
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended May 31, 2002

OR

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

Commission File Number: 0-19417

PROGRESS SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

MASSACHUSETTS
(State or other jurisdiction of
incorporation or organization)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

As of July 9, 2002, there were 36,160,000 shares of the Registrant's Common Stock, \$.01 par value per share, outstanding.

TABLE OF CONTENTS

PART 1. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

RESULTS OF OPERATIONS

PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

SIGNATURES

EX-10.10 NONQUALIFIED STOCK OPTION PLAN

PROGRESS SOFTWARE CORPORATION
FORM 10-Q
FOR THE THREE MONTHS ENDED MAY 31, 2002

INDEX

PART I FINANCIAL INFORMATION

Item 1.	Condensed Consolidated Financial Statements	3
	Condensed Consolidated Balance Sheets as of May 31, 2002 and November 30, 2001.	3
	Condensed Consolidated Statements of Operations for the three month and six month periods ended May 31, 2002 and 2001.	4
	Condensed Consolidated Statements of Cash Flows for the six months ended May 31, 2002 and 2001.	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	10
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	19

PART II OTHER INFORMATION

Item 4.	Submission of Matters to a Vote of Security Holders	20
Item 6.	Exhibits and Reports on Form 8-K	20
	Signatures	21

[Table of Contents](#)**PART 1. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****Consolidated Balance Sheets (unaudited)***(In thousands, except share data)*

	May 31, 2002	November 30, 2001
Assets		
Current assets:		
Cash and equivalents	\$124,530	\$108,337
Short-term investments	66,591	66,179
Accounts receivable (less allowances of \$7,408 in 2002 and \$6,333 in 2001)	46,085	54,230
Other current assets	11,827	11,067
Deferred income taxes	9,845	9,632
Total current assets	258,878	249,445
Property and equipment, net	36,200	36,990
Other assets	11,473	12,945
Total	\$306,551	\$299,380
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 8,811	\$ 10,386
Accrued compensation and related taxes	17,446	20,146
Income taxes payable	8,843	8,886
Other accrued liabilities	9,653	10,323
Deferred revenue	69,096	64,463
Total current liabilities	113,849	114,204
Commitments and contingent liabilities		
Shareholders' equity:		
Common stock, \$.01 par value, and additional paid-in capital; authorized, 100,000,000 shares; issued and outstanding, 35,733,586 in 2002 and 35,621,071 shares in 2001	43,960	42,382
Retained earnings, including accumulated other comprehensive loss of \$2,771 in 2002 and \$2,720 in 2001	148,742	142,794
Total shareholders' equity	192,702	185,176
Total	\$306,551	\$299,380

See notes to condensed consolidated financial statements.

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2002	2001	2002	2001
Revenue:				
Software licenses	\$23,023	\$24,266	\$ 45,500	\$ 46,100
Maintenance and services	44,279	41,462	86,050	79,867
Total revenue	67,302	65,728	131,550	125,967
Costs and expenses:				
Cost of software licenses	2,586	2,760	5,468	5,147
Cost of maintenance and services	14,126	13,494	28,141	26,395
Sales and marketing	24,456	24,864	50,435	50,696
Product development	10,563	10,393	21,281	20,716
General and administrative	7,153	7,062	14,540	14,401
Total costs and expenses	58,884	58,573	119,865	117,355
Income from operations	8,418	7,155	11,685	8,612
Other income (expense):				
Interest income	1,121	1,748	2,214	3,752
Investment impairment charge	(1,000)	—	(1,000)	—
Foreign currency losses	(346)	(711)	(1,177)	(1,209)
Other	38	19	25	(70)
Total other income (expense), net	(187)	1,056	62	2,473
Income before provision for income taxes	8,231	8,211	11,747	11,085
Provision for income taxes	2,469	2,545	3,524	3,436
Net income	\$ 5,762	\$ 5,666	\$ 8,223	\$ 7,649
Earnings per share:				
Basic	\$ 0.16	\$ 0.16	\$ 0.23	\$ 0.22
Diluted	\$ 0.15	\$ 0.15	\$ 0.21	\$ 0.20
Weighted average shares outstanding:				
Basic	35,749	35,347	35,733	35,406
Diluted	39,117	38,144	39,259	38,268

See notes to condensed consolidated financial statements.

[Table of Contents](#)**Consolidated Statements of Cash Flows (unaudited)***(In thousands)*

	Six Months Ended May 31,	
	2002	2001
Cash flows from operating activities:		
Net income	\$ 8,223	\$ 7,649
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,358	6,022
Investment impairment charge	1,000	—
Deferred income taxes and other	(172)	35
Changes in operating assets and liabilities:		
Accounts receivable	8,887	2,218
Other current assets	(804)	394
Accounts payable and accrued expenses	(4,961)	(4,558)
Income taxes payable	1,060	(3,465)
Deferred revenue	3,638	8,717
Net cash provided by operating activities	<u>22,229</u>	<u>17,012</u>
Cash flows from investing activities:		
Purchases of investments available for sale	(12,916)	(17,931)
Maturities of investments available for sale	12,356	17,253
Purchases of property and equipment	(3,961)	(4,375)
Capitalized software costs	—	(96)
Increase in other non-current assets	(19)	(89)
Net cash used for investing activities	<u>(4,540)</u>	<u>(5,238)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock	4,838	6,362
Repurchase of common stock	(6,683)	(8,457)
Net cash used for financing activities	<u>(1,845)</u>	<u>(2,095)</u>
Effect of exchange rate changes on cash	349	(2,228)
Net increase in cash and equivalents	16,193	7,451
Cash and equivalents, beginning of period	108,337	90,722
Cash and equivalents, end of period	<u>\$124,530</u>	<u>\$ 98,173</u>

See notes to condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by Progress Software Corporation (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2001.

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

Note 2: Revenue Recognition

Revenue is recognized when earned. Software license revenue is recognized upon shipment of the product provided that the license fee is fixed and determinable, persuasive evidence of an arrangement exists and collection is probable. The Company does not license its software with a right of return and generally does not license its software with conditions of acceptance. If an arrangement does contain conditions of acceptance, recognition of the revenue is deferred until the acceptance criteria are met or the period of acceptance has passed. The Company generally recognizes revenue for products distributed through indirect channels, including independent software vendors, original equipment manufacturers and distributors, when sold through to the end user.

Software licenses sold together with maintenance and/or consulting services are generally recognized upon shipment using the residual method, provided that the above criteria have been met. If payment of the software license fees is dependent upon the performance of consulting services or the consulting services are essential to the functionality of the licensed software, then both the software license and consulting fees are recognized under the percentage-of-completion method of contract accounting.

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

Note 3: Income Taxes

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

Note 4: Investment in Related Party

The Company holds a minority interest in EasyAsk, Inc., a privately-held software company whose chairman is on the board of directors of the Company. In the second quarter of fiscal 2002, the Company recorded an impairment charge of \$1.0 million related to this investment. The Company regularly monitors the carrying value of its investment in EasyAsk. Recent events and market conditions indicated that a decline in the value of the investment was other than temporary. EasyAsk is in the process of completing its next round of financing and based on the expected valuation, the Company wrote down the carrying amount of its investment to the estimated fair value. The investment was valued at \$0.3 million at May 31, 2002 and is included in other assets.

Note 5: Earnings Per Share

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

<i>(In thousands, except per share data)</i> Three Months Ended May 31,	2002	2001
Net income	\$ 5,762	\$ 5,666
Weighted average shares outstanding	35,749	35,347
Dilutive impact from outstanding stock options	3,368	2,797
Diluted weighted average shares outstanding	39,117	38,144
Basic earnings per share	\$ 0.16	\$ 0.16
Diluted earnings per share	\$ 0.15	\$ 0.15
 <i>(In thousands, except per share data)</i> Six Months Ended May 31,		
Net income	\$ 8,223	\$ 7,649
Weighted average shares outstanding	35,733	35,406
Dilutive impact from outstanding stock options	3,526	2,862
Diluted weighted average shares outstanding	39,259	38,268
Basic earnings per share	\$ 0.23	\$ 0.22
Diluted earnings per share	\$ 0.21	\$ 0.20

Approximately 730,000 and 850,000 outstanding stock options were excluded from the calculation of diluted earnings per share in the three months ended May 31, 2002 and 2001, respectively, because these were anti-dilutive. However, these options could be dilutive in the future.

Note 6: Comprehensive Income

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

<i>(In thousands)</i> Three Months Ended May 31,	2002	2001
Net income	\$5,762	\$5,666
Foreign currency translation adjustments	(192)	(424)
Unrealized losses on foreign exchange hedging contracts	(315)	—
Unrealized holding gains on investments	529	74
Total comprehensive income	\$5,784	\$5,316

<i>(In thousands)</i> Six Months Ended May 31,	2002	2001
Net income	\$8,223	\$7,649
Foreign currency translation adjustments	(280)	(297)
Unrealized losses on foreign exchange hedging contracts	(315)	—
Unrealized holding gains on investments	544	513
Total comprehensive income	\$8,172	\$7,865

Note 7: Accounting Change

Effective December 1, 2001, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). This statement requires that goodwill and certain other intangibles no longer be amortized, but instead be tested for impairment at least annually. SFAS 142 also requires completion of a two-step transitional goodwill impairment test. In connection with the completion of the first step of its transitional analysis, the Company assigned goodwill to two reporting units, both of which are included in the E-Business Application Development & Deployment segment. Completion of the first step of the Company's analysis did not indicate impairment as the fair value of each reporting unit exceeded its carrying amount, which includes goodwill. As the first step did not indicate that any impairment existed, completion of the second step was not required. The Company will assess the impairment of goodwill on an annual basis or if other indicators of impairment arise.

Net income for the first six months of fiscal 2001, if adjusted to exclude amortization expense, net of taxes, would have increased by \$0.2 million to \$7.8 million and diluted earnings per share would have increased by \$0.01 to \$0.21.

During the first six months of fiscal 2002, no goodwill was acquired, impaired or written off. At May 31, 2002, goodwill, which is included in other assets, totaled approximately \$4.0 million.

At May 31, 2002, other acquired intangible assets, which are included in other assets and are all subject to amortization, were composed primarily of purchased technology and totaled \$0.7 million (net of accumulated amortization of \$0.2 million). These intangible assets are being amortized over an estimated useful life of three to four years with no expected residual value. Amortization expense related to these intangible assets was \$0.1 million for the six months ended May 31, 2002 and is estimated to be approximately \$0.1 million for the remainder of fiscal 2002 and \$0.2 million in each of fiscal years 2003 through 2005.

Note 8: Segment Information

The Company conducts business through three separate operating units and a supporting research and business development unit. The first operating unit conducts business as the Progress Company and provides OpenEdge, an e-business platform that includes the Progress RDBMS. The second operating unit, Sonic Software Corporation, is a provider of Web services and messaging software. The third operating unit, NuSphere Corporation, provides enhanced open source software and services. PSC Labs has responsibility for research and new business development activities.

Segment information is presented in accordance with SFAS 131, "Disclosures About Segments of an Enterprise and Related Information." This standard is based on a management approach, which requires

[Table of Contents](#)

segmentation based upon the Company's internal organization and disclosure of revenue and operating income based upon internal accounting methods.

Based upon the aggregation criteria for segment reporting, the Company has two reportable segments: E-Business Application Development & Deployment, which includes the Progress Company, NuSphere and PSC Labs, and E-Business Integration, which includes Sonic Software and certain Sonic-related international sales and marketing functions within the Progress Company. The Company does not internally report its assets, capital expenditures, interest income or provision for income taxes by segment.

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

(In thousands)

Three Months Ended May 31:	E-Business Application Development & Deployment	E-Business Integration	Eliminations	Total
2002:				
Revenue	\$64,291	\$ 3,447	\$(436)	\$67,302
Income (loss) from operations	\$13,050	\$(4,196)	\$(436)	\$ 8,418
2001:				
Revenue	\$64,835	\$ 1,117	\$(224)	\$65,728
Income (loss) from operations	\$13,339	\$(5,960)	\$(224)	\$ 7,155

(In thousands)

Six Months Ended May 31:	E-Business Application Development & Deployment	E-Business Integration	Eliminations	Total
2002:				
Revenue	\$126,846	\$ 5,641	\$(937)	\$131,550
Income (loss) from operations	\$ 21,487	\$ (8,865)	\$(937)	\$ 11,685
2001:				
Revenue	\$124,422	\$ 1,946	\$(401)	\$125,967
Income (loss) from operations	\$ 20,743	\$(11,730)	\$(401)	\$ 8,612

Amounts included under Eliminations represent intersegment sales. Total revenue from the Sonic product line, generated by both segments, was \$7.2 million in the first six months of fiscal 2002 as compared to \$2.9 million in the first six months of fiscal 2001.

Note 9: 2002 Nonqualified Stock Plan

In June 2002, the Board of Directors approved and adopted the 2002 Nonqualified Stock Plan, for which the approval of shareholders is not required. The total number of shares authorized for issuance under the plan is 3,500,000. Executive officers and directors are not eligible for awards under this plan. Awards under the plan may include non-qualified stock options, grants of conditioned stock, unrestricted grants of stock, grants of stock contingent upon the attainment of performance goals and stock appreciation rights.

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

Cautionary Statements

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

Critical Accounting Policies

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

The Company has identified the following critical accounting policies that require the use of significant judgments and estimates in the preparation of consolidated financial statements. This listing is not a comprehensive list of all of the Company's accounting policies. For further information regarding the application of these and other accounting policies, see the Notes to Condensed Consolidated Financial Statements in Item 1 of this Form 10-Q and Note 1 in the Notes to Consolidated Financial Statements in Item 8 of the Company's Annual Report on Form 10-K for the year ended November 30, 2001.

Revenue Recognition — The Company's revenue recognition policy is significant because revenue is a key component affecting operations. In addition, revenue recognition determines the timing of certain expenses, such as commissions and bonuses. While the Company follows specific and detailed rules and guidelines related to revenue recognition, significant management judgments and estimates must be made and used in connection with the revenue recognized in any reporting period, particularly in the area of collectibility. If management used different estimates or judgments, material differences in the timing of the recognition of revenue could occur.

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

[Table of Contents](#)

Investment in Related Party — The Company holds a minority interest in EasyAsk, Inc., a privately-held software company whose chairman is on the board of directors of the Company. In the second quarter of fiscal 2002, the Company recorded an impairment charge of \$1.0 million related to this investment. The investment was valued at \$0.3 million at May 31, 2002. The Company periodically considers available evidence in evaluating potential impairment of its investment in EasyAsk. Because no public market exists for this investment, the Company estimates its value based on potential financing valuations, the anticipated future performance of the company, as well as the external markets for these types of investments. If these estimates prove to be inaccurate, or in the event of future adverse changes in market conditions or poor operating results of the underlying company, an inability to recover the remaining carrying value of the investment could result, thereby possibly requiring an additional impairment charge.

Deferred Income Taxes — The Company has a net deferred tax asset of \$14.2 million at May 31, 2002. The Company records valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. The Company considers scheduled reversals of deferred tax liabilities, projected future taxable income, ongoing tax planning strategies and other matters in assessing the need for and the amount of a valuation allowance. If the Company were to change its assumptions or otherwise determine that it was unable to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period that such change or determination was made.

Overview

The Company develops, markets and supports application development, deployment, integration and management software. Its core product line, Progress, is composed primarily of the Progress ProVision, Progress RDBMS, Progress WebSpeed, Progress AppServer and Progress DataServer products. In May 2002, the Company began shipping the latest release of its Progress product line, Progress Version 9.1D. The Company began commercial shipments of the Sonic product line in December 1999 and shipped the latest release of SonicMQ in October 2001 and released SonicXQ in December 2001. Software license revenue continues to be generated primarily from internally developed products. The Company also resells, in connection with its own software, third-party products for reporting and business intelligence solutions. Geographic expansion in overseas markets has been achieved through a combination of establishing offices in new markets and the acquisition of Progress-related assets of certain distributors. Over the past several years, the Company's revenue and earnings per share have been adversely affected by the strengthening of the U.S. dollar against many of the major currencies from which a substantial portion of its international revenue is derived.

The Company conducts business through three separate operating units and a supporting research and business development unit. The first operating unit conducts business as the Progress Company and provides OpenEdge, an e-business platform that includes the Progress RDBMS. The second operating unit, Sonic Software Corporation, is a provider of Web services and messaging software. The third operating unit, NuSphere Corporation, provides enhanced open source software and services. PSC Labs is the unit that has responsibility for research and new business development activities.

Results of Operations

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

	Percentage of Total Revenue				Period-to-Period Change	
	Three Months Ended		Six Months Ended		Three Month Period	Six Month Period
	May 31, 2002	May 31, 2001	May 31, 2002	May 31, 2001		
Revenue:						
Software licenses	34%	37%	35%	37%	(5)%	(1)%
Maintenance and services	66	63	65	63	7	8
Total revenue	100	100	100	100	2	4
Costs and expenses:						
Cost of software licenses	4	4	4	4	(6)	6
Cost of maintenance and services	21	20	21	21	5	7
Sales and marketing	36	38	39	40	(2)	(1)
Product development	16	16	16	17	2	3
General and administrative	10	11	11	11	1	1
Total costs and expenses	87	89	91	93	1	2
Income from operations	13	11	9	7	18	36
Other income	(1)	1	0	2	(118)	(97)
Income before provision for taxes	12	12	9	9	0	6
Provision for income taxes	3	3	3	3	(3)	3
Net income	9%	9%	6%	6%	2%	8%

The Company's total revenue increased 2% from \$65.7 million in the second quarter of fiscal 2001 to \$67.3 million in the second quarter of fiscal 2002. Total revenue would have increased by 3% in the second quarter of fiscal 2002 as compared to the second quarter of fiscal 2001 if exchange rates had been constant in the second quarter of fiscal 2002 as compared to the exchange rates in effect in the second quarter of fiscal 2001.

The Company's total revenue increased 4% from \$126.0 million in the first six months of fiscal 2001 to \$131.6 million in the first six months of fiscal 2002. On a constant currency basis, total revenue for the first six months of fiscal 2002 would have increased by 6%.

Total revenue derived from the Sonic product line increased from \$1.8 million in the second quarter of fiscal 2001 to \$4.3 million in the second quarter of fiscal 2002 and increased from \$2.9 million in the first six months of fiscal 2001 to \$7.2 million in the first six months of fiscal 2002. The Sonic product line revenue total for the second quarter of fiscal 2002 included the recognition of \$1.8 million of deferred license revenue related to the expiration of one contract signed in a previous year. Revenue from the NuSphere product line in each period was not significant.

Software license revenue decreased 5% from \$24.3 million in the second quarter of fiscal 2001 to \$23.0 million in the second quarter of fiscal 2002. Software license revenue decreased 1% from \$46.1 million in the first six months of fiscal 2001 to \$45.5 million in the first six months of fiscal 2002. The decrease in software license revenue in the second quarter and first six months of fiscal 2002 was primarily due to a decline in sales to direct end user accounts, partially offset by an increase in revenue from Independent Software Vendors (ISVs), companies which have written software applications utilizing Progress Software technology and which resell the Company's products in conjunction with the sale of their applications. Software license revenue from the Progress product set decreased year over year, primarily within the database product and development products such as Progress ProVision. This decrease was partially offset by increases in revenue from new products such as the Sonic product line. In addition, the Company's license revenue was adversely affected by the year-over-year strengthening of the U.S. dollar.

[Table of Contents](#)

Maintenance and services revenue increased 7% from \$41.5 million in the second quarter of fiscal 2001 to \$44.3 million in the second quarter of fiscal 2002. Maintenance and services revenue increased 8% from \$79.9 million in the first six months of fiscal 2001 to \$86.1 million in the first six months of fiscal 2002. The increase in maintenance and services revenue was primarily the result of growth in the Company's installed customer base, renewal of maintenance contracts and growth in consulting revenue in the Europe, Middle East and Africa (EMEA) region. The maintenance and services revenue increase was partially offset by a decline in global education revenue and a decline in consulting revenue in North America and Asia Pacific. The decline in North America and Asia Pacific consulting revenue was primarily due to delays in new engagements, fewer projects as a result of economic conditions and a slower overall market for professional services.

Total revenue generated in markets outside North America increased 3% from \$40.1 million in the second quarter of fiscal 2001 to \$41.1 million in the second quarter of fiscal 2002 and represented 61% of total revenue in the second quarter of fiscal 2002, the same as in the second quarter of fiscal 2001. The dollar increase in revenue was the result of higher revenue in EMEA, partially offset by lower amounts from the Asia Pacific and Latin American regions. Total revenue generated in markets outside North America would have remained at 61% of total revenue in the second quarter of fiscal 2002 if exchange rates had been constant in the second quarter of fiscal 2002 as compared to the exchange rates in effect in the second quarter of fiscal 2001.

Total revenue generated in markets outside North America increased 3% from \$75.8 million in the first six months of fiscal 2001 to \$77.8 million in the first six months of fiscal 2002. Such revenue represented 59% of total revenue in the first six months of fiscal 2002 as compared to 60% in the first six months of fiscal 2001. Total revenue generated in markets outside North America would have represented 60% of total revenue in the first six months of fiscal 2002 if exchange rates had been constant as compared to the exchange rates in effect in the first six months of fiscal 2001.

The Company is planning for total revenue growth for all of fiscal 2002 in the range of 4% to 6%. The Company's expectation for fiscal 2002 revenue growth is based on a continued growth of revenue from the ISV channel, the Company's plans to generate additional software license and service revenue by focusing more of its selling efforts on end users, continued growth of new products and no strengthening of the U.S dollar. However, there can be no assurance that the Company will be successful in achieving its forecasts and plans or that other factors will not negatively impact its revenue.

Cost of software licenses consists primarily of cost of product media, documentation, duplication, packaging, royalties and amortization of capitalized software costs. Cost of software licenses decreased 6% from \$2.8 million in the second quarter of fiscal 2001 to \$2.6 million in the second quarter of fiscal 2002 and remained approximately the same percentage of software license revenue at 11%. Cost of software licenses increased 6% from \$5.1 million in the first six months of fiscal 2001 to \$5.5 million in the first six months of fiscal 2002 and increased as a percentage of software license revenue from 11% to 12%. The percentage and dollar increases for the six month periods were primarily due to higher royalty expense for products and technologies licensed from third parties, partially offset by lower amortization expense from previously capitalized software costs. Cost of software licenses as a percentage of software license revenue varies from period to period depending upon the relative product mix in a given period.

Cost of maintenance and services consists primarily of costs of providing customer technical support, education and consulting. Cost of maintenance and services increased 5% from \$13.5 million in the second quarter of fiscal 2001 to \$14.1 million in the second quarter of fiscal 2002, but decreased as a percentage of maintenance and services revenue from 33% to 32%. Cost of maintenance and services increased 7% from \$26.4 million in the first six months of fiscal 2001 to \$28.1 million in the first six months of 2002 and remained approximately the same percentage of maintenance and services revenue at 33%. The dollar increase was due to greater usage of third-party contractors for service engagements, partially offset by lower headcount in the professional services group. The Company's technical support, education, and consulting headcount decreased by 10% from the end of the second quarter of fiscal 2001 to the end of the second quarter of fiscal 2002.

[Table of Contents](#)

Sales and marketing expenses decreased 2% from \$24.9 million for the second quarter of fiscal 2001 to \$24.5 million in the second quarter of fiscal 2002 and decreased as a percentage of total revenue from 38% to 36%. Sales and marketing expenses decreased 1% from \$50.7 million in the first six months of fiscal 2001 to \$50.4 million in the first six months of fiscal 2002 and decreased as a percentage of total revenue from 40% to 39%. The dollar decrease in sales and marketing expenses was due to a 4% decrease in the sales, sales support and marketing headcount, partially offset by a slight increase in the level of discretionary marketing spending for trade shows, advertising campaigns, direct mail solicitations and other events. The percentage decrease was primarily due to the increase in revenue without the need for a commensurate change in sales and marketing expenses. For all of fiscal 2002, the Company expects to increase revenue at a higher rate of growth than sales and marketing expenses. However, there can be no assurance that the Company will be successful in achieving this goal.

Product development expenses increased 2% from \$10.4 million in the second quarter of fiscal 2001 to \$10.6 million in the second quarter of fiscal 2002, but remained the same percentage of total revenue at 16%. Product development expenses increased 3% from \$20.7 million in the first six months of fiscal 2001 to \$21.3 million in the first six months of fiscal 2002, but decreased as a percentage of total revenue from 17% to 16%. The dollar increase was primarily due to an increase in compensation-related expenses and greater use of outside contractors. The major product development efforts in the second quarter of fiscal 2002 primarily related to the development and enhancement of new products such as SonicXQ, SonicMQ, Fathom, Dynamics and the next release of the Company's principal product line, Progress Version 9. Software development costs capitalized in each period of fiscal 2001 and fiscal 2002 were insignificant due to the timing and stage of development of projects that might qualify for capitalization under the Company's software capitalization policy. The Company's product development headcount remained approximately the same from the end of the second quarter of fiscal 2001 to the end of the second quarter of fiscal 2002.

General and administrative expenses include the costs of the finance, human resources, legal, information systems and administrative departments of the Company. General and administrative expenses increased 1% from \$7.1 million in the second quarter of fiscal 2001 to \$7.2 million in the second quarter of fiscal 2002, but decreased as a percentage of total revenue from 11% to 10%. General and administrative expenses increased 1% from \$14.4 million in the first six months of fiscal 2001 to \$14.5 million in the first six months of fiscal 2002, but remained the same percentage of total revenue at 11%. The Company's administrative headcount decreased 3% from the end of the second quarter of fiscal 2001 to the end of the second quarter of fiscal 2002.

Income from operations increased as a percentage of total revenue from 11% in the second quarter of fiscal 2001 to 13% in the second quarter of fiscal 2002 and from 7% in the first six months of fiscal 2001 to 9% in the first six months of fiscal 2002. The increase in operating income as a percentage of revenue was primarily due to revenue growth in the period. If the Company is able to meet its forecasted revenue target and expenses occur as planned for the remainder of the fiscal year, the Company expects operating income as a percentage of revenue to be approximately 10% for all of fiscal 2002.

Other income decreased 118% from \$1.1 million in the second quarter of fiscal 2001 to (\$0.2) million in the second quarter of fiscal 2002. Other income decreased 97% from \$2.5 million in the first six months of fiscal 2001 to \$0.1 million in the first six months of fiscal 2002. The decrease was primarily due to the noncash impairment charge of \$1.0 million related to the Company's investment in a related party, EasyAsk, Inc., lower interest income and, to a lesser extent, higher foreign currency losses in fiscal 2002 as compared to fiscal 2001. The Company regularly monitors the carrying value of its investment in EasyAsk. Recent events and market conditions indicated that a decline in the value of the investment was other than temporary. EasyAsk is in the process of completing its next round of financing and based on the expected valuation, the Company wrote down the carrying amount of its investment to the estimated fair value. The foreign currency losses in each period primarily related to premiums paid for foreign exchange option contracts, transaction gains and losses and translation losses on intercompany receivable balances. The decrease in interest income in the second quarter of fiscal 2002 as compared to the second quarter of fiscal 2001 was due to lower interest rates. The Company expects its average interest earned on invested cash

[Table of Contents](#)

balances to continue to be lower in fiscal 2002 as compared to the same periods of fiscal 2001 due to the year-over-year reduction in market interest rates.

The Company's effective tax rate was 30% in the second quarter and first six months of fiscal 2002 as compared to 31% in the second quarter and first six months of fiscal 2001. The Company expects its effective tax rate to remain at approximately 30% for all of fiscal 2002.

Liquidity and Capital Resources

At the end of the second quarter of fiscal 2002, the Company's cash and short-term investments totaled \$191.1 million. The increase of \$16.6 million since the end of fiscal 2001 resulted primarily from cash generated from operations and proceeds from stock issuances under the Company's stock purchase plan and exercises of stock options, partially offset by capital expenditures and common stock repurchases.

The Company generated \$22.2 million in cash from operations in the first six months of fiscal 2002 and \$17.0 million in the first six months of fiscal 2001. The increase in cash generated from operations in the first six months of fiscal 2002 was primarily due to higher net income and improved collections of outstanding accounts receivable.

Accounts receivable decreased by \$8.1 million from the end of fiscal 2001. This resulted in accounts receivable days sales outstanding (DSO) decreasing to 62 days at the end of the second quarter of fiscal 2002 as compared to 63 days at the end of the second quarter of fiscal 2001 and 70 days at the end of fiscal 2001. The Company targets a DSO range of 60 to 80 days.

The Company purchased \$4.0 million of property and equipment in the first six months of fiscal 2002 and \$4.4 million of property and equipment in the first six months of fiscal 2001. The purchases consisted primarily of computer equipment and software. The Company financed these purchases primarily from cash generated from operations.

The Company purchased and retired approximately 408,000 shares of its common stock for \$6.7 million in the first six months of fiscal 2002 and approximately 614,000 shares of its common stock for \$8.5 million in the first six months of fiscal 2001. The Company financed these purchases primarily from cash generated from operations.

In September 2001, the Board of Directors authorized, for the period October 1, 2001 through September 30, 2002, the purchase of up to 10,000,000 shares of the Company's common stock, at such times when the Company deems such purchases to be an effective use of cash. Shares that are repurchased may be used for various purposes, including the issuance of shares pursuant to the Company's stock option and stock purchase plans. At May 31, 2002, approximately 9,500,000 shares of common stock remained available for repurchase under this authorization.

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

The Company's only significant long-term financial commitment relates to operating lease obligations. Future annual minimum rental lease payments are detailed in Note 8 of the Notes to Consolidated Financial Statements in Item 8 of the Company's Annual Report on Form 10-K for the year ended November 30, 2001.

The Company believes that existing cash balances together with funds generated from operations will be sufficient to finance the Company's operations and meet its foreseeable cash requirements (including planned capital expenditures and lease commitments) through at least the next twelve months.

Accounting Change

Effective December 1, 2001, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). This statement requires that goodwill and certain other intangibles no longer be amortized, but instead be tested for impairment at least annually. SFAS 142 also requires completion of a two-step transitional goodwill impairment test. In connection with the completion of the first step of its transitional analysis, the Company assigned goodwill to two reporting units. Completion of the first step of the Company's analysis did not indicate impairment as the fair value of each reporting unit exceeded its carrying amount, which includes goodwill. As the first step did not indicate that any impairment existed, completion of the second step was not required. The Company will assess the impairment of goodwill on an annual basis or if other indicators of impairment arise.

Net income for the first six months of fiscal 2001, if adjusted to exclude amortization expense, net of taxes, would have increased by \$0.2 million to \$7.8 million and diluted earnings per share would have increased by \$0.01 to \$0.21.

Factors That May Affect Future Results

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

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

Global Economic Conditions — The global economic environment and the current business climate is likely to impact the Company's revenue and net income in the near-term. Various economic indicators and analysts do not predict an increase in demand for capital spending, especially within the technology sector, within the near future. If customers' buying patterns, such as lengthier decision-making processes, timing of expected deliveries and timing of new projects, unfavorably change due to worsening economic conditions, there will be a material adverse effect on the Company's business and its financial results.

Products — Ongoing enhancements to the Progress product set and Sonic product set will be required to enable the Company to maintain its competitive position. There can be no assurance that the Company will be successful in developing and marketing enhancements to its products on a timely basis, or that the enhancements will adequately address the changing needs of the marketplace. Delays in the release of enhancements could have a material adverse effect on the Company's business, financial condition and operating results.

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

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

Table of Contents

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

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

Distribution Channels and New Markets — Future results also depend upon the Company's continued successful distribution of its products through its ISV channel and may be impacted by downward pressure on pricing, which may not be offset by increases in volume. ISVs utilize technology from the Company to create their applications and resell the Company's products along with their own applications. While revenue from the ISV channel increased in the first six months of fiscal 2002, such revenue experienced a year-over-year decrease in fiscal 2001. If this negative revenue trend were to reoccur in the remainder of fiscal 2002, the Company's business and operating results would be adversely affected. Any other adverse effect on the ISVs' businesses related to competition, pricing and other factors could also have a material adverse effect on the Company's business, financial condition and operating results.

The Company is devoting significant resources to enable its ISVs to move their applications to the Internet and the Application Service Provider (ASP) distribution model by providing a combination of technology, professional services and partnerships. The ASP distribution model enables ISVs to rent their business applications to end-user organizations over the Internet or through other thin-client technologies. The ASP market continues to evolve. There can be no assurance that the ASP model will become a viable market for business applications or that the Company will be successful in penetrating this new market.

NuSphere has and continues to develop a set of products and services for the open source market. The success of an open source business model, which gives customers the right to freely copy and distribute software, is unproven. Few open source software products have gained widespread commercial acceptance, partly due to the lack of viable open source industry participants to offer adequate service and support on a long-term basis. In addition, open source vendors are not able to provide industry standard warranties and indemnities for their products, since largely independent parties over whom open source vendors exercise no control or supervision have developed these products. There can be no assurance that NuSphere will be successful in building a sustainable business model or that the enhanced open source products provided by NuSphere will attain sufficient market acceptance to support such a business.

Table of Contents

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

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

International Operations — Revenue generated outside of North America represented 59% of the Company's total revenue in the first six months of fiscal 2002 and 60% in the first six months of fiscal 2001. Because a majority of the Company's total revenue is derived from international operations that are primarily conducted in foreign currencies, changes in the value of these foreign currencies relative to the U.S. dollar may affect the Company's results of operations and financial position. There can be no assurance that the Company's currency hedging transactions will materially reduce the effect of fluctuation in foreign currency exchange rates on such results. If for any reason exchange or price controls or other restrictions on the conversion of foreign currencies were imposed, the Company's business could be adversely affected.

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

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

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

In addition, litigation may be necessary in the future to enforce the Company's intellectual property rights, to protect the Company's trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement. Although the Company believes that its products and

[Table of Contents](#)

technology do not infringe on any existing proprietary rights of others, there can be no assurance that third parties will not assert infringement claims in the future. Such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on the Company's business, financial condition and operating results.

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Exposure to market rate risk for changes in interest rates relates to the Company's investment portfolio. The Company has not used derivative financial instruments in its investment portfolio. The Company places its investments with high-quality issuers and has policies limiting, among other things, the amount of credit exposure to any one issuer. The Company limits default risk by purchasing only investment-grade securities. The Company's investments have an average remaining maturity of less than two years and are primarily fixed-rate instruments. In addition, the Company has classified all its debt securities as available for sale. This classification reduces the income statement exposure to interest rate risk. 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 would be immaterial, although the actual effects may differ materially from the hypothetical analysis.

The Company has entered into foreign exchange option and forward contracts to hedge certain transactions of selected foreign currencies (mainly in Europe and Asia Pacific) against fluctuations in exchange rates. The Company has not entered into foreign exchange option and forward contracts for speculative or trading purposes. The Company's accounting policies for these contracts are based on the designation of the contracts as hedging instruments. The criteria the Company uses for designating a contract as a hedge include the contract's effectiveness in risk reduction and matching of derivative instruments to the underlying transactions. Market value increases and decreases on the foreign exchange option and forward contracts are generally recognized in income in the same period as gains and losses on the underlying transactions. The Company operates in certain countries where there are limited forward currency exchange markets and thus the Company has unhedged transaction exposures in these currencies. The Company generally does not hedge the net assets of its international subsidiaries. The notional principal amount of outstanding foreign exchange option contracts at May 31, 2002 was \$50.8 million. Unrealized market value gains on such contracts were immaterial at May 31, 2002. Based on a hypothetical 10% adverse movement in all foreign currency exchange rates, the Company's revenue would be adversely affected by approximately 6% and the Company's net income would be adversely affected by approximately 20% (excluding any offsetting positive impact, if any, from the Company's ongoing hedging programs), although the actual effects may differ materially from the hypothetical analysis.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Shareholders of the Company held on April 19, 2002, the shareholders voted on the items described below:

- To elect the following seven directors: Joseph W. Alsop, Larry R. Harris, Roger J. Heinen, Jr., Michael L. Mark, Arthur J. Marks, Scott A. McGregor and Amram Rasiel:

<u>NOMINEE</u>	<u>FOR</u>	<u>WITHHOLD AUTHORITY</u>
Joseph W. Alsop	27,129,236	4,748,592
Larry R. Harris	31,373,362	504,466
Roger J. Heinen, Jr.	31,374,062	503,766
Michael L. Mark	30,790,562	1,087,266
Arthur J. Marks	25,101,386	6,776,442
Scott A. McGregor	31,374,162	503,666
Amram Rasiel	31,371,912	505,916

- To act upon a proposal to amend the Company's 1997 Stock Incentive Plan to increase the maximum number of shares that may be issued under such plan from 7,540,000 shares to 11,040,000 shares:

<u>Affirmative Votes Cast</u>	<u>Negative Votes Cast</u>	<u>Votes Abstaining</u>	<u>Broker Non-votes</u>
9,533,604	16,796,311	26,620	5,521,293

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

10.10 2002 Nonqualified Stock Plan

b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended May 31, 2002.

SIGNATURES

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

PROGRESS SOFTWARE CORPORATION

(Registrant)

Dated: July 12, 2002

/s/ Joseph W. Alsop

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

Dated: July 12, 2002

/s/ Norman R. Robertson

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

Dated: July 12, 2002

/s/ David H. Benton, Jr.

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

PROGRESS SOFTWARE CORPORATION

2002 NONQUALIFIED STOCK PLAN

SECTION 1. *General Purpose of the Plan; Definitions*

The name of the plan is the Progress Software Corporation 2002 Nonqualified Stock Plan (the "Plan"). The purpose of the Plan is to encourage and enable employees of Progress Software Corporation, a Massachusetts corporation (the "Company"), and its Subsidiaries to acquire a proprietary interest in the Company. It is anticipated that providing employees with a direct stake in the Company's welfare will assure a closer identification of their interests with those of the Company and its stockholders, thereby stimulating their efforts on the Company's behalf and strengthening their desire to remain with the Company. The Company intends that this purpose will be effected by the granting of Awards (as defined below) under the Plan.

The following terms shall be defined as set forth below:

"Affiliate" means any company in an "affiliated group," as such term is defined in Section 1504(a) of the Code, which includes the Company.

"Award" or "Awards," except where referring to a particular category of grant under the Plan, shall include Non-Statutory Stock Options, Restricted Stock Awards, Unrestricted Stock Awards and Performance Share Awards.

"Board" means the Board of Directors of the Company.

"Cause" means (i) any material breach by the participant of any agreement to which the participant and the Company are both parties, (ii) any act or omission to act by the participant which may have a material and adverse effect on the Company's business or on the participant's ability to perform services for the Company, including, without limitation, the commission of any crime (other than ordinary traffic violations), or (iii) any material misconduct or material neglect of duties by the participant in connection with the business or affairs of the Company or any affiliate of the Company.

"Change of Control" shall have the meaning set forth in Section 15.

"Code" means the Internal Revenue Code of 1986, as amended, and any successor code, and related rules, regulations and interpretations.

"Committee" shall mean the Board or, if appointed by the Board, a committee of not less than two (2) directors. It is the intention of the Company that the Plan shall be administered by "non-employee directors" within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934, as amended, but the authority and validity of any act taken or not taken by the Committee shall not be affected if any director administering the Plan is not a non-employee director.

“Disability” means disability as set forth in Section 22(e)(3) of the Code.

“Effective Date” means the date on which the Plan is adopted by the Board as set forth in Section 17.

“Eligible Person” shall have the meaning set forth in Section 4.

“Fair Market Value” on any given date means the closing price per share of the Stock on such date as reported by a nationally recognized stock exchange, or, if the Stock is not listed on such an exchange, as reported by the Nasdaq Stock Market, or, if the Stock is not quoted by the Nasdaq Stock Market, the fair market value of the Stock as determined by the Committee.

“Non-Statutory Stock Option” means any stock option that is not an incentive stock option as defined in Section 422 of the Code.

“Normal Retirement” means retirement from active employment with the Company and its Subsidiaries in accordance with the retirement policies of the Company and its Subsidiaries then in effect.

“Officer” means an officer as defined in Rule 16a-1(f) of the Securities Exchange Act of 1934, as amended.

“Performance Share Award” means an Award granted pursuant to Section 8.

“Restricted Stock” shall have the meaning set forth in Section 6.

“Restricted Stock Award” means an Award granted pursuant to Section 6.

“Stock” means the common stock, \$0.01 par value per share, of the Company, subject to adjustments pursuant to Section 3.

“Stock Option” means any option to purchase shares of Stock granted pursuant to Section 5.

“Subsidiary” means a subsidiary as defined in Section 424 of the Code.

“Unrestricted Stock Award” means an award granted pursuant to Section 7.

SECTION 2. Administration of Plan; Committee Authority to Select Participants and Determine Awards

(a) *Committee.* The Plan shall be administered by the Committee. The Committee shall select one of its members as its chairman and shall hold its meetings at such times and places as it shall deem advisable. A majority of its members shall constitute a quorum, and all actions of the Committee shall require the affirmative vote of a majority of its members. Any action may be taken by a written instrument signed by all of the members, and any action so taken shall be as fully effective as if it had been taken by a vote of a majority of the members at a meeting duly called and held. Except as specifically reserved to the Board under the terms of the

Plan, the Committee shall have full and final authority to operate, manage and administer the Plan on behalf of the Company. Action by the Committee shall require the affirmative vote of a majority of all members thereof.

(b) *Powers of Committee.* The Committee shall have the power and authority to grant and modify Awards consistent with the terms of the Plan, including the power and authority:

(i) to select the persons to whom Awards may from time to time be granted;

(ii) to determine the time or times of grant, and the extent, if any, of Non-Statutory Stock Options, Restricted Stock, Unrestricted Stock and Performance Shares, or any combination of the foregoing, granted to any one or more participants;

(iii) to determine the number of shares to be covered by any Award;

(iv) to determine and modify the terms and conditions, including restrictions, not inconsistent with the terms of the Plan, of any Award, which terms and conditions may differ among individual Awards and participants, and to approve the form of written instruments evidencing the Awards; *provided, however,* that no such action shall adversely affect rights under any outstanding Award without the participant's consent;

(v) to accelerate the exercisability or vesting of all or any portion of any Award;

(vi) subject to the provisions of Section 5(b), to extend the period in which any outstanding Stock Option may be exercised;

(vii) to determine whether, to what extent, and under what circumstances Stock and other amounts payable with respect to an Award shall be deferred either automatically or at the election of the participant and whether and to what extent the Company shall pay or credit amounts equal to interest (at rates determined by the Committee) or dividends or deemed dividends on such deferrals;

(viii) to delegate to other persons the responsibility for performing ministerial actions in furtherance of the Plan's purpose; and

(ix) to adopt, alter and repeal such rules, guidelines and practices for administration of the Plan and for its own acts and proceedings as it shall deem advisable; to interpret the terms and provisions of the Plan and any Award (including related written instruments); to make all determinations it deems advisable for the administration of the Plan; to decide all disputes arising in connection with the Plan; and to otherwise supervise the administration of the Plan.

All decisions and interpretations of the Committee shall be binding on all persons, including the Company and Plan participants.

SECTION 3. *Shares Issuable under the Plan; Mergers; Substitution*

(a) *Shares Issuable.* The maximum number of shares of Stock with respect to which Awards may be granted under the Plan, subject to adjustment upon changes in capitalization of the Company as provided in this Section 3, shall be three million five hundred thousand (3,500,000) shares of Stock. For purposes of this limitation, if any shares of Stock covered by an Award granted under the Plan, or to which such an Award relates, are repurchased or forfeited, or if an Award has expired, terminated or been canceled for any reason whatsoever (other than by reason of exercise or vesting), then such shares of Stock or the shares of Stock covered by such Award, as the case may be, shall be added back to the shares of Stock with respect to which Awards may be granted under the Plan. Subject to such overall limitation, any type or types of Award may be granted with respect to shares of Stock. Shares of Stock issued under the Plan may be authorized but unissued shares or shares reacquired by the Company.

(b) *Stock Dividends, Mergers, etc.* In the event that the Company effects a stock dividend, stock split or similar change in capitalization affecting the Stock, the Committee shall make appropriate adjustments in (i) the number and kind of shares of stock or securities with respect to which Awards may thereafter be granted (including without limitation the limitations set forth in Section 3(a) above), (ii) the number and kind of shares remaining subject to outstanding Awards, and (iii) the option or purchase price in respect of such shares. In the event of the merger, consolidation, dissolution or liquidation of the Company, the Committee in its sole discretion may, as to any outstanding Awards, make such substitution or adjustment in the aggregate number of shares reserved for issuance under the Plan and in the number and purchase price (if any) of shares subject to such Awards as it may determine and as may be permitted by the terms of such transaction, or accelerate, amend or terminate such Awards upon such terms and conditions as it shall provide (which, in the case of the termination of the vested portion of any Award, shall require payment or other consideration which the Committee deems equitable in the circumstances).

(c) *Substitute Awards.* The Committee may grant Awards under the Plan by assumption of or in substitution for stock and stock-based awards granted or issued by another company to its directors, officers, employees, consultants and other service providers if such persons become Eligible Persons in connection with an acquisition of that company or any division thereof by the Company, whether by merger, consolidation, purchase of stock, purchase of assets or otherwise. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances. Shares which may be delivered under such substitute awards may be in addition to the maximum number of shares provided for in Section 3(a).

SECTION 4. Eligibility

Awards may be granted to employees of the Company or its Subsidiaries, and to consultants or other persons who render services to the Company, regardless of whether they are also employees (“Eligible Persons”), provided, however, that members of the Board and Officers are not eligible to receive Awards under the Plan.

SECTION 5. Stock Options

The Committee may grant Stock Options to Eligible Persons pursuant to the Plan. Any Stock Option granted under the Plan shall be in writing and in such form as the Committee may from time to time approve. Stock Options granted under the Plan shall be Non-Statutory Stock Options.

The Committee in its discretion may determine the effective date of Stock Options. Stock Options granted pursuant to this Section 5 shall be subject to the following terms and conditions and the terms and conditions of Section 9 and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Committee shall deem desirable:

(a) *Exercise Price.* The exercise price per share for the Stock covered by a Stock Option granted pursuant to this Section 5 shall be determined by the Committee at the time of grant; provided, however, that the exercise price shall not be less than Fair Market Value on the date of grant.

(b) *Option Term.* The term of each Stock Option shall be fixed by the Committee, but no Stock Option shall be exercisable more than ten (10) years after the date the Stock Option is granted.

(c) *Exercisability; Rights of a Stockholder.* Stock Options shall become vested and exercisable at such time or times, whether or not in installments, and upon such conditions, as shall be determined by the Committee at or after the grant date. The Committee may at any time accelerate the exercisability of all or any portion of any Stock Option. An optionee shall have the rights of a stockholder only as to shares acquired upon the exercise of a Stock Option and not as to unexercised Stock Options.

(d) *Method of Exercise.* Stock Options may be exercised in whole or in part, by delivering written notice of exercise to the Company, specifying the number of shares to be purchased. Payment of the purchase price may be made by one or more of the following methods:

(i) in cash, by certified or bank check or other instrument acceptable to the Committee;

(ii) with the consent of the Committee, in the form of shares of Stock owned by the optionee for a period of at least six (6) months and not then subject to restrictions. Such surrendered shares shall be valued at Fair Market Value on the exercise date;

(iii) with the consent of the Committee, by the optionee delivering to the Company a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company cash or a check payable and acceptable to the Company to pay the purchase price; *provided that* in the event the optionee chooses to pay the purchase price as so provided, the optionee and the broker shall comply with such procedures and enter into such agreements of indemnity and other agreements as the Committee shall prescribe as a condition of such payment procedure. The Company need not act upon such exercise notice until the Company receives full payment of the exercise price; or

(iv) by any other means (including, without limitation, by delivery of a promissory note of the optionee payable on such terms as are specified by the Committee; *provided, however,* that the interest rate borne by such note shall not be less than the lowest applicable federal rate, as defined in Section 1247(d) of the Code) which the Committee determines are consistent with the purpose of the Plan and with applicable laws and regulations.

The delivery of certificates representing shares of Stock to be purchased pursuant to the exercise of a Stock Option will be contingent upon receipt from the optionee (or a purchaser acting in his stead in accordance with the provisions of the Stock Option) by the Company of the full purchase price for such shares and the fulfillment of any other requirements contained in the Stock Option or imposed by applicable laws and regulations, as determined by the Committee in its sole discretion.

(e) *Transferability of Options.* No Stock Option shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution, and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee or his or her legal representative; provided, however, that the Committee may, in the manner established by the Committee, permit the transfer, without payment of consideration, of a Non-Statutory Stock Option by an optionee to a member of the optionee's immediate family or to a trust or partnership whose beneficiaries are members of the optionee's immediate family; and such transferee shall remain subject to all the terms and conditions applicable to the option prior to the transfer. For purposes of this provision, an optionee's "immediate family" shall mean the holder's spouse, children and grandchildren.

(f) *Form of Settlement.* Shares of Stock issued upon exercise of a Stock Option shall be free of all restrictions under the Plan, except as otherwise provided in this Plan or in the terms of such Stock Option.

SECTION 6. Restricted Stock Awards

(a) *Nature of Restricted Stock Award.* The Committee in its discretion may grant Restricted Stock Awards to any Eligible Person, entitling the recipient to acquire, for a purchase price determined by the Committee (but not less than Fair Market Value on the date of grant), shares of Stock subject to such restrictions and conditions as the Committee may determine at the time of grant ("Restricted Stock"), including continued employment and/or achievement of pre-established performance goals and objectives.

(b) *Acceptance of Award.* A participant who is granted a Restricted Stock Award shall have no rights with respect to such Award unless the participant shall have accepted the Award within ten (10) days (or such shorter date as the Committee may specify) following the delivery of written notice to the participant of the Award by making payment to the Company of the specified purchase price of the shares covered by the Award and by executing and delivering to the Company a written instrument that sets forth the terms and conditions applicable to the Restricted Stock in such form as the Committee shall determine.

(c) *Rights as a Stockholder.* Upon complying with Section 6(b) above, a participant shall have all the rights of a stockholder with respect to the Restricted Stock, including voting and dividend rights, subject to non-transferability restrictions and Company repurchase rights described in this Section 6 and subject to such other conditions contained in the written instrument evidencing the Restricted Stock Award. Unless the Committee shall otherwise determine, certificates evidencing shares of Restricted Stock shall remain in the possession of the Company until such shares are vested as provided in Section 6(e) below.

(d) *Restrictions.* Shares of Restricted Stock may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of except as specifically provided herein. In the event of termination of employment with or services to the Company and its Subsidiaries for any reason (including death, Disability, Normal Retirement, and voluntary termination by the participant), the Company shall have the right, at the discretion of the Committee, to repurchase shares of Restricted Stock with respect to which conditions have not lapsed at their purchase price from the participant or the participant's legal representative. The Company must exercise such right of repurchase within sixty (60) days following such termination of employment (unless otherwise specified in the written instrument evidencing the Restricted Stock Award).

(e) *Vesting of Restricted Stock.* The Committee at the time of grant shall specify the date or dates and/or the attainment of pre-established performance goals, objectives and other conditions on which the non-transferability of the Restricted Stock and the Company's right of repurchase shall lapse. Subsequent to such date or dates and/or the attainment of such pre-established performance goals, objectives and other conditions, the shares on which all restrictions have lapsed shall no longer be Restricted Stock and shall be deemed "vested." Subject to Section 12, the Committee at any time may accelerate such date or dates and otherwise waive or amend any conditions of the Award.

(f) *Waiver, Deferral and Reinvestment of Dividends.* The written instrument evidencing the Restricted Stock Award may require or permit the immediate payment, waiver, deferral or investment of dividends paid on the Restricted Stock.

SECTION 7. *Unrestricted Stock Awards*

(a) *Grant or Sale of Unrestricted Stock.* The Committee in its discretion may grant or sell to any Eligible Person shares of Stock free of any restrictions under the Plan ("Unrestricted Stock") at a purchase price determined by the Committee. Shares of Unrestricted Stock may be granted or sold as described in the preceding sentence in respect of past services or other valid consideration.

(b) *Restrictions on Transfers.* The right to receive Unrestricted Stock may not be sold, assigned, transferred, pledged or otherwise encumbered, other than by will or the laws of descent and distribution.

SECTION 8. *Performance Share Awards*

A Performance Share Award is an award entitling the recipient to acquire shares of Stock upon the attainment of specified performance goals. The Committee may make Performance Share Awards independent of or in connection with the granting of any other Award under the Plan. Performance Share Awards may be granted under the Plan to any Eligible Person. The Committee in its discretion shall determine whether and to whom Performance Share Awards shall be made, the performance goals applicable under each such Award, the periods during which performance is to be measured, the conditions under which such Award shall terminate, and all other limitations and conditions applicable to the awarded Performance Shares.

SECTION 9. *Termination of Stock Options*

(a) *Standard Termination Provisions:*

(i) *Termination by Death.* If any participant's employment by or services to the Company and its Subsidiaries terminates by reason of death, any Stock Option owned by such participant may thereafter be exercised to the extent exercisable at the date of death, by the legal representative or legatee of the participant, for a period of one (1) year (or such longer period as the Committee shall specify at any time) from the date of death, or until the expiration of the stated term of the Stock Option, if earlier.

(ii) *Termination by Reason of Disability or Normal Retirement.*

(A) Any Stock Option held by a participant whose employment by or service to the Company and its Subsidiaries has terminated by reason of Disability may thereafter be exercised, to the extent it was exercisable at the time of such termination, for a period of one (1) year (or such longer period as the Committee shall specify at any time) from the date of such termination, or until the expiration of the stated term of the Stock Option, if earlier.

(B) Any Stock Option held by a participant whose employment by or service to the Company and its Subsidiaries has terminated by reason of Normal Retirement may thereafter be exercised, to the extent it was exercisable at the time of such termination, for a period of ninety (90) days from the date of such termination, or until the expiration of the stated term of the Stock Option, if earlier.

(C) The Committee shall have sole authority and discretion to determine whether a participant's employment or services have been terminated by reason of Disability or Normal Retirement.

(iii) *Termination for Cause.* If any participant's employment by or services to the Company and its Subsidiaries has been terminated for Cause, any Stock Option held

by such participant shall immediately terminate and be of no further force and effect; provided, however, that the Committee may, in its sole discretion, provide that such Stock Option can be exercised for a period of up to thirty (30) days from the date of termination of employment or services or until the expiration of the stated term of the Stock Option, if earlier.

(iv) *Voluntary Termination.* If any participant's employment by or services to the Company and its Subsidiaries is voluntarily terminated, any Stock Option held by such participant shall immediately terminate and be of no further force and effect; provided, however, that the Committee may, in its sole discretion, provide that such Stock Option can be exercised for a period of up to ninety (90) days from the date of termination of employment or services or until the expiration of the stated term of the Stock Option, if earlier.

(v) *Other Termination.* Unless otherwise determined by the Committee, if a participant's employment by or services to the Company and its Subsidiaries terminates for any reason other than death, Disability, Normal Retirement, for Cause or voluntary termination, any Stock Option held by such participant may thereafter be exercised, to the extent it was exercisable on the date of such termination, for ninety (90) days (or such longer period as the Committee shall specify at any time) from the date of termination or until the expiration of the stated term of the Stock Option, if earlier.

(b) *Committee Discretion.* Notwithstanding the foregoing, the Committee may grant Stock Options under the Plan which contain such terms and conditions with respect to termination as the Committee, in its discretion, may from time to time determine.

SECTION 10. Tax Withholding

(a) *Payment by Participant.* Each participant shall, no later than the date as of which the value of an Award or of any Stock or other amounts received thereunder first becomes includable in the gross income of the participant for Federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Committee regarding the payment of, any Federal, state, local or other taxes of any kind required by law to be withheld with respect to such income. The Company and its Subsidiaries shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the participant.

(b) *Payment in Shares.* A participant may elect, with the consent of the Committee, to have such tax withholding obligation satisfied, in whole or in part, by (i) authorizing the Company to withhold from shares of Stock to be issued pursuant to an Award a number of shares with an aggregate Fair Market Value (as of the date the withholding is effected) that would satisfy the minimum withholding amount due with respect to such Award, or (ii) transferring to the Company shares of Stock owned by the participant for a period of at least six (6) months and with an aggregate Fair Market Value (as of the date the withholding is effected) that would satisfy the minimum withholding amount due with respect to such Award.

SECTION 11. *Transfer, Leave of Absence, Etc.*

For purposes of the Plan, a transfer to the employment of the Company from a Subsidiary or from the Company to a Subsidiary, or from one Subsidiary to another, shall not be deemed a termination of employment. Whether authorized leave of absence, or absence on military or government service, shall constitute termination of the employment relationship between the Company and the participant shall be determined by the Committee at the time thereof.

SECTION 12. *Amendments and Termination*

The Board may at any time amend or discontinue the Plan in any manner allowed by law and the Committee may at any time, subject to Section 2, amend or cancel any outstanding Award (or provide substitute Awards) for the purpose of satisfying changes in law or for any other lawful purpose, but no such action shall adversely affect rights under any outstanding Award without the holder's consent.

SECTION 13. *Status of Plan*

With respect to the portion of any Award that has not been exercised, a participant shall have no rights greater than those of a general creditor of the Company unless the Committee shall otherwise expressly determine in connection with any Award or Awards. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the Company's obligations to deliver Stock or make payments with respect to Awards hereunder, *provided* that the existence of such trusts or other arrangements is consistent with the provision of the foregoing sentence.

SECTION 14. *Lockup Agreement*

The acceptance of any Award under this Plan by the participant or any subsequent holder shall constitute the agreement of such person that, upon the request of the Company or the underwriters managing any underwritten offering of the Company's securities, such person will not, for a period of time (not to exceed one hundred eighty (180) days) following the effective date of any registration statement filed by the Company under the Securities Act of 1933, as amended, sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of any shares of Stock received pursuant to such Award, without the prior written consent of the Company or such underwriters, as the case may be, and that such person will execute and deliver to the Company or such underwriters a written agreement to that effect, in such form as the Company or such underwriters shall designate.

SECTION 15. *Change in Control*

(a) Upon the occurrence of a Change of Control as defined in this Section 15:

(i) subject to the provisions of clause (iii) below, after the effective date of such Change of Control, each holder of an outstanding Stock Option, Conditional Stock Award, Performance Share Award or Stock Appreciation Right shall be entitled, upon exercise of such Award, to receive, in lieu of shares of Stock (or consideration based upon the Fair Market Value of Stock), shares of such stock or other securities, cash or

property (or consideration based upon shares of such stock or other securities, cash or property) as the holders of shares of Stock received in connection with the Change of Control;

(ii) the Committee may accelerate the time for exercise of, and waive all conditions and restrictions on, each unexercised and unexpired Stock Option, Conditional Stock Award, Performance Share Award and Stock Appreciation Right, effective upon a date prior or subsequent to the effective date of such Change of Control, specified by the Committee; or

(iii) each outstanding Stock Option, Conditional Stock Award, Performance Share Award and Stock Appreciation Right may be cancelled by the Committee as of the effective date of any such Change of Control provided that (x) notice of such cancellation shall be given to each holder of such an Award and (y) each holder of such an Award shall have the right to exercise such Award to the extent that the same is then exercisable or, if the Committee shall have accelerated the time for exercise of all such unexercised and unexpired Awards, in full during the 30-day period preceding the effective date of such Change of Control.

(b) "Change of Control" shall mean the occurrence of any one of the following events:

(i) any "person" (as such term is used in Sections 13(d) and 14(d)(2) of the Act) becomes a "beneficial owner" (as such term is defined in Rule 13d-3 promulgated under the Act) (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company), directly or indirectly, of securities of the Company representing thirty-five percent (35%) or more of the combined voting power of the Company's then outstanding securities; or

(ii) persons who, as of January 1, 1997, constituted the Company's Board (the "Incumbent Board") cease for any reason, including without limitation as a result of a tender offer, proxy contest, merger or similar transaction, to constitute at least a majority of the Board, provided that any person becoming a director of the Company subsequent to January 1, 1997 whose election was approved by, or who was nominated with the approval of, at least a majority of the directors then comprising the Incumbent Board shall, for purposes of this Plan, be considered a member of the Incumbent Board; or

(iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation or other entity, other than (a) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 65% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (b) a merger or consolidation effected to implement a recapitalization of the Company (or similar

transaction) in which no “person” (as hereinabove defined) acquires more than 50% of the combined voting power of the Company’s then outstanding securities; or

(iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company’s assets.

SECTION 16. General Provisions

(a) *No Distribution; Compliance with Legal Requirements.* The Committee may require each person acquiring shares pursuant to an Award to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof, in such form as the Committee shall in its sole discretion deem advisable.

No shares of Stock shall be issued pursuant to an Award until, in the opinion of the Committee, all applicable securities laws and other legal and stock exchange requirements have been satisfied. The Committee may require the placing of such stop orders and restrictive legends on certificates for Stock and Awards as it deems appropriate.

(b) *Delivery of Stock Certificates.* Delivery of stock certificates to participants under this Plan shall be deemed effected for all purposes when the Company or a stock transfer agent of the Company shall have delivered such certificates in the United States mail, addressed to the participant, at the participant’s last known address on file with the Company.

(c) *Other Compensation Arrangements; No Employment Rights.* Nothing contained in this Plan shall prevent the Board from adopting other or additional compensation arrangements, including trusts, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases. The adoption of the Plan or any Award under the Plan does not confer upon any employee any right to continued employment with the Company or any Subsidiary.

SECTION 17. Effective Date of Plan

The Plan shall become effective upon its adoption by the Board.

SECTION 18. Governing Law

This Plan and each Award under the Plan shall be governed by, and construed and enforced in accordance with, the substantive laws of the Commonwealth of Massachusetts without regard to its principles of conflicts of laws.