PROGRESS SOFTWARE CORP /MA
Form 10-Q
October 10, 2008

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

**FORM 10-Q**

(Mark One)

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

**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** | **04-2746201** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (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 þ No o
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 þ | Accelerated filer o | Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |
|---|---|---|---|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
As of September 30, 2008, there were 39,822,000 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, 2008**
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**PART 1. FINANCIAL INFORMATION**
**Item 1. Unaudited Consolidated Financial Statements**
**Condensed Consolidated Balance Sheets (unaudited)**
*(In thousands)*

| | August 31, 2008 | November 30, 2007 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and equivalents | $ 212,269 | $ 53,879 |
| Short-term investments | 19,194 | 285,646 |
| Total cash and short-term investments | 231,463 | 339,525 |
| Accounts receivable, net | 90,160 | 93,998 |
| Other current assets | 20,529 | 17,891 |
| Deferred income taxes | 12,323 | 13,009 |
| Total current assets | 354,475 | 464,423 |
| Property and equipment, net | 63,045 | 64,949 |
| Acquired intangible assets, net | 54,346 | 59,931 |
| Goodwill | 155,333 | 149,057 |
| Deferred income taxes | 20,614 | 17,617 |
| Investments | 51,526 | |
| Other assets | 14,585 | 5,851 |
| Total | $ 713,924 | $ 761,828 |
| Liabilities and Shareholders Equity | | |
| Current liabilities: | | |
| Current portion, long-term debt | $ 324 | $ 305 |
| Accounts payable | 10,408 | 12,684 |
| Accrued compensation and related taxes | 37,928 | 50,092 |
| Income taxes payable | 945 | 3,409 |
| Other accrued liabilities | 26,466 | 26,493 |
| Short-term deferred revenue | 137,821 | 135,487 |
| Total current liabilities | 213,892 | 228,470 |
| Long-term debt, less current portion | 1,107 | 1,352 |
| Long-term deferred revenue | 9,169 | 11,200 |
| Deferred income taxes | 4,235 | 2,817 |

| | | |
|---|---|---|
| Other non-current liabilities | 3,773 | 115 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Common stock and additional paid-in capital; authorized, 100,000 shares; issued and outstanding, 39,817 shares in 2008 and 42,380 shares in 2007 | 207,206 | 240,647 |
| Retained earnings and accumulated other comprehensive gains of $1,505 in 2008 and $4,833 in 2007 | 274,542 | 277,227 |
| Total shareholders equity | 481,748 | 517,874 |
| Total | $ 713,924 | $ 761,828 |

See notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended Aug. 31, | | Nine Months Ended Aug 31, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Revenue: | | | | |
| Software licenses | $ 45,998 | $ 44,011 | $ 136,115 | $ 133,295 |
| Maintenance and services | 80,622 | 77,793 | 240,014 | 223,380 |
| Total revenue | 126,620 | 121,804 | 376,129 | 356,675 |
| Costs of revenue: | | | | |
| Cost of software licenses | 3,219 | 2,109 | 7,679 | 5,661 |
| Cost of maintenance and services | 16,558 | 16,915 | 51,914 | 50,048 |
| Amortization of acquired intangibles for purchased technology | 2,958 | 2,496 | 8,448 | 7,480 |
| Total costs of revenue | 22,735 | 21,520 | 68,041 | 63,189 |
| Gross profit | 103,885 | 100,284 | 308,088 | 293,486 |
| Operating expenses: | | | | |
| Sales and marketing | 48,367 | 47,644 | 142,366 | 138,034 |
| Product development | 21,076 | 19,829 | 62,299 | 61,013 |
| General and administrative | 14,966 | 13,188 | 43,472 | 47,248 |
| Amortization of other acquired intangibles | 1,369 | 1,820 | 4,092 | 5,746 |
| Total operating expenses | 85,778 | 82,481 | 252,229 | 252,041 |
| Income from operations | 18,107 | 17,803 | 55,859 | 41,445 |
| Other income (expense): | | | | |
| Interest income and other | 2,230 | 2,602 | 8,045 | 6,851 |
| Foreign currency gain (loss) | 410 | (332) | (153) | (1,870) |
| Total other income, net | 2,640 | 2,270 | 7,892 | 4,981 |
| Income before provision for income taxes | 20,747 | 20,073 | 63,751 | 46,426 |
| Provision for income taxes | 8,210 | 7,026 | 23,907 | 16,250 |
| Net income | $ 12,537 | $ 13,047 | $ 39,844 | $ 30,176 |
| Earnings per share: | | | | |
| Basic | $ 0.31 | $ 0.31 | $ 0.96 | $ 0.73 |

| | | | | |
|---|---|---|---|---|
| Diluted | $ 0.30 | $ 0.30 | $ 0.92 | $ 0.69 |
| | | | | |
| Weighted average shares outstanding: | | | | |
| Basic | 40,528 | 41,712 | 41,416 | 41,319 |
| Diluted | 42,156 | 44,153 | 43,189 | 43,742 |

See notes to unaudited condensed consolidated financial statements.

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

| | Nine Months Ended August 31, | |
|---|---|---|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net income | $ 39,844 | $ 30,176 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of property and equipment | 7,845 | 7,276 |
| Write-down for asset impairment | | 2,388 |
| Amortization of capitalized software costs | | 131 |
| Amortization of acquired intangible assets | 12,540 | 13,226 |
| Stock-based compensation | 11,612 | 16,586 |
| Deferred income taxes | 1,615 | 1,843 |
| Tax benefit from stock options | 2,361 | 556 |
| Excess tax benefit from stock options | (1,574) | |
| Changes in operating assets and liabilities, net of effects from acquisitions: | | |
| Accounts receivable | 3,077 | 8,005 |
| Other current assets | 1,161 | 1,188 |
| Accounts payable and accrued expenses | (16,227) | (18,555) |
| Income taxes payable | (3,820) | (149) |
| Deferred revenue | 2,003 | 9,165 |
| Net cash provided by operating activities | 60,437 | 71,836 |
| Cash flows from investing activities: | | |
| Purchases of investments available for sale | (140,806) | (196,115) |
| Sales and maturities of investments available for sale | 352,859 | 134,496 |
| Purchases of property and equipment | (6,024) | (14,625) |
| Acquisitions, net of cash acquired | (11,758) | |
| Investment in IONA Technologies | (6,668) | |
| Increase in other non-current assets | (1,837) | (953) |
| Net cash provided by (used for) investing activities | 185,766 | (77,197) |
| Cash flows from financing activities: | | |
| Issuance of common stock | 21,711 | 24,669 |
| Excess tax benefit from stock options | 1,574 | 1,473 |
| Payment of long-term debt | (226) | (209) |
| Repurchase of common stock | (108,316) | (19,529) |
| Net cash provided by (used for) financing activities | (85,257) | 6,404 |
| Effect of exchange rate changes on cash | (2,556) | 2,994 |

| | | |
|---|---|---|
| Net increase in cash and equivalents | 158,390 | 4,037 |
| Cash and equivalents, beginning of period | 53,879 | 46,449 |
| Cash and equivalents, end of period | $ 212,269 | $ 50,486 |

See notes to unaudited condensed consolidated financial statements.

**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.

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.

**New Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (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 September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands fair value measurement disclosures. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 and FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 . Collectively, the Staff Positions defer the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of SFAS 157. We have adopted SFAS 157 except for those items specifically deferred under FSP No. FAS 157-2. We are currently evaluating the impact of the full adoption of SFAS 157 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS 160). The standard changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated shareholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as a part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We are currently evaluating the impact of adopting SFAS 160 on our consolidated financial statements.

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 the impact of adopting SFAS 161 on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets . FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets . FSP FAS 142-3 is effective for fiscal years beginning after

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December 15, 2008 and early adoption is prohibited. We are currently evaluating the impact of adopting FSP FAS 142-3 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.

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 Aug. 31, | | Nine Months Ended Aug. 31, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | $ 12,537 | $ 13,047 | $ 39,844 | $ 30,176 |
| Weighted average shares outstanding | 40,528 | 41,712 | 41,416 | 41,319 |
| Dilutive impact from outstanding stock Options and deferred stock units | 1,628 | 2,441 | 1,773 | 2,423 |
| Diluted weighted average shares outstanding | 42,156 | 44,153 | 43,189 | 43,742 |
| Earnings per share: | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Basic | $ | 0.31 | $ | 0.31 | $ | 0.96 | $ | 0.73 |
| Diluted | $ | 0.30 | $ | 0.30 | $ | 0.92 | $ | 0.69 |

Stock options to purchase approximately 3,406,000 shares and 2,098,000 shares of common stock were excluded from the calculation of diluted earnings per share in the third quarter of fiscal years 2008 and 2007, respectively,

because these options were anti-dilutive. Stock options to purchase approximately 2,945,000 shares and 2,406,000 shares of common stock were excluded from the calculation of diluted earnings per share in the first nine 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.

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

*(In thousands)*

| | Three Months Ended Aug. 31, | | Nine Months Ended Aug. 31, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Cost of software licenses | $ 12 | $ 24 | $ 48 | $ 97 |
| Cost of maintenance and services | 212 | 286 | 705 | 1,148 |
| Sales and marketing | 1,335 | 1,499 | 4,184 | 5,997 |
| Product development | 881 | 960 | 2,737 | 3,810 |
| General and administrative | 1,092 | 1,409 | 3,938 | 5,534 |
| Total stock-based compensation expense | $3,532 | $4,178 | $11,612 | $16,586 |

**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.

**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)*

| | | Fair Value Measurements at the Reporting Date Using | | |
|---|---|---|---|---|
| Description | August 31, 2008 | 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 | $ 70,720 | $ 19,194 | | $ 51,526 |
| Investment in IONA | 7,201 | 7,201 | | |
| Foreign exchange derivatives | 820 | | $ 820 | |
| Total | $ 78,741 | $ 26,395 | $ 820 | $ 51,526 |

We have reclassified our investments related to auction rate securities (ARS) to the Level 3 category, which total $51.5 million and are classified as non-current. During the first quarter of fiscal 2008, 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 2008, 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. During the third quarter, investments totaling $17.2 million were either redeemed at par by the issuer or sold at a successful auction, reducing the par value of our ARS investments to $54.4 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, 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:

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*(In thousands)*

| | Available For-sale Securities |
|---|---|
| Balance, December 1, 2007 and February 29, 2008 | $ |
| Transfers from Level 2 | 109,800 |
| Redemptions and sales | (38,245) |
| Unrealized losses included in accumulated other comprehensive income | (3,864) |
| Balance, May 31, 2008 | 67,691 |
| Redemptions and sales | (17,155) |
| Reduction in the unrealized loss included in accumulated other comprehensive income | 990 |
| Balance, August 31, 2008 | $ 51,526 |

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 $51.5 million, and we recorded a temporary impairment charge of $2.9 million to reduce the value of our ARS. Based on our cash and short-term investments balance of $231.5 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. 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 in our results of operations.

**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 Aug. 31, | | Nine Months Ended Aug. 31, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net income, as reported | $ 12,537 | $ 13,047 | $ 39,844 | $ 30,176 |
| Foreign currency translation adjustments, net of tax | (3,172) | 364 | (1,873) | 1,582 |
| Unrealized gains (losses) on investments, net of tax | 946 | 51 | (1,455) | 17 |
| Total comprehensive income | $ 10,311 | $ 13,462 | $ 36,516 | $ 31,775 |

**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 3,752,000 shares of our common stock for $108.3 million in the first nine months of fiscal 2008 as compared to approximately 705,000 shares of our common stock for $19.5 million in the first nine months of fiscal 2007. In September 2008, the Board of Directors authorized, for the period from October 1, 2008 through September 30, 2009, 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.


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**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, excluding a preliminary allocation of $2.2 million of goodwill related to the Mindreef acquisition which occurred in June 2008, $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 $30.4 million to the other operating segment. See Note 11 for a description of the current year acquisitions and 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 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 Apama Division, the DataXtend Division and the EasyAsk Division.

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, other income or provision for income taxes by segment. We manage such items on a consolidated company basis.

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

| *(In thousands)* | Three months ended, Aug. 31, 2008 | Nine months ended, Aug. 31, 2008 |
|---|---|---|
| Revenue: | | |
| OpenEdge and SOA segment | $ 100,306 | $ 302,173 |
| DataDirect Technologies segment | 20,068 | 54,678 |
| Other segment | 9,963 | 26,016 |
| Reconciling items | (3,717) | (6,738) |
| Total | $ 126,620 | $ 376,129 |
| Income (loss) from operations: | | |
| OpenEdge and SOA segment | $ 25,045 | $ 85,258 |
| DataDirect Technologies segment | 2,865 | 5,434 |
| Other segment | (1,118) | (6,172) |
| Reconciling items | (8,685) | (28,661) |

| | | |
|---|---|---|
| Total | $ 18,107 | $ 55,859 |

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.

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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:

*(In thousands)*

| | Three Months Ended Aug. 31, | | Nine Months Ended Aug. 31, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| DataDirect | $ 20,068 | $ 16,996 | $ 54,678 | $ 50,191 |
| Enterprise Infrastructure | 25,140 | 22,511 | 69,936 | 60,527 |
| Progress OpenEdge and other | 81,412 | 82,297 | 251,515 | 245,957 |
| Total revenue | $ 126,620 | $ 121,804 | $ 376,129 | $ 356,675 |

**Note 11: Acquisitions**

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 providing data access and integration for service oriented architectures. 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.
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 $6.0 million, net of cash acquired. Mindreef develops and sells quality assurance and validation solutions for SOA deployments. The purpose of the acquisition was to expand the capabilities of our Actional product-line. The Mindreef assets were combined with our OpenEdge and SOA segment. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations of Mindreef in our operating results from June 13, 2008, the date of acquisition. As of August 31, 2008, we accrued transaction costs related to this acquisition of $0.3 million of direct acquisition costs. We paid the purchase price in cash from available funds.
For both acquisitions, we obtained a valuation from an independent appraiser for the amounts assigned to intangible assets. The preliminary allocation of the purchase price for the two acquisitions as of August 31, 2008 was as follows:

*(In thousands)*

| | Total | Life (in years) |
|---|---|---|
| Assets and liabilities, including cash | $ (905) | |
| Acquired intangible assets | 8,020 | 3 to 8 years |
| Goodwill (tax deductible) | 2,175 | |
| Goodwill (not deductible for tax purposes) | 4,204 | |
| Deferred tax liabilities | (1,258) | |
| Total purchase price | 12,236 | |

| | |
|---|---|
| Less: cash acquired | (478) |
| Net cash paid | $ 11,758 |

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Pro forma financial information has not been presented as the historical operations of the acquired companies were not significant to our consolidated financial statements either individually or in the aggregate.

**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 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.

On September 25, 2008, the United States District Court for the District of Massachusetts entered an order approving publication of a notice of settlement related to a Stipulation of Settlement (the Settlement Agreement ) entered into on September 5, 2008 by us which, if finally judicially approved, will resolve all pending shareholder derivative lawsuits relating to our historical stock option-granting practices. On September 18, 2008, the Massachusetts Superior Court entered an order approving the publication of a notice of proposed settlement (subject to the federal court s approval of the notice) and scheduled a hearing for December 2, 2008 to determine whether to approve the settlement.

Under the terms of the Settlement Agreement, which we entered into on the determination of the Special Litigation Committee of our Board of Directors, we have agreed to make certain corporate governance changes principally relating to stock option-granting procedures. The Settlement Agreement also reflects that eight of the individual defendants, previously (i) amended any below-market, unexercised stock options they received to increase the exercise prices to an amount equal to the fair market value of our common stock as of the actual measurement dates of those options for accounting and tax purposes, and (ii) with respect to restated stock options previously exercised, paid us the amount by which the fair market value of those options exceeded the exercise price on the measurement date for accounting and tax purposes, reduced by the amount of any federal and state taxes already paid by those individuals in connection with such exercises. The total amount of the above-described reimbursements is valued at approximately $7.0 million (net of tax payments), based on the transfer of shares of our common stock, the cancellation of vested stock options, the repricing of unexercised stock options and cash consideration. The Settlement Agreement also provides for us or our insurers to pay up to $1.9 million to plaintiffs attorneys for their fees and expenses, subject to court approval of these fees and expenses. Except as described above, we and the individual defendants in these lawsuits agreed to the terms of the Settlement Agreement without admitting any liability, fault or wrongdoing or incurring any additional liability of any kind.

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 September 12, 2008, we completed the acquisition of IONA Technologies PLC (IONA) for $4.05 per share in cash. This represents an aggregate purchase price of approximately $123 million, net of cash acquired. As of August 31, 2008, we owned 362,000 shares of IONA common stock and had an economic interest, through contracts for difference, in 1,443,000 shares of IONA common stock. Such equity was purchased in the second fiscal quarter and represents approximately 5% of the issued share capital of IONA. We will account for the acquisition as a purchase and accordingly, we will include the results of operations of IONA in our operating results from September 12, 2008, the date of acquisition. We paid the purchase price in cash from available funds. We anticipate that we will incur a restructuring charge in the fourth quarter primarily relating to severance costs associated with reductions in our workforce being made in connection with our transition and integration of IONA and our on-going cost management and strategic alignment activities. We also expect to incur acquisition-related expenses, primarily in-process research and development and restructuring costs, as a result of the acquisition. We anticipate that the restructuring charge and the acquisition related expenses will be approximately $12 million.

## 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 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

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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 three quarters 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:

- Revenue recognition
- Allowance for doubtful accounts
- Goodwill and intangible assets
- Income tax accounting
- Stock-based compensation
- Investments in debt securities

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.

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

Goodwill and Intangible Assets We had goodwill and net intangible assets of approximately $210 million at August 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 $29 million at August 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 would occur.

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 August 31, 2008, we had approximately $52 million in investments related to auction rate securities (ARS), all of which are classified as non-current. 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

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for each security. Based on this methodology, we determined that the fair value of our ARS investments is $52 million, and we recorded a temporary impairment charge of $3 million to reduce the value of our ARS. Based on our cash and short-term investments balance 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. 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, or they are redeemed by the issuer. As such, certain of these investments currently lack short-term liquidity and were therefore reclassified as non-current on our balance sheet. If we used different assumptions and judgment determinations or 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 | | Nine Months Ended | | Three | Nine |
| | Aug. 31, 2008 | Aug. 31, 2007 | Aug. 31, 2008 | Aug. 31, 2007 | Month Period | Month Period |
| Revenue: | | | | | | |
| Software licenses | 36% | 36% | 36% | 37% | 5% | 2% |
| Maintenance and services | 64 | 64 | 64 | 63 | 4 | 7 |
| Total revenue | 100 | 100 | 100 | 100 | 4 | 5 |
| Costs of revenue: | | | | | | |
| Cost of software licenses | 3 | 2 | 2 | 2 | 53 | 36 |
| Cost of maintenance and services | 13 | 14 | 14 | 14 | (2) | 4 |
| Amortization of acquired intangibles for purchased technology | 2 | 2 | 2 | 2 | 19 | 13 |
| Total costs of revenue | 18 | 18 | 18 | 18 | 6 | 8 |
| Gross profit | 82 | 82 | 82 | 82 | 4 | 5 |
| Operating expenses: | | | | | | |
| Sales and marketing | 38 | 39 | 38 | 39 | 2 | 3 |
| Product development | 17 | 16 | 17 | 17 | 6 | 2 |
| General and administrative | 12 | 11 | 11 | 13 | 13 | (8) |
| Amortization of other acquired intangibles | 1 | 2 | 1 | 1 | (25) | (29) |
| Total operating expenses | 68 | 68 | 67 | 70 | 4 | 0 |
| Income from operations | 14 | 14 | 15 | 12 | 2 | 35 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other income | 2 | 2 | 2 | 1 | 16 | 58 |
| Income before provision for taxes | 16 | 16 | 17 | 13 | 3 | 37 |
| Provision for income taxes | 6 | 6 | 6 | 5 | 17 | 47 |
| Net income | 10% | 10% | 11% | 8% | (4)% | 32% |

*Revenue.* Our total revenue increased 4% from $121.8 million in the third quarter of fiscal 2007 to $126.6 million in the third quarter of fiscal 2008. Total revenue would have decreased by 1% if exchange rates had been constant in the third quarter of fiscal 2008 as compared to exchange rates in effect in the third quarter of fiscal 2007. Total revenue increased 5% from $356.7 million in the first nine months of fiscal 2007 to $376.1 million in the first nine months of fiscal 2008. Total revenue would have been flat if exchange rates had been constant in the first nine months of fiscal 2008 as compared to exchange rates in effect in the first nine months of fiscal 2007.

Revenue from our Progress OpenEdge product line decreased 1% from $82.3 million in the third quarter of fiscal 2007 to $81.4 million in the third quarter of fiscal 2008 and increased 2% from $246.0 million in the first nine months of fiscal 2007 to $251.5 million in the first nine months of fiscal 2008. Revenue derived from our Enterprise

Infrastructure product lines increased 12% from $22.5 million in the third quarter of fiscal 2007 to $25.1 million in the third quarter of fiscal 2008 and increased 16% from $60.5 million in the first nine months of fiscal 2007 to $69.9 million in the first nine months of fiscal 2008. Revenue from our DataDirect product line increased 18% from $17.0 million in the third quarter of fiscal 2007 to $20.1 million in the third quarter of fiscal 2008 and increased 9% from $50.2 million in the first nine months of fiscal 2007 to $54.7 million in the first nine months of fiscal 2008.

Software license revenue increased 5% from $44.0 million in the third quarter of fiscal 2007 to $46.0 million in the third quarter of fiscal 2008. Software license revenue would have increased by 1% if exchange rates had been constant in the third quarter of fiscal 2008 as compared to exchange rates in effect in the third quarter of fiscal 2007. Excluding the impact of changes in exchange rates, the increase in software license revenue in the third quarter was due to an increase in our Enterprise Infrastructure product lines, especially Apama and DataXtend products, and our DataDirect product line, partially offset by a decrease in our OpenEdge product line. Software license revenue increased 2% from $133.3 million in the first nine months of fiscal 2007 to $136.1 million in the first nine months of fiscal 2008. Software license revenue would have decreased by 2% if exchange rates had been constant in the first nine months of fiscal 2008 as compared to exchange rates in effect in the first nine months of fiscal 2007. Excluding the impact of changes in exchange rates, the decrease in software license revenue was due to a decrease in our OpenEdge product line partially offset by increases in our Enterprise Infrastructure and DataDirect product lines.

Maintenance and services revenue increased 4% from $77.8 million in the third quarter of fiscal 2007 to $80.6 million in the third quarter of fiscal 2008. Maintenance and services revenue would have decreased by 2% if exchange rates had been constant in the third quarter of fiscal 2008 as compared to exchange rates in effect in the third quarter of fiscal 2007. Maintenance and services revenue increased 7% from $223.4 million in the first nine months of fiscal 2007 to $240.0 million in the first nine months of fiscal 2008. Maintenance and services revenue would have increased by 1% if exchange rates had been constant in the first nine months of fiscal 2008 as compared to exchange rates in effect in the first nine 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. Professional services revenue decreased in the third quarter and first nine months of fiscal 2008 as compared to the third quarter and first nine months of fiscal 2007, respectively. The decrease was due in part to a few large engagements that were substantially completed in early fiscal 2008.

Total revenue generated in markets outside North America increased 9% from $69.0 million in the third quarter of fiscal 2007 to $74.9 million in the third quarter of fiscal 2008 and represented 57% of total revenue in the third quarter of fiscal 2007 and 59% of total revenue in the third 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 third quarter of fiscal 2008 as compared to the third 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 third quarter of fiscal 2008 as compared to the exchange rates in effect in the third quarter of fiscal 2007.

Total revenue generated in markets outside North America increased 10% from $202.1 million in the first nine months of fiscal 2007 to $222.6 million in the first nine months of fiscal 2008 and represented 57% of total revenue in the first nine months of fiscal 2007 and 59% of total revenue in the first nine 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 nine months of fiscal 2008 as compared to the exchange rates in effect in the first nine 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 53% from $2.1 million in the third quarter of fiscal 2007 to $3.2 million in the third quarter of fiscal 2008, and increased as a percentage of software license revenue from 5% in the third quarter of fiscal 2007 to 7% in the third quarter of fiscal 2008. Cost of software licenses increased 36% from $5.7 million in the first nine months of fiscal 2007 to $7.7 million in the first nine months of fiscal 2008, and increased as a percentage of software licenses revenue from 4% in the first nine months of fiscal 2007 to 6% in the first nine months of fiscal 2008. The dollar increase for the third quarter and for the first nine 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 decreased 2% from $16.9 million in the third quarter of fiscal 2007 to $16.6 million in the third quarter of fiscal 2008, and decreased as a percentage of maintenance and services revenue from 22% in the third quarter of fiscal 2007 to 21% in the third quarter of fiscal 2008. Cost of maintenance and services increased 4% from $50.0 million in the first nine months of fiscal 2007 to $51.9 million in the first nine months of fiscal 2008, but remained the same percentage of maintenance and services revenue at 22%. The total dollar amount in the third quarter of fiscal 2008 decreased primarily due to a decrease in professional services revenue in the third quarter of fiscal 2008 compared to the third quarter of fiscal 2007. The total dollar amount in the first nine months of fiscal 2008 increased primarily due to higher headcounts and higher usage of third-party contractors for service engagements. Our technical support, education and consulting headcount increased by 4% from the end of the third quarter of fiscal 2007 to the end of the third 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 19% from $2.5 million in the third quarter of fiscal 2007 to $3.0 million in the third quarter of fiscal 2008. Amortization of acquired intangibles for purchased technology increased 13% from $7.5 million in the first nine months of fiscal 2007 to $8.4 million in the first nine months of fiscal 2008. The increase was due to amortization expense associated with the acquisitions of Xcalia and Mindreef in fiscal 2008.
*Gross Profit*. Our gross profit increased 4% from $100.3 million in the third quarter of fiscal 2007 to $103.9 million in the third quarter of fiscal 2008. Our gross profit increased 5% from $293.5 million in the first nine months of fiscal 2007 to $308.1 million in the first nine months of fiscal 2008. Our gross profit as a percentage of total revenue remained the same at 82% for each such period of fiscal 2007and fiscal 2008.
*Sales and Marketing.* Sales and marketing expenses increased 2% from $47.6 million in the third quarter of fiscal 2007 to $48.4 million in the third quarter of fiscal 2008, but decreased as a percentage of total revenue from 39% to 38%. Sales and marketing expenses increased 3% from $138.0 million in the first nine months of fiscal 2007 to $142.4 million in the first nine months of fiscal 2008, but decreased as a percentage of total revenue from 39% to 38%. The increase in sales and marketing expenses was due to higher average costs per employee in selling, partially offset by a decrease in marketing program expenses. Our sales support and marketing headcount increased by 1% from the end of the third quarter of fiscal 2007 to the end of the third quarter of fiscal 2008.
*Product Development.* Product development expenses increased 6% from $19.8 million in the third quarter of fiscal 2007 to $21.1 million in the third quarter of fiscal 2008, and increased as a percentage of revenue from 16% to 17%. Product development expenses increased 2% from $61.0 million in the first nine months of fiscal 2007 to $62.3 million in the first nine months of fiscal 2008, but remained the same as a percentage of total revenue at 17%. The dollar increase in the first nine months of fiscal 2008 as compared to the first nine months of fiscal 2007 was primarily due to expenses related to the development teams associated with the acquisitions of Xcalia and Mindreef during 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 7% from the end of the third quarter of fiscal 2007 to the end of the third quarter of fiscal 2008, primarily due to our acquisitions of Xcalia and Mindreef.
*General and Administrative.* General and administrative expenses include the costs of our finance, human resources, legal, information systems and administrative departments. General and administrative expenses increased 13% from $13.2 million in the third quarter of fiscal 2007 to $15.0 million in the third quarter of fiscal 2008, and increased as a percentage of revenue from 11% to 12%. General and administrative expenses decreased 8% from $47.2 million in the first nine months of fiscal 2007 to $43.5 million in the first nine months of fiscal 2008, and decreased as a percentage of revenue from 13% to 11%. The dollar decrease for the first nine months of fiscal 2008 compared to fiscal 2007 was primarily due to lower stock-based compensation and professional services fees

associated with the investigation and shareholder derivative lawsuits related to our historical stock option grant practices and lower headcount. Our administrative headcount decreased 3% from the end of the third quarter of fiscal 2007 to the end of the third 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 $1.8 million in the third quarter of fiscal 2007 to $1.4 million in the third quarter of fiscal 2008. Amortization of other acquired intangibles decreased from $5.7 million in the first nine months of fiscal 2007 to $4.1 million in the first nine months of fiscal 2008. The decrease in both periods was related to certain intangibles from prior acquisitions becoming fully amortized, partially offset by amortization expense related to intangible assets acquired in the Xcalia and Mindreef acquisitions.

*Income From Operations*. Income from operations increased 2% from $17.8 million in the third quarter of fiscal 2007 to $18.1 million in the third quarter of fiscal 2008 and decreased as a percentage of total revenue from 15% in the third quarter of fiscal 2007 to 14% in the third quarter of fiscal 2008. Income from operations increased 35% from $41.4 million in the first nine months of fiscal 2007 to $55.9 million in the first nine months of fiscal 2008 and increased as a percentage of total revenue from 12% in the first nine months of fiscal 2007 to 15% in the first nine months of fiscal 2008 for the reasons set forth above.

*Other Income*. Other income, consisting of interest income and foreign currency gains and losses, increased 16% from $2.3 million in the third quarter of fiscal 2007 to $2.6 million in the third quarter of fiscal 2008. Other income increased 58% from $5.0 million in the first nine months of fiscal 2007 to $7.9 million in the first nine months of fiscal 2008. The increase in the three and nine months ended in August, 2008 compared to the same periods ended in August, 2007 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 38% in the first nine months of fiscal 2008 as compared to 35% in the first nine 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, an increase in the estimate of expected taxes on foreign income and lower estimates of tax exempt interest income.

**Liquidity and Capital Resources**

At the end of the third quarter of fiscal 2008, our cash and short-term investments totaled $231.5 million. The decrease of $108.1 million since the end of fiscal 2007 resulted primarily from purchases of our common stock, the reclassification of ARS to non-current investments (see below), and cash used for acquisitions, partially offset by cash generated from operations and proceeds from issuances of common stock.

In addition to the $231.5 million of cash and short-term investments, we had $51.5 million in investments related to ARS that are classified as non-current. Our ARS are floating rate securities with longer-term maturities that 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 2008, 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 and third quarters, investments totaling $55.4 million were either redeemed at par by the issuer or sold at a successful auction, reducing the par value of our ARS investments to $54.4 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, 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 $51.5 million, and we recorded a temporary impairment charge in accumulated other comprehensive income of $2.9 million to reduce the value of our ARS. Based on our cash and short-term investments balance of $231.5 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. 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.

We generated $60.4 million in cash from operations in the first nine months of fiscal 2008 as compared to $71.8 million in the first nine months of fiscal 2007. The decrease in cash generated from operations in the first nine months of fiscal 2008 over the first nine months of fiscal 2007 was primarily due to timing of collections of accounts receivables and an increase in estimated tax payments.

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

| *(In thousands)* | Nine Months Ended August 31, | |
|---|---|---|
| | 2008 | 2007 |
| Net income | $ 39,844 | $ 30,176 |
| Depreciation, amortization and other noncash charges | 31,997 | 39,607 |
| Tax benefit from stock plans | 787 | 556 |
| Changes in operating assets and liabilities | (12,191) | 1,497 |
| Total | $ 60,437 | $ 71,836 |

Accounts receivable decreased by $3.8 million from the end of fiscal 2007. Accounts receivable days sales outstanding, or DSO, increased two days to 64 days at the end of the third quarter of fiscal 2008 as compared to the end of fiscal 2007 and increased by eight days from 56 days at the end of the third quarter of fiscal 2007. We target a DSO range of 60 to 80 days.

We purchased property and equipment totaling $6.0 million in the first nine months of fiscal 2008 as compared to $14.6 million in the first nine months of fiscal 2007. The purchases consisted primarily of computer equipment and software and building and leasehold improvements. The decrease primarily related to higher expenditures associated with our ERP implementation in the first nine months of fiscal 2007 as compared to the first nine months of fiscal 2008.

On February 5, 2008, we acquired, through a wholly-owned subsidiary, the stock of Xcalia for an aggregate purchase price of $5.7 million, net of cash acquired. Xcalia is a leader in providing data access and integration for service oriented architectures. 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.

On June 13, 2008, we acquired substantially all of the assets and assumed certain liabilities of Mindreef for an aggregate purchase price of approximately $6.0 million, net of cash acquired. Mindreef develops and sells quality assurance and validation solutions for SOA deployments. The purpose of the acquisition was to expand the capabilities of our Actional product-line. The Mindreef assets were combined with our OpenEdge and SOA segment. We accounted for the acquisition as a purchase, and accordingly, we included the results of operations of Mindreef in

our operating results from June 13, 2008, the date of acquisition. As of August 31, 2008, we accrued transaction costs related to this acquisition of $0.3 million of direct acquisition costs. We paid the purchase price in cash from available funds.

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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 3,752,000 shares of our common stock for $108.3 million in the first nine months of fiscal 2008 as compared to approximately 705,000 shares of our common stock for $19.5 million in the first nine months of fiscal 2007. In September 2008, the Board of Directors authorized, for the period from October 1, 2008 through September 30, 2009, 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 received $21.7 million in the first nine months of fiscal 2008 from the exercise of stock options and the issuance of shares under our Employee Stock Purchase Plan as compared to $24.7 million in the first nine months of fiscal 2007.

On September 12, 2008, following the receipt of all required regulatory and shareholder approvals, we completed the acquisition of IONA Technologies PLC (IONA) for $4.05 per share in cash. This represents an aggregate purchase price of approximately $123 million, net of cash acquired. As of August 31, 2008, we owned 362,000 shares of IONA common stock and had an economic interest, through contracts for difference, in 1,443,000 shares of IONA common stock. Such equity was purchased in the second fiscal quarter and represents approximately 5% of the issued share capital of IONA with a total purchase price of $6.7 million. We will account for the acquisition as a purchase and accordingly, we will include the results of operations of IONA in our operating results from September 12, 2008, the date of acquisition. We paid the purchase price in cash from available funds. We anticipate that we will incur a restructuring charge in the fourth quarter primarily relating to severance costs associated with reductions in our workforce being made in connection with our transition and integration of IONA and our on-going cost management and strategic alignment activities. We also expect to incur acquisition related expenses, primarily in-process research and development and restructuring costs, as a result of the acquisition. We anticipate that the restructuring charge and the acquisition related expenses will be approximately $12 million.

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

*Revenue Backlog* Our aggregate revenue backlog at August 31, 2008 was approximately $172 million, of which $147 million was included on our balance sheet as deferred revenue, primarily related to unexpired maintenance and support contracts. At August 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 August 31, 2007 was approximately $163 million, of which $139 million was included on our balance sheet as deferred revenue, primarily related to unexpired maintenance and support contracts. At August 31, 2007, the remaining amount of backlog of approximately $24 million was composed of multi-year licensing arrangements of approximately $20 million and open software license orders received but not shipped of approximately $4 million.

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.

**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 Financial Accounting Standards Board (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 September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands fair value measurement disclosures. In February 2008, the FASB issued FASB Staff Position No. FAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 and FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 . Collectively, the Staff Positions defer the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value on a recurring basis at least annually, and amend the scope of SFAS 157. We have adopted SFAS 157 except for those items specifically deferred under FSP No. FAS 157-2. We are currently evaluating the impact of the full adoption of SFAS 157 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS 160). The standard changes the accounting for noncontrolling (minority) interests in consolidated financial statements including the requirements to classify noncontrolling interests as a component of consolidated shareholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as a part of consolidated earnings. Additionally, SFAS 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. We are currently evaluating the impact of adopting SFAS 160 on our consolidated financial statements.

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 .

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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 the impact of adopting SFAS 161 on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS 142-3, Determination of the Useful Life of Intangible Assets . FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets . FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and early adoption is prohibited. We are currently evaluating the impact of adopting FSP FAS 142-3 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 the discussion concerning ARS in Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations under the section entitled, 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 $0.8 million (and a notional value of $129.6 million) at August 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 $0.1 million and $(0.1) million at August 31, 2008 and August 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.

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The table below details outstanding forward contracts, which mature in 90 days or less, at August 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 | | $ 8,207 | 1.16 |
| Brazilian real | $ 9,196 | | 1.64 |
| Euro | | 48,180 | 0.68 |
| Japanese yen | 4,027 | | 109.27 |
| South African rand | 322 | | 7.77 |
| U.K. pound | | 30,586 | 0.55 |
| | $ 13,545 | $ 86,973 | |

* 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 August 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 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.

On September 25, 2008, the United States District Court for the District of Massachusetts entered an order approving publication of a notice of settlement related to a Stipulation of Settlement (the Settlement Agreement ) entered into on September 5, 2008 by us which, if finally judicially approved, will resolve all pending shareholder derivative lawsuits relating to our historical stock option-granting practices. On September 18, 2008, the Massachusetts Superior Court entered an order approving the publication of a notice of proposed settlement (subject to the federal court s approval of the notice) and scheduled a hearing for December 2, 2008 to determine whether to approve the settlement.

Under the terms of the Settlement Agreement, which we entered into on the determination of the Special Litigation Committee of our Board of Directors, we have agreed to make certain corporate governance changes principally relating to stock option-granting procedures. The Settlement Agreement also reflects that eight of the individual defendants, previously (i) amended any below-market, unexercised stock options they received to increase the exercise prices to an amount equal to the fair market value of our common stock as of the actual measurement dates of those options for accounting and tax purposes, and (ii) with respect to restated stock options previously exercised, paid us the amount by which the fair market value of those options exceeded the exercise price on the measurement date for accounting and tax purposes, reduced by the amount of any federal and state taxes already paid by those individuals in connection with such exercises. The total amount of the above-described reimbursements is valued at approximately $7.0 million (net of tax payments), based on the transfer of shares of our common stock, the cancellation of vested stock options, the repricing of unexercised stock options and cash consideration. The Settlement Agreement also provides for us or our insurers to pay up to $1.9 million to plaintiffs attorneys for their fees and expenses, subject to court approval of these fees and expenses. Except as described above, we and the individual defendants in these lawsuits agreed to the terms of the Settlement Agreement without admitting any liability, fault or wrongdoing or incurring any additional liability of any kind.

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,

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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 August 31, 2008, we had approximately $51.5 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 remaining funds until a future auction for these ARS is successful, we sell the securities in a secondary market, or they are redeemed by the issuer. In the first nine months of fiscal 2008, we recorded a temporary impairment charge in accumulated other comprehensive income of $2.9 million to reduce the value of our ARS investments. 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 acquisition of IONA Technologies PLC.*** On September 12, 2008, following the receipt of all required regulatory and shareholder approvals, we completed the acquisition of IONA. We face various risks in connection with our acquisition of IONA, including 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, diversion of management, uncertainties as to whether anticipated synergies will be realized and uncertainties as to whether IONA s business will be successfully integrated with our business. Any one or more of these factors could have a material adverse effect on the combined business, our results of operations and our financial condition.

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**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) |
|---|---|---|---|---|
| June 1, 2008 June 30, 2008 | 136 | $ 25.82 | 136 | 7,200 |
| July 1, 2008 July 31, 2008 | 1,528 | $ 27.41 | 1,528 | 5,672 |
| Aug. 1, 2008 Aug. 31, 2008 | | | | |
| Total | 1,664 | $ 27.28 | 1,664 | 5,672 |

(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.

**Item 6. Exhibits**

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

| **Exhibit No.** | **Description** |
|---|---|
| 2.1 | Implementation Agreement, dated as of June 25, 2008, by and among IONA Technologies PLC, SPK Acquisitions Limited and Progress Software Corporation (1) |
| 2.2 | Deed of Limited Guaranty, dated as of June 25, 2008, by and among IONA Technologies PLC and Progress Software Corporation (1) |
| 2.3 | |

| | | |
|---|---|---|
| | Expenses Reimbursement and Non-Solicitation Agreement, dated as of June 25, 2008, by and among IONA Technologies PLC, SPK Acquisitions Limited and Progress Software Corporation (1) | |
| 2.4 | Form of Voting Undertaking executed by members of the IONA Board of Directors (1) | |
| 2.5 | Voting Undertaking, dated June 25, 2008, by Progress Software Corporation (1) | |
| 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 | |

(1) Incorporated by reference to our Current Report on Form 8-K filed on June 26, 2008

* Filed herewith

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**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: October 10, 2008

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

Dated: October 10, 2008

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

Dated: October 10, 2008

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