 35,239 shares in 2003	64,979	53,102
Retained earnings, including accumulated other comprehensive loss of $1,868 in 2004 and $1,825 in 2003	186,339	168,939
Total shareholders’ equity	251,318	222,041
Total	$408,901	$367,770

See notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Operations (unaudited)

(In thousands, except per share data)

	Three Months Ended August 31,		Nine months ended August 31,	
	2004	2003	2004	2003
Revenue:				
Software licenses	$32,864	$27,191	$103,664	$ 79,719
Maintenance and services	56,452	50,504	162,804	147,348
Total revenue	89,316	77,695	266,468	227,067
Costs and expenses:				
Cost of software licenses	2,092	1,907	6,983	6,312
Cost of maintenance and services	12,826	13,088	39,611	38,995
Sales and marketing	35,310	30,731	107,590	91,879
Product development	14,907	12,956	44,791	38,163
General and administrative	9,674	8,348	29,187	25,344
Amortization of acquired intangibles	1,809	602	5,205	1,684
In-process research and development	—	—	2,600	200
Total costs and expenses	76,618	67,632	235,967	202,577
Income from operations	12,698	10,063	30,501	24,490
Other income (expense):				
Interest income and other	606	811	2,027	2,557
Foreign currency losses	(503)	(404)	(1,285)	(966)
Total other income, net	103	407	742	1,591
Income before provision for income taxes	12,801	10,470	31,243	26,081
Provision for income taxes	4,281	3,141	9,998	7,824
Net income	$ 8,520	$ 7,329	$ 21,245	$ 18,257
Earnings per share:				
Basic	$ 0.24	$ 0.21	$ 0.59	$ 0.54
Diluted	$ 0.22	$ 0.19	$ 0.54	$ 0.49
Weighted average shares outstanding:				
Basic	36,220	34,604	35,970	33,953
Diluted	38,853	38,182	39,014	37,196

See notes to condensed consolidated financial statements.

Table of Contents

Condensed Consolidated Statements of Cash Flows (unaudited)

(In thousands)

	Nine months ended August 31,	
	2004	**2003**
Cash flows from operating activities:		
Net income	$ 21,245	$ 18,257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,290	8,280
In-process research and development	2,600	200
Deferred income taxes and other	251	290
Changes in operating assets and liabilities:		
Accounts receivable, net	4,176	13,920
Other current assets	1,616	2,038
Accounts payable and accrued expenses	(6,461)	(1,812)
Income taxes payable	4,362	657
Deferred revenue	15,354	4,692
Net cash provided by operating activities	55,433	46,522
Cash flows from investing activities:		
Purchases of short-term investments	(23,706)	(35,733)
Maturities and sales of short-term investments	46,544	17,453
Purchases of property and equipment	(5,943)	(4,445)
Acquisitions, net of cash acquired	(87,520)	(24,040)
Increase in other non-current assets	(138)	(396)
Net cash used for investing activities	(70,763)	(47,161)
Cash flows from financing activities:		
Proceeds from issuance of common stock	16,189	19,624
Repurchase of common stock	(12,060)	(11,703)
Net cash provided by financing activities	4,129	7,921
Effect of exchange rate changes on cash	579	823
Net increase (decrease) in cash and equivalents	(10,622)	8,105
Cash and equivalents, beginning of period	152,117	117,425
Cash and equivalents, end of period	$141,495	$125,530

See notes to condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by Progress Software Corporation (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission 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 should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2003.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited financial statements, and 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.

Certain amounts from the prior periods have been reclassified to conform to the presentation in the current periods. In the third quarter of fiscal 2004, the Company adjusted the allocation of the purchase price related to its December 2002 acquisition of eXcelon Corporation by reducing goodwill by $2.7 million to reflect an additional tax benefit not contemplated in the original allocation.

Note 2: Stock-based Compensation

The Company uses the intrinsic value method to measure compensation expense associated with the grants of stock options or awards to employees. The Company accounts for stock options and awards to non-employees using the fair value method. The Company has not granted any stock options or awards to non-employees.

Under the intrinsic value method, compensation associated with stock options or awards to employees is determined as the excess, if any, of the current fair value of the underlying common stock on the date compensation is measured over the price an employee must pay to exercise the option or award. The measurement date for employee options or awards is generally the date of grant. Under the fair value method, compensation associated with stock options and awards is determined based on the estimated fair value of the option or award itself, measured using either current market data or an established option pricing model.

Had the Company used the fair value method to measure compensation related to stock options and awards to employees, pro forma net income and pro forma earnings per share would have been as follows:

(In thousands, except per share data)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Net income, as reported	$ 8,520	$ 7,329	$21,245	$18,257
Less: stock-based compensation expense determined under fair value method for all awards, net of tax	(2,298)	(2,144)	(7,203)	(6,181)
Pro forma net income	$ 6,222	$ 5,185	$14,042	$12,076
Basic earnings per share:				
As reported	$ 0.24	$ 0.21	$ 0.59	$ 0.54
Pro forma	$ 0.17	$ 0.15	$ 0.39	$ 0.36
Diluted earnings per share:				
As reported	$ 0.22	$ 0.19	$ 0.54	$ 0.49
Pro forma	$ 0.16	$ 0.14	$ 0.36	$ 0.32

Note 3: Revenue Recognition

Revenue is recognized when earned. Software license revenue is recognized 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 and determinable, persuasive evidence of an arrangement exists and collection is probable. The Company does not license its software with a right of return and generally does not license its software with conditions of acceptance. If an arrangement does contain conditions of acceptance, recognition of the revenue is deferred until the acceptance criteria are met or the period of acceptance has passed. The Company generally recognizes revenue for products distributed through application partners and distributors when sold through to the end user.

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

Revenue from software licenses sold together with maintenance and/or consulting services is generally recognized 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, all revenue from the arrangement is deferred 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 the entire fee is recognized 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 both the software license and consulting fees are recognized under the percentage-of-completion method of contract accounting.

Maintenance revenue is recognized ratably over the term of the applicable agreement. Revenue from services, primarily consulting and customer education, is generally recognized as the related services are performed.

Note 4: Income Taxes

The Company provides for income taxes at the end of each interim period based on the estimated effective tax rate for the full fiscal year. Cumulative adjustments to the tax provision are recorded in the interim period in which a change in the estimated annual effective rate is determined.

Note 5: Earnings Per Share

Basic earnings per share is calculated using the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the treasury stock method. The following table sets forth the calculation of basic and diluted earnings per share on an interim basis:

(In thousands, except per share data)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Net income	$ 8,520	$ 7,329	$21,245	$18,257
Weighted average shares outstanding	36,220	34,604	35,970	33,953
Dilutive impact from outstanding stock options	2,633	3,578	3,044	3,243
Diluted weighted average shares outstanding	38,853	38,182	39,014	37,196
Earnings per share:				
Basic	$ 0.24	$ 0.21	$ 0.59	$ 0.54
Diluted	$ 0.22	$ 0.19	$ 0.54	$ 0.49

Approximately 1,517,000 and zero outstanding stock options were excluded from the calculation of diluted earnings per share for the three months ended August 31, 2004 and 2003, respectively, and approximately 506,000 and 468,000 outstanding stock options were excluded from the calculation of diluted earnings per share for the nine months ended August 31, 2004 and 2003, respectively, because these options were anti-dilutive. However, these options could be dilutive in the future.

Note 6: Comprehensive Income

Comprehensive income includes foreign currency translation gains and losses, net of tax, and unrealized gains and losses on investments, net of tax, that have been excluded from net income and reflected instead in shareholders' equity. The following table sets forth the calculation of comprehensive income on an interim basis:

(In thousands)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Net income, as reported	$8,520	$7,329	$21,245	$18,257
Foreign currency translation adjustments	250	(413)	101	806
Unrealized gains (losses) on foreign exchange hedging contracts	245	180	157	(165)
Unrealized holding gains (losses) on investments	112	(526)	(301)	(376)
Total comprehensive income	$9,127	$6,570	$21,202	$18,522

Note 7: Segment Information

The Company conducts business through five operating units and a supporting research and business development unit. The Company's principal operating unit conducts business as the Progress Company and is a division of the Company. Two of the other operating units, Sonic Software Corporation and PeerDirect Corporation, address the needs of emerging markets and operate as subsidiaries of the Company. The fourth operating unit is ObjectStore, a division of the Company, which provides data management software for developing applications that require the processing of large amounts of data. The fifth operating unit, DataDirect Technologies (DataDirect), was acquired in December 2003. DataDirect is a division of the Company and provides standards-based data connectivity software. PSC Labs, a division of the Company based in Cambridge, Massachusetts, focuses on new business development, research and strategic investments.

Based upon the aggregation criteria for segment reporting, the Company has two reportable segments: Application Development & Deployment, which primarily includes the Progress Company, DataDirect, ObjectStore, PeerDirect and PSC Labs, and Enterprise Application Integration, which primarily includes Sonic Software. The Company does not internally report its assets, capital expenditures, interest income or provision for income taxes by segment.

The following table sets forth revenue and income from operations from the Company's reportable segments on an interim basis:

(In thousands)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Revenue:				
Application Development and Deployment	$84,485	$73,915	$251,567	$216,512
Enterprise Application Integration	5,526	4,910	17,022	14,491
Eliminations	(695)	(1,130)	(2,121)	(3,936)
Total	$89,316	$77,695	$266,468	$227,067
Income (loss) from operations:				
Application Development and Deployment	$19,485	$16,942	$ 51,647	$ 45,644
Enterprise Application Integration	(6,092)	(5,749)	(19,025)	(17,218)
Eliminations	(695)	(1,130)	(2,121)	(3,936)
Total	$12,698	$10,063	$ 30,501	$ 24,490

Amounts included under Eliminations represent intersegment sales. Total revenue from the Sonic product line, generated by both segments, was $19.3 million in the first nine months of fiscal 2004 as compared to $16.8 million in the first nine months of fiscal 2003.

Note 8: Acquisition of DataDirect Technologies

On December 23, 2003, the Company, through a wholly owned subsidiary, acquired substantially all of the assets and certain subsidiaries and assumed certain liabilities of DataDirect Technologies Limited, a private company incorporated under the laws of Ireland, for an aggregate purchase price of approximately $87.5 million, net of cash acquired and subject to certain post-closing adjustments. The aggregate purchase price included $0.7 million of direct transaction costs. DataDirect is a provider of standards-based software for data connectivity. The Company acquired DataDirect in order to expand its business. The acquisition was accounted for as a purchase, and accordingly, the results of operations of DataDirect are included in the Company's operating results from the date of acquisition. The purchase price was paid in cash from available funds.

Acquired in-process research and development (IPR&D) of $2.6 million was expensed when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. Research and development costs to bring the acquired products to technological feasibility are not expected to have a material impact on the Company's future results of operations or cash flows. The Company used an independent appraiser to calculate the amounts allocated to assets and liabilities acquired, including intangible assets and IPR&D. The preliminary allocation of the purchase price as of August 31, 2004 was as follows:

(In thousands)

	Total	Life (in years)
Assets and liabilities, including cash	$ 6,148	
Acquired intangible assets	35,870	1 to 10 years
Goodwill	48,714	
In-process research and development	2,600	
Total purchase price	93,332	
Less: cash acquired	(5,812)	
Net cash paid	$87,520	

The following table sets forth supplemental pro forma financial information that assumes the acquisition was completed at the beginning of the earliest period presented. The information for the three months ended August 31, 2003 includes the historical results of the Company for the quarter ended August 31, 2003 and the historical results of DataDirect for the three month period ended July 31, 2003, and the information for the nine months ended August 31, 2003 includes the historical results of the Company for the nine months ended August 31, 2003 and the historical results of DataDirect for the nine month period ended July 31, 2003 due to different fiscal period ends.

The pro forma results include estimates and assumptions regarding increased amortization of intangible assets related to the acquisition, a reduction in interest expense related to bank loans of DataDirect and decreased interest income related to cash paid for the acquisition purchase price, which the Company believes are reasonable. However, pro forma results are not necessarily indicative of the results that would have occurred if the acquisition had occurred on the date indicated, or that may result in the future.

(In thousands, except per share data)

Three Months Ended August 31,	2003
Pro forma revenue	$86,915
Pro forma net income	$ 7,325
Pro forma diluted earnings per share	$ 0.19

(In thousands, except per share data)

Nine months ended August 31,	2003
Pro forma revenue	$260,051
Pro forma net income	$ 21,278
Pro forma diluted earnings per share	$ 0.57

Note 9: Subsequent Event

On September 27, 2004, the Company announced the signing of a definitive agreement to acquire Persistence Software, Inc. (Persistence), a provider of data access and caching software, in an all-cash transaction for a purchase price of $5.70 per share or approximately $16 million in the aggregate. Upon the closing of the transaction, Persistence will become part of ObjectStore. The acquisition has been approved by the boards of directors of the Company and Persistence and is subject to the approval of Persistence’s stockholders. The acquisition is expected to close within 90 days, subject to satisfaction of customary closing conditions.

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

Cautionary Statements

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This Form 10-Q contains, and other information provided by the Company or statements made by its 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. Forward-looking statements include statements concerning plans, objectives, goals, strategies, expectations, intentions, projections, developments, future events, performance or products, underlying assumptions and other statements which are other than statements of historical facts. In some cases, forward-looking statements are identified by terminology such as "may," "will," "should," "expects," "intends," "plans," "anticipates," "estimates," "believes," "contemplates," "predicts," "projects," "continue" and other similar terminology or the negative of these terms. All such forward-looking statements, whether written or oral, are expressly qualified by the cautionary statements contained in this Form 10-Q, including those set forth below under the heading "Factors That May Affect Future Results," and any other cautionary statements which may accompany the forward-looking statements. Although the Company has sought to identify the most significant risks to its business, the Company cannot predict whether, or to what extent, any of such risks may be realized, nor can there be any assurance that the Company has identified all possible issues which the Company might face. The Company undertakes no obligation to update any forward-looking statements it makes.

Overview

The Company develops, markets and distributes software to simplify and accelerate the development, deployment, integration and management of business applications. The mission of the Company is to deliver software products and services that empower partners and customers to improve their development, deployment, integration and management of quality applications worldwide. The Company's products include development tools, databases, application servers, messaging servers, application management tools, data connectivity products and integration products for distributed and Web-based applications as well as for client/server applications. The Company, through its various operating units, markets its products globally to a broad range of organizations in manufacturing, distribution, finance, retail, healthcare, telecommunications, government and many other fields.

A significant portion of the Company's revenue is derived from international operations. In the first nine months of fiscal 2004 as well as in fiscal years 2003 and 2002, the weakening of the U.S. dollar against most major currencies, primarily the euro and the British pound, positively affected the Company's results. Prior to that, the U.S. dollar was stronger and the Company's results were adversely affected.

The Company conducts business through five operating units and a supporting research and business development unit. The Company's principal operating unit conducts business as the Progress Company and is a division of the Company. Two of the other operating units, Sonic Software Corporation and PeerDirect Corporation, address the needs of emerging markets and operate as subsidiaries of the Company. The fourth operating unit is ObjectStore, a division of the Company, which provides data management software for developing applications that require processing of large amounts of data. The fifth operating unit, DataDirect Technologies (DataDirect), was acquired in December 2003. DataDirect is a division of the Company and provides standards-based data connectivity software. PSC Labs, a division of the Company based in Cambridge, Massachusetts, focuses on new business development, research, and strategic investments.

The Progress Company provides the Progress® OpenEdge™ platform, a set of development and deployment technologies, including the OpenEdge RDBMS, one of the leading embedded databases, for building business applications. Sonic Software Corporation delivers a distributed, standards-based communications and integration infrastructure, built on an enterprise service bus that integrates existing business applications and orchestrates business processes across the extended enterprise. PeerDirect Corporation is a supplier of technology for distributed application deployment and management. Its flagship product suite, PeerDirect™ Distributed Enterprise, allows companies to centrally manage distributed applications with synchronized databases deployed across widely distributed locations.

ObjectStore, acquired in December 2002 as part of the acquisition of eXcelon Corporation (eXcelon), provides advanced data management software for developing real-time, high performance operational applications. ObjectStore products enable complex relationships among data elements to be modeled identically in memory and on disk, providing fast storage and retrieval of complex data structures at in-memory speeds.

In December 2003, the Company completed its cash acquisition of certain assets and subsidiaries and the assumption of certain liabilities of DataDirect Technologies Limited for approximately $87.5 million, net of cash acquired and subject to certain post-closing adjustments. DataDirect's principal products provide connectivity between software applications and databases in heterogeneous environments.

Critical Accounting Policies

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

The Company has identified the following critical accounting policies that require the use of significant judgments and estimates in the preparation of its consolidated financial statements. This listing is not a comprehensive list of all of the Company's 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 the Company's Annual Report on Form 10-K for the year ended November 30, 2003.

Revenue Recognition — The Company's 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, the Company is often required to exercise judgment regarding the application of its accounting policies to a particular arrangement. For example, judgment is required in determining whether a customer arrangement has multiple elements. If 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 the Company follows specific and detailed rules and guidelines related to revenue recognition, significant management judgments and estimates are made and used 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 — The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of customers to make required payments. This allowance is established using estimates that the Company makes based on factors such as the composition of the accounts receivable aging, historical bad debts, changes in payment patterns, customer creditworthiness and current economic trends. If the Company used different estimates, or if the financial condition of customers were to deteriorate, resulting in an impairment of their ability to make payments, additional provisions for doubtful accounts would be required and would increase bad debt expense.

Deferred Income Taxes — The Company had a net deferred tax asset of approximately $24 million at August 31, 2004. The Company records valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. The Company considers scheduled reversals of deferred tax liabilities, projected future taxable income, ongoing tax planning strategies and other matters in assessing the need for and the amount of a valuation allowance. If the Company were to change its assumptions or otherwise determine that it was unable to realize all or part of its 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.

Table of Contents

Results of Operations

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

	Percentage of Total Revenue				Period-to-Period Change	
	Three Months Ended		Nine Months Ended			
	Aug 31, 2004	Aug 31, 2003	Aug 31, 2004	Aug 31, 2003	Three Month Period	Nine Month Period
Revenue:						
Software licenses	37%	35%	39%	35%	21%	30%
Maintenance and services	63	65	61	65	12	10
Total revenue	100	100	100	100	15	17
Costs and expenses:						
Cost of software licenses	2	2	3	3	10	11
Cost of maintenance and services	14	17	15	17	(2)	2
Sales and marketing	40	39	40	40	15	17
Product development	17	17	17	17	15	17
General and administrative	11	11	11	11	16	15
Amortization of acquired intangibles	2	1	2	1	200	209
In-process research and development	—	—	1	0	—	*
Total costs and expenses	86	87	89	89	13	16
Income from operations	14	13	11	11	26	25
Other income	0	0	1	0	(75)	(53)
Income before provision for taxes	14	13	12	11	22	20
Provision for income taxes	4	4	4	3	36	28
Net income	10%	9%	8%	8%	16%	16%

* not meaningful

The Company’s total revenue increased 15% from $77.7 million in the third quarter of fiscal 2003 to $89.3 million in the third quarter of fiscal 2004. Total revenue would have increased by approximately 10% if exchange rates had been constant in the third quarter of fiscal 2004 as compared to the exchange rates in effect in the third quarter of fiscal 2003. The Company’s total revenue increased 17% from $227.1 million in the first nine months of fiscal 2003 to $266.5 million in the first nine months of fiscal 2004. Total revenue would have increased by approximately 11% if exchange rates had been constant in the first nine months of fiscal 2004 as compared to the exchange rates in effect in the first nine months of fiscal 2003. In addition to the positive effect of changes in exchange rates, the Company’s revenue increased due to software license and maintenance revenue derived from the products acquired as part of the DataDirect acquisition and software license and maintenance revenue growth of all of the Company’s major product lines including Progress OpenEdge, Sonic and ObjectStore.

Total revenue derived from the Sonic product line increased from $5.8 million in the third quarter of fiscal 2003 to $6.6 million in the third quarter of fiscal 2004 and increased from $16.8 million in the first nine months of fiscal 2003 to $19.3 million in the first nine months of fiscal 2004. Revenue from the ObjectStore product line increased from $3.6 million in the third quarter of fiscal 2003 to $5.2 million in the third quarter of fiscal 2004 and increased from $10.0 million in the first nine months of fiscal 2003 to $13.7 million in the first nine months of fiscal 2004. Revenue from the DataDirect product line, which was acquired in the acquisition of DataDirect Technologies, contributed $7.0 million of revenue in the third quarter of fiscal 2004 and $20.3 million in the first nine months of fiscal 2004. Revenue from the PeerDirect product line in each period was not significant.

Software license revenue increased 21% from $27.2 million in the third quarter of fiscal 2003 to $32.9 million in the third quarter of fiscal 2004 and increased 30% from $79.7 million in the first nine months of fiscal 2003 to $103.7 million in the first nine months of fiscal 2004. Software license revenue would have increased by approximately 16% if exchange rates had been constant in the third quarter of fiscal 2004 as compared to the exchange rates in effect in the third quarter of fiscal 2003, and would have increased by approximately 23% if exchange rates had been constant in the first nine months of fiscal 2004 as compared to the exchange rates in effect in the first nine months of fiscal 2003. The increase in software license revenue was positively affected by the addition of DataDirect, which accounted for 13% of software license revenue in the third quarter of fiscal 2004 and 12% in the first nine months of fiscal 2004. Software license revenue from indirect channels, including application partners which have written software applications utilizing Progress Software technology and which resell the Company's products in conjunction with the sale of their applications and OEMs, and from sales to direct end users both increased in the third quarter of fiscal 2004 as compared to the third quarter of fiscal 2003. Software license revenue from the Progress OpenEdge product set increased year over year, primarily within the database products. Software license revenue also increased from newer products such as the Sonic and ObjectStore product lines.

Maintenance and services revenue increased 12% from $50.5 million in the third quarter of fiscal 2003 to $56.5 million in the third quarter of fiscal 2004 and increased 10% from $147.3 million in the first nine months of fiscal 2003 to $162.8 million in the first nine months of fiscal 2004. Maintenance and services revenue would have increased by approximately 7% if exchange rates had been constant in the third quarter of fiscal 2004 as compared to the exchange rates in effect in the third quarter of fiscal 2003, and would have increased by approximately 4% if exchange rates had been constant in the first nine months of fiscal 2004 as compared to the exchange rates in effect in the first nine months of fiscal 2003. The increase in maintenance and services revenue was also the result of growth in the Company's installed customer base, renewal of maintenance and the acquisition of DataDirect, partially offset by a decline in professional services revenue. The decline in services revenue was primarily the result of decreases in consulting revenue in the Europe, Middle East and Africa (EMEA) region as a result of economic conditions and a slower overall market for professional services.

Total revenue generated in markets outside North America increased 14% from $45.2 million in the third quarter of fiscal 2003 to $51.6 million in the third quarter of fiscal 2004, primarily due to revenue in EMEA increasing by 19%, and represented 58% of total revenue in each of the third quarter of fiscal 2004 and the third quarter of fiscal 2003. Total revenue generated in markets outside North America would have represented 56% of total revenue if exchange rates had been constant in the third quarter of fiscal 2004 as compared to the exchange rates in effect in the third quarter of fiscal 2003.

Total revenue generated in markets outside North America increased 12% from $136.6 million in the first nine months of fiscal 2003 to $153.1 million in the first nine months of fiscal 2004 and represented 57% of total revenue in the first nine months of fiscal 2004 as compared to 60% in the first nine months of fiscal 2003. Revenue from the three major regions outside of North America, consisting of EMEA, Latin America and Asia Pacific, each increased in the first nine months of fiscal 2004 as compared to the first nine months of fiscal 2003. Total revenue generated in markets outside North America would have represented 55% of total revenue if exchange rates had been constant in the first nine months of fiscal 2004 as compared to the exchange rates in effect in the first nine months of fiscal 2003.

The Company anticipates total revenue in the fourth quarter of fiscal 2004 to be in the range of $93 million to $95 million, representing an increase of 13% to 16% as compared to the fourth quarter of fiscal 2003. This level of revenue would result in total revenue for all of fiscal 2004 being in the range of $360 million to $362 million, representing an increase of 16% to 17% over fiscal 2003 amounts. This revenue expectation is based on the continued success of the Company's application partners and other channel partners, continued improvement in the Company's ability to generate new business in end user accounts and continued growth and success from the newer DataDirect, Sonic and ObjectStore product lines. However, external factors, such as geopolitical issues or a significant strengthening of the U.S. dollar against currencies from which the Company derives a significant portion of its business, could negatively impact its revenue expectation.

Cost of software licenses consists primarily of cost of product media, documentation, duplication, packaging, electronic software distribution, royalties and amortization of capitalized software costs. Cost of software licenses increased 10% from $1.9 million in the third quarter of fiscal 2003 to $2.1 million in the third quarter of fiscal 2004, but decreased as a percentage of software license revenue from 7% to 6%. Cost of software licenses increased 11% from $6.3 million in the first nine months of fiscal 2003 to $7.0 million in the first nine months of fiscal 2004, but decreased as a percentage of software license revenue from 8% to 7%. The dollar increase was primarily due to higher royalty expense for products and technologies licensed 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 consists primarily of costs of providing customer technical support, education and consulting. Cost of maintenance and services decreased 2% from $13.1 million in the third quarter of fiscal 2003 to $12.8 million in the third quarter of fiscal 2004 and decreased as a percentage of maintenance and services revenue from 26% to 23%. Cost of maintenance and services increased 2% from $39.0 million in the first nine months of fiscal 2003 to $39.6 million in the first nine months of fiscal 2004, but decreased as a percentage of maintenance and services revenue from 26% to 24%. The maintenance and services revenue margin improvement was due to maintenance revenue, which has a substantially higher margin than professional services revenue, representing a greater proportion of the total maintenance and services revenue in 2004. The dollar decrease in the third quarter of fiscal 2004 was due to lower professional services expenses related to the year over year decrease in such revenue. The dollar increase in the first nine months of fiscal 2004 was due to the impact of year-over-year changes in exchange rates and additional technical support personnel and related costs associated with DataDirect, partially offset by lower expenses in professional services. The Company’s technical support, education and consulting headcount decreased by 2% from the end of the third quarter of fiscal 2003 to the end of the third quarter of fiscal 2004.

Sales and marketing expenses increased 15% from $30.7 million in the third quarter of fiscal 2003 to $35.3 million in the third quarter of fiscal 2004 and increased as a percentage of revenue from 39% to 40%. Sales and marketing expenses increased 17% from $91.9 million in the first nine months of fiscal 2003 to $107.6 million in the first nine months of fiscal 2004 and remained the same percentage of revenue at 40%. The increase in sales and marketing expenses was due to the addition of sales and marketing personnel and related expenses resulting from the acquisition of DataDirect as well as a slight increase in the level of discretionary marketing spending for trade shows, advertising campaigns, lead generation, direct mail solicitations and other events. Expenses also increased due to the impact of year-over-year changes in exchange rates as a significant percentage of sales and marketing expenses are incurred outside of North America. The Company’s sales, sales support and marketing headcount increased by 3% from the end of the third quarter of fiscal 2003 to the end of the third quarter of fiscal 2004.

Product development expenses increased 15% from $13.0 million in the third quarter of fiscal 2003 to $14.9 million in the third quarter of fiscal 2004, but remained approximately the same percentage of revenue at 17%. Product development expenses increased 17% from $38.2 million in the first nine months of fiscal 2003 to $44.8 million in the first nine months of fiscal 2004, but remained the same percentage of total revenue at 17%. The dollar increase was primarily due to an increase in headcount and related expenses resulting from the acquisition of DataDirect. There were no capitalized software development costs in the third quarter of either fiscal 2003 or fiscal 2004, due to the timing and stage of development of projects that might qualify for capitalization under the Company’s software capitalization policy. Capitalized software costs associated with Progress OpenEdge 10 totaled $0.3 million in the first nine months of fiscal 2004 as compared to none in the first nine months of fiscal 2003. The Company’s product development headcount increased 21% from the end of the third quarter of fiscal 2003 to the end of the third quarter of fiscal 2004.

General and administrative expenses include the costs of the finance, human resources, legal, information systems and administrative departments of the Company. General and administrative expenses increased 16% from $8.3 million in the third quarter of fiscal 2003 to $9.7 million in the third quarter of fiscal 2004, but remained the same percentage of revenue at 11%. General and administrative expenses increased 15% from $25.3 million in the first nine months of fiscal 2003 to $29.2 million in the first nine months of fiscal 2004, but remained the same percentage of revenue at 11%. The dollar increase was primarily due to headcount related costs, higher transition and integration costs associated with acquisitions, higher professional services fees and the impact of changes in exchange rates. The Company’s administrative headcount increased 7% from the end of the third quarter of fiscal 2003 to the end of the third quarter of fiscal 2004.

Amortization of acquired intangibles increased from $0.6 million in the third quarter of fiscal 2003 to $1.8 million in the third quarter of fiscal 2004. Amortization of acquired intangibles increased from $1.7 million in the first nine months of fiscal 2003 to $5.2 million in the first nine months of fiscal 2004. The increase was due to amortization expense associated with the acquisition of DataDirect. The Company expects amortization of acquired intangibles to total approximately $1.8 million in the fourth quarter of fiscal 2004 and to total approximately $7.0 million for all of fiscal 2004.

Acquired in-process research and development from the acquisition of DataDirect totaled $2.6 million in the first nine months of fiscal 2004 and was expensed when the acquisition was consummated because the technological feasibility of several products under development at the time of the acquisition had not been achieved and no alternate future uses had been established. Research and development costs to bring the acquired products to technological feasibility are not expected to have a material impact on the Company's future results of operations or cash flows. The value of in-process research and development was determined based on an independent appraisal from a third party. In the first nine months of fiscal 2003, the Company incurred $0.2 million of in-process research and development related to the acquisition of eXcelon.

Income from operations as a percentage of total revenue increased from 13% in the third quarter of fiscal 2003 to 14% in the third quarter of fiscal 2004. Noncash charges for amortization of purchased intangibles represented 1% of total revenue in the third quarter of fiscal 2003 as compared to 2% of total revenue in the third quarter of fiscal 2004. Income from operations as a percentage of total revenue remained approximately the same at 11% in each of the first nine months of fiscal 2003 and the first nine months of fiscal 2004. Noncash charges for amortization of purchased intangibles and in-process research and development represented 1% of total revenue in the first nine months of fiscal 2003 as compared to 3% of total revenue in the first nine months of fiscal 2004. If the Company is able to meet its forecasted revenue target and expenses occur as planned in the fourth quarter of fiscal 2004, the Company expects operating income as a percentage of revenue to be between 12% and 13% for all of fiscal 2004.

Other income decreased 75% from $0.4 million in the third quarter of fiscal 2003 to $0.1 million in the third quarter of fiscal 2004 and decreased 53% from $1.6 million in the first nine months of fiscal 2003 to $0.7 million in the first nine months of fiscal 2004. The decrease was primarily due to lower interest income, resulting from lower interest rates and the reduction in cash and short-term investment balances due to the acquisition of DataDirect.

The Company's effective tax rate was 30% in the third quarter and first nine months of fiscal 2003 as compared to 33% in the third quarter and 32% in the first nine months of fiscal 2004. The third quarter of fiscal 2004 included an adjustment of $0.2 million to reflect a change in the estimated effective tax rate for the full fiscal year from 31% to 32%. The Company estimates that its effective tax rate will remain at approximately 32% in the fourth quarter of fiscal 2004.

Liquidity and Capital Resources

The Company's cash and short-term investments totaled $185.4 million at August 31, 2004. The decrease of $33.7 million since the end of fiscal 2003 resulted primarily from the acquisition of DataDirect and stock repurchases, partially offset by cash generated from operations and proceeds from exercises of stock options and stock issuances under the Company's stock purchase plan.

The Company generated $55.4 million in cash from operations in the first nine months of fiscal 2004 and $46.5 million in the first nine months of fiscal 2003. The increase in cash generated from operations in the first nine months of fiscal 2004 as compared to the first nine months of fiscal 2003 was primarily due to higher net income and changes in operating assets and liabilities.

Accounts receivable decreased by $1.8 million from the end of fiscal 2003. Accounts receivable days sales outstanding (DSO) decreased by 6 days to 51 days at the end of the third quarter of fiscal 2004 as compared to 57 days at the end of fiscal 2003 and increased by 2 days from 49 days at the end of the third quarter of fiscal 2003. The third quarter of each fiscal year is typically the quarter-end period within the year with the lowest DSO due to a lower proportion of annual customer billings for maintenance renewals occurring in this quarterly period. The Company targets a DSO range of 60 to 80 days.

The Company purchased property and equipment totaling $5.9 million in the first nine months of fiscal 2004 and $4.4 million in the first nine months of fiscal 2003. The purchases consisted primarily of computer equipment and software. The Company financed these purchases primarily from cash generated from operations.

The Company purchased and retired approximately 600,000 shares of its common stock for $12.1 million in the first nine months of fiscal 2004 and approximately 668,000 shares of its common stock for $11.7 million in the first nine months of fiscal 2003. The Company financed these purchases primarily from cash generated from operations.

In September 2004, the Board of Directors authorized, for the period from October 1, 2004 through September 30, 2005, the purchase of up to 10,000,000 shares of the Company's common stock, at such times that the Company deems such purchases to be an effective use of cash. Shares that are repurchased may be used for various purposes, including the issuance of shares pursuant to the Company's stock option and stock purchase plans.

In December 2003, the Company, through a wholly owned subsidiary, acquired substantially all of the assets and certain subsidiaries and assumed certain liabilities of DataDirect Technologies Limited, a private company incorporated under the laws of Ireland, for an aggregate purchase price of approximately $87.5 million, net of cash acquired and subject to certain post-closing adjustments. The aggregate purchase price included $0.7 million of direct transaction costs. DataDirect is a provider of standards-based software for data connectivity. The acquisition was accounted for as a purchase, and accordingly, the results of operations of DataDirect are included in the Company's operating results from the date of acquisition. The purchase price was paid in cash from available funds.

On September 27, 2004, the Company announced the signing of a definitive agreement to acquire Persistence Software, Inc. (Persistence), a provider of data access and caching software, in an all-cash transaction for a purchase price of $5.70 per share or approximately $16 million in the aggregate. Upon the closing of the transaction, Persistence will become part of ObjectStore. The acquisition has been approved by the boards of directors of the Company and Persistence and is subject to the approval of Persistence's stockholders. The acquisition is expected to close within 90 days, subject to satisfaction of customary closing conditions.

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

The Company has no long-term debt. The Company believes that existing cash balances together with funds generated from operations will be sufficient to finance the Company's operations and meet its foreseeable cash requirements (including planned capital expenditures, lease commitments, potential cash acquisitions and other long-term obligations) through at least the next twelve months.

Off-Balance Sheet Arrangements

The Company's only significant off-balance sheet arrangements relate to operating lease obligations. Future annual minimum rental lease payments are detailed in Note 10 of the Notes to Consolidated Financial Statements in Item 8 of the Company's Annual Report on Form 10-K for the year ended November 30, 2003.

Factors That May Affect Future Results

The Company operates in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond the Company's control. The following discussion highlights some of these risks.

Fluctuations in Revenue and Quarterly Results - The Company may experience significant fluctuations in future quarterly operating results that may be caused by many factors. Some of these factors include changes in demand for the Company's products, introduction, enhancement or announcement of products by the Company and its competitors, market acceptance of new products, the growth rates of certain market segments including enterprise application integration and messaging, size and timing of significant orders, budgeting cycles of customers, mix of distribution channels, mix of products and services sold, mix of international and North American revenues, fluctuations in currency exchange rates, changes in the level of operating expenses, changes in the Company's sales incentive plans, customer order deferrals in anticipation of new products announced by the Company or its competitors and general economic conditions in regions in which the Company conducts business. Revenue forecasting is uncertain, in large part, because the Company generally ships its products shortly after receipt of orders. Most of the Company's expenses are relatively fixed, including costs of personnel and facilities, and are not easily reduced. Thus, an unexpected reduction in the Company's revenue, or failure to achieve the anticipated rate of growth, would have a material adverse effect on the profitability of the Company.

Global Economic and Political Conditions - The global economic and political environment and the current business climate could impact the Company's revenue and net income in the near term. Political instability, oil price shocks and armed conflict in various regions of the world also contribute to economic uncertainty. If customers' buying patterns, such as decision-making processes, timing of expected deliveries and timing of new projects, unfavorably change due to economic or political conditions, there will be a material adverse effect on the Company's business, financial condition and operating results.

Products - Ongoing enhancements to the Company's various product sets will be required to enable the Company to maintain its competitive position. There can be no assurance that the Company will be successful in developing and marketing enhancements to its products on a timely basis, or that the enhancements will adequately address the changing needs of the marketplace. Failure to develop enhancements that meet market needs in a timely manner could have a material adverse effect on the Company's business, financial condition and operating results.

Overlaying the risks associated with the Company's existing products and enhancements are ongoing technological developments and rapid changes in customer requirements. The Company's future success will depend upon its ability to develop and introduce in a timely manner new products that take advantage of technological advances and respond to new customer requirements. The development of new products is increasingly complex and uncertain, which increases the risk of delays. There can be no assurance that the Company will be successful in developing new products incorporating new technology on a timely basis, or that its new products will adequately address the changing needs of the marketplace.

The Company derives a significant portion of its revenue from its core product line, Progress OpenEdge, and other products that complement OpenEdge and are generally licensed only in conjunction with OpenEdge. Accordingly, the Company's future results depend on continued market acceptance of OpenEdge and any factor adversely affecting the market for OpenEdge could have a material adverse effect on the Company's business, financial condition and operating results.

Some of the Company's newer products, such as the Sonic and PeerDirect product sets, require a higher level of development, distribution and support expenditures, on a percentage of revenue basis, than the OpenEdge or DataDirect product lines. If revenue generated from these products becomes a greater percentage of the Company's total revenue and if the expenses associated with these products do not decrease on a percentage of revenue basis, then the Company's operating margins will be adversely affected.

International Operations – The Company typically generates between 55% and 60% of its total revenue from sales outside of North America. Because a majority of the Company's total revenue is derived from international operations that are primarily conducted in foreign currencies, changes in the value of these foreign currencies relative to the U.S. dollar may affect the Company's results of operations and financial position. In the past year, the U.S. dollar has been significantly weaker than in the previous few years against most major foreign currencies, which has positively affected the Company's revenue and results of operations. This trend may not continue. There can be no assurance that the Company's currency hedging transactions will materially reduce the effect of fluctuations in foreign currency exchange rates on such results. If for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, the Company's business could be adversely affected.

Other potential risks inherent in the Company's international business generally include longer payment cycles, greater difficulties in accounts receivable collection, unexpected changes in regulatory requirements, export restrictions, tariffs and other trade barriers, difficulties in staffing and managing foreign operations, political instability, reduced protection for intellectual property rights in some countries, seasonal reductions in business activity during the summer months in Europe and certain other parts of the world, economic instability in emerging markets and potentially adverse tax consequences. Any one of these factors could adversely impact the success of the Company's international operations. There can be no assurance that one or more of such factors will not have a material adverse effect on the Company's future international operations, and, consequently, on the Company's business, financial condition and operating results.

Acquisitions - As part of its business strategy, the Company has made and expects to continue to make acquisitions of businesses or investments in companies that offer complementary products, services and technologies, such as the acquisition of DataDirect at the beginning of fiscal 2004. Such acquisitions or investments involve a number of risks, including the risks of assimilating the operations and personnel of acquired companies, realizing the value of the acquired assets relative to the price paid, distraction of management from the Company’s ongoing businesses and potential product disruptions associated with the sale of the acquired company’s products. These factors could have a material adverse effect on the Company’s business, financial condition and operating results. Consideration paid for future acquisitions, if any, could include company stock. As a result, future acquisitions could cause dilution to existing shareholders and to earnings per share.

Distribution Channels and New Markets - Future results also depend upon the Company’s continued successful distribution of its products through its application partner (AP) and OEM channels and may be impacted by downward pressure on pricing, which may not be offset by increases in volume. APs utilize technology from the Company to create their applications and resell the Company’s products along with their own applications. OEMs embed the Company’s products within their software product or technology device. Any adverse effect on the APs’ or OEMs’ businesses related to competition, pricing and other factors could also have a material adverse effect on the Company’s business, financial condition and operating results.

Sonic Software is currently developing and enhancing the Sonic product set and other new products and services. The market for enterprise application integration, Web services, messaging products and other Internet business-to-business products is highly competitive. Many potential customers have made significant investments in proprietary or internally developed systems and would incur significant costs in switching to the Sonic product set or other third-party products. Global e-commerce and online exchange of information on the Internet and other similar open wide area networks continue to evolve. There can be no assurance that the Company’s products will be successful in penetrating these evolving markets.

Competition - The Company experiences significant competition from a variety of sources with respect to the marketing and distribution of its products. Many of the Company’s competitors have greater financial, marketing or technical resources than the Company and may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than can the Company. Increased competition could make it more difficult for the Company to maintain its market presence. The marketplace for new products is intensely competitive and characterized by low barriers to entry. As a result, new competitors possessing technological, marketing or other competitive advantages may emerge and rapidly acquire market share.

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

Taxation of Extraterritorial Income - The Company currently receives significant benefits from the extraterritorial income (ETI) exclusion provisions of the current U.S. tax law. The World Trade Organization (WTO) has ruled that these provisions constitute a prohibited export subsidy. In March 2004, the European Union began imposing sanctions against a wide range of U.S. exports (software not included) as part of an effort, authorized by the WTO, to force the U.S. to bring its ETI rules into compliance. President Bush has stated the U.S. will bring its tax laws into compliance with the WTO ruling and tax law changes, including repeal of the ETI, are at various stages of passage within each body of Congress. If the ETI exclusion is repealed and replacement legislation providing similar benefit is not enacted, the loss of this tax benefit, which currently provides approximately a four to six absolute percentage point reduction in the Company’s effective tax rate, would have a material adverse effect on the profitability of the Company.

Hiring and Retention of Skilled Employees - The Company’s future success will depend in large part upon its ability to attract and retain highly skilled technical, managerial and marketing personnel. There is significant competition for such personnel in the software industry. There can be no assurance that the Company will continue to be successful in attracting and retaining the personnel it requires to develop new and enhanced products and to continue to grow and operate profitably.

Intellectual Property and Proprietary Rights - The Company's success is heavily dependent upon its proprietary software technology. The Company relies principally on a combination of contract provisions and copyright, trademark, patent and trade secret laws to protect its proprietary technology. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. Policing unauthorized use of the Company's products is difficult. There can be no assurance that the steps taken by the Company to protect its proprietary rights will be adequate to prevent misappropriation of its technology or independent development by others of similar technology.

In addition, litigation may be necessary in the future to enforce the Company's intellectual property rights, to protect the Company's trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement. Although the Company believes that its products and technology do not infringe on any existing proprietary rights of others, there can be no assurance that third parties will not assert infringement claims in the future or that any such claims will not be successful. Such litigation could result in substantial costs and diversion of resources, whether or not the Company ultimately prevails on the merits, and could have a material adverse effect on the Company's business, financial condition and operating results. Such litigation could also result in the Company being prohibited from selling one or more of its products or cause reluctance by potential customers to purchase the Company's products.

Third-Party Technology - The Company also utilizes certain technology which it licenses from third parties, including software which is integrated with internally developed software and used in the Company's products to perform key functions. There can be no assurance that functionally similar technology will continue to be available on commercially reasonable terms in the future, or at all.

Stock Price Volatility - The market price of the Company's common stock, like that of other technology companies, is highly volatile and is subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by the Company or its competitors, changes in financial estimates by securities analysts or other events or factors. The Company's stock price may also be affected by broader market trends unrelated to the Company's performance.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to a variety of risks, including changes in interest rates affecting the return on its investments and foreign currency fluctuations. The Company has established policies and procedures to manage its exposure to fluctuations in interest rates and foreign currency exchange rates.

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

The Company has entered into foreign exchange option and forward contracts to hedge certain transactions of selected foreign currencies, primarily in EMEA and Asia Pacific, against fluctuations in exchange rates. The Company has not entered into foreign exchange option and forward contracts for speculative or trading purposes. The Company's accounting policies for these contracts are based on the designation of the contracts as hedging instruments. The criteria the Company uses for designating a contract as a hedge include the contract's effectiveness in risk reduction and matching of derivative instruments to the underlying transactions. Market value increases and decreases on the foreign exchange option and forward contracts are generally recognized in income in the same period as gains and losses on the underlying transactions. The Company operates in certain countries where there are limited forward currency exchange markets and thus the Company has unhedged transaction exposures in these currencies. The Company generally does not hedge the net assets of its international subsidiaries. The notional principal amount of outstanding foreign exchange option contracts at August 31, 2004 was $76.2 million. Unrealized market value gains on such contracts were immaterial at August 31, 2004. Based on a hypothetical 10% adverse movement in all foreign currency exchange rates, the Company's revenue would be adversely affected by approximately 6% and the Company's net income would be adversely affected by approximately 20% (excluding any offsetting positive impact from the Company's 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 August 31, 2004 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*
Brazilian real	$ 368	—	2.99
Euro	—	$8,298	0.83
Japanese yen	4,288	—	109.61
South African rand	712	—	6.75
U.K. pound	1,432	—	0.56
	$6,800	$8,298	

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

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures*. The Company's management, including the Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as of the end the period covered by this quarterly report. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's 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 the Company under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the requisite time periods.

(b) *Changes in internal control over financial reporting*. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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 (1)	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 (2)
June 1, 2004 – June 30, 2004	—	—	—	9,784
July 1, 2004 – July 31, 2004	251	$19.56	251	9,533
August 1, 2004 – August 31, 2004	152	$19.06	152	9,381
	403	$19.37	403	9,381

(1) all shares were purchased in open market transactions

(2) in September 2003, the Board of Directors authorized, for the period from October 1, 2003 through September 30, 2004, the purchase of up to 10,000,000 shares of the Company's common stock, at such times that the Company deems such purchases to be an effective use of cash

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

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

b) Reports on Form 8-K

The Company filed a report on Form 8-K on June 17, 2004, furnishing, under Item 7, a copy of a press release related to the Company's second quarter financial results, and identifying such press release as required by Item 12.

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: September 30, 2004	/s/ Joseph W. Alsop Joseph W. Alsop Chief Executive Officer (Principal Executive Officer)
Dated: September 30, 2004	/s/ Norman R. Robertson Norman R. Robertson Senior Vice President, Finance and Administration and Chief Financial Officer (Principal Financial Officer)
Dated: September 30, 2004	/s/ David H. Benton, Jr. David H. Benton, Jr. Vice President and Corporate Controller (Principal Accounting Officer)

Exhibit 31.1

CERTIFICATION

I, Joseph W. Alsop, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Progress Software Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure control and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 30, 2004

/s/ JOSEPH W. ALSOP

- ------------------------------

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

Exhibit 31.2

CERTIFICATION

I, Norman R. Robertson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Progress Software Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure control and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 30, 2004

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

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Progress Software Corporation (the Company) for the three months ended May 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the Report), each of the undersigned, Joseph W. Alsop, Chief Executive Officer, and Norman R. Robertson, Senior Vice President, Finance and Administration and Chief Financial Officer, of the Company, certifies, to the best knowledge and belief of the signatory, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JOSEPH W. ALSOP	/s/ NORMAN R. ROBERTSON
Chief Executive Officer	Senior Vice President, Finance and Administration and Chief Financial Officer
Date: September 30, 2004	Date: September 30, 2004