PROGRESS SOFTWARE CORP /MA
Form 10-Q
April 09, 2007

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

FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended February 28, 2007

OR

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

Commission File Number: 0-19417

PROGRESS SOFTWARE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of March 30, 2007, there were 41,022,000 shares of the registrant s common stock, $.01 par value per share, outstanding.

PROGRESS SOFTWARE CORPORATION
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PART 1. FINANCIAL INFORMATION
Item 1. Unaudited Consolidated Financial Statements
Condensed Consolidated Balance Sheets (unaudited)
(In thousands)

	February 28, 2007	November 30, 2006
Assets		
Current assets:		
Cash and equivalents	$ 56,445	$ 46,449
Short-term investments	177,375	194,866
Total cash and short-term investments	233,820	241,315
Accounts receivable, net	91,663	82,762
Other current assets	16,351	17,943
Deferred income taxes	19,280	18,119
Total current assets	361,114	360,139
Property and equipment, net	61,215	57,585
Acquired intangible assets, net	70,578	75,069
Goodwill	157,343	157,858
Deferred income taxes	14,263	14,153
Other assets	4,770	5,435
Total	$ 669,283	$ 670,239
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion, long-term debt	$ 287	$ 281
Accounts payable	13,994	15,034
Accrued compensation and related taxes	29,561	48,398
Income taxes payable	8,159	6,316
Other accrued liabilities	21,972	23,166
Short-term deferred revenue	136,758	120,974
Total current liabilities	210,731	214,169
Long-term debt, less current portion	1,583	1,657
Long-term deferred revenue	9,179	6,355
Other non-current liabilities	3,778	3,494
Commitments and contingencies		
Shareholders equity:		

Common stock and additional paid-in capital; authorized, 100,000 shares; issued and outstanding, 40,866 shares in 2007 and 41,177 shares in 2006	196,279	197,748
Retained earnings, including accumulated other comprehensive gains of $921 in 2007 and $1,106 in 2006	247,733	246,816
Total shareholders equity	444,012	444,564
Total	$ 669,283	$ 670,239

See notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended Feb. 28, 2007	2006
Revenue:		
Software licenses	$ 44,729	$ 42,780
Maintenance and services	70,500	61,141
Total revenue	115,229	103,921
Costs of revenue:		
Cost of software licenses	1,672	2,210
Cost of maintenance and services	16,262	14,231
Amortization of acquired intangibles for purchased technology	2,491	1,524
Total costs of revenue	20,425	17,965
Gross profit	94,804	85,956
Operating expenses:		
Sales and marketing	44,645	42,644
Product development	20,795	18,927
General and administrative	15,031	13,198
Amortization of other acquired intangibles	1,980	1,383
Acquisition-related expenses		1,534
Total operating expenses	82,451	77,686
Income from operations	12,353	8,270
Other income (expense):		
Interest income and other	1,918	1,795
Foreign currency loss	(828)	(1,098)
Total other income, net	1,090	697
Income before provision for income taxes	13,443	8,967
Provision for income taxes	4,705	3,058
Net income	$ 8,738	$ 5,909
Earnings per share:		
Basic	$ 0.21	$ 0.15
Diluted	$ 0.20	$ 0.14

Weighted average shares outstanding:		
Basic	41,069	40,499
Diluted	43,437	43,057

See notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended Feb. 28, 2007	2006
Cash flows from operating activities:		
Net income	$ 8,738	$ 5,909
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	2,492	2,084
Amortization of capitalized software costs	44	44
Amortization of acquired intangible assets	4,471	2,907
Stock-based compensation	4,877	5,943
Deferred income taxes	(1,151)	(1,136)
Tax benefit from stock options	77	504
In-process research and development		900
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable, net	(8,970)	(5,285)
Other current assets	2,047	(3,677)
Accounts payable and accrued expenses	(20,781)	(19,930)
Income taxes payable	1,880	985
Deferred revenue	18,526	16,553
Net cash provided by operating activities	12,250	5,801
Cash flows from investing activities:		
Purchases of investments available for sale	(43,050)	(86,961)
Sales and maturities of investments available for sale	60,541	159,460
Purchases of property and equipment	(6,103)	(4,878)
Acquisitions, net of cash acquired		(62,033)
Increase in other non-current assets	200	26
Net cash provided by investing activities	11,588	5,614
Cash flows from financing activities:		
Issuance of common stock	5,681	4,166
Excess tax benefit from stock options	233	374
Payment of long-term debt	(65)	(65)
Repurchase of common stock	(19,238)	(3,361)
Net cash (used for) provided by financing activities	(13,389)	1,114
Effect of exchange rate changes on cash	(453)	659
Net increase in cash and equivalents	9,996	13,188
Cash and equivalents, beginning of period	46,449	40,398
Cash and equivalents, end of period	$ 56,445	$ 53,586

See notes to unaudited condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements

Note 1: Basis of Presentation

We have prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2006.

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

Note 2: Revenue Recognition

We recognize revenue when earned. We recognize software license revenue upon shipment of the product or, if delivered electronically, when the customer has the right to access the software, provided that the license fee is fixed or determinable, persuasive evidence of an arrangement exists and collection is probable. We do not consider software license arrangements with payment terms greater than ninety days beyond our standard payment terms to be fixed and determinable and therefore such software license fees are recognized upon due date. We do not license our software with a right of return and generally do not license our software with conditions of acceptance. If an arrangement does contain conditions of acceptance, we defer recognition of the revenue until the acceptance criteria are met or the period of acceptance has passed. We generally recognize revenue for products distributed through application partners and distributors when sold through to the end-user.

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

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

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

Note 3: Earnings Per Share

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

(In thousands, except per share data)

	Three Months Ended Feb. 28,	
	2007	2006
Net income	$ 8,738	$ 5,909
Weighted average shares outstanding	41,069	40,499
Dilutive impact from outstanding stock options	2,368	2,558
Diluted weighted average shares outstanding	43,437	43,057
Earnings per share:		
Basic	$ 0.21	$ 0.15
Diluted	$ 0.20	$ 0.14

Stock options to purchase approximately 2,965,000 shares and 1,669,000 shares of common stock were excluded from the calculation of diluted earnings per share in the first quarter of fiscal years 2007 and 2006, respectively, because these options were anti-dilutive.

Note 4: Stock-based Compensation

We account for stock-based compensation expense in accordance with Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment (SFAS 123R). Under SFAS 123R, stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We estimate the fair value of each stock-based award on the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield.

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

(In thousands)

	Three Months Ended Feb. 28,	
	2007	2006
Cost of software licenses	$ 30	$ 40
Cost of maintenance and services	347	450
Sales and marketing	1,796	2,224
Product development	1,119	1,354
General and administrative	1,585	1,875
Total stock-based compensation expense	$ 4,877	$ 5,943

Note 5: Income Taxes

We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year. We record cumulative adjustments to the tax provision in an interim period in which a change in the estimated annual effective rate is determined. We record valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. We have not provided for U.S. income taxes on the undistributed earnings of non-U.S. subsidiaries, as these earnings have been permanently reinvested or would be principally offset by foreign tax credits.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with Statement 109 and prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, with early adoption permitted. We are currently evaluating the impact that the adoption of FIN 48 will have on our consolidated financial statements.

Note 6: Comprehensive Income

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

(In thousands)

	Three Months Ended Feb. 28,	
	2007	2006
Net income, as reported	$ 8,738	$ 5,909
Foreign currency translation adjustments, net of tax	(168)	359
Unrealized (losses) gains on investments, net of tax	(17)	27
Total comprehensive income	$ 8,553	$ 6,295

Note 7: Shareholders Equity

Common Stock Repurchases

In September 2006, the Board of Directors authorized, for the period from October 1, 2006 through September 30, 2007, the purchase of up to 10,000,000 shares of our common stock, at such times that management deems such purchases to be an effective use of cash. We purchased and retired approximately 695,000 shares of our common stock for $19.2 million in the first three months of fiscal 2007 as compared to approximately 119,000 shares of our common stock for $3.4 million in the first three months of fiscal 2006.

Tender Offer Disclosure

We recently determined that the exercise price of some of our stock options from previous years were less than the fair market value of our common stock on the date of grant. Options determined to have been granted with an exercise price below the fair market value of our common stock on the actual grant date and vesting subsequent to December 2004 result in nonqualified deferred compensation for purposes of Section 409A of the Internal Revenue Code, and holders are subject to an excise tax on the value of the options in the year in which they vest. We have determined that options to purchase approximately 2.8 million shares of our common stock held by current and former employees may be subject to adverse tax consequences under Section 409A.

In order to mitigate the unfavorable personal tax consequences under Section 409A, we offered holders of these options the opportunity to amend their affected options. Specifically, on December 22, 2006, we commenced a tender offer in which we offered to amend the affected options to increase the exercise price to the fair market value of our common stock on the revised grant date, and to give the option holders (excluding certain executive officers and employees) a cash payment, to be paid in increments on certain dates in fiscal years 2008 through 2010, for the increase in the exercise price. The tender offer is expected to be completed in April 2007.

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We also entered into option amendment agreements containing similar terms with a limited number of individuals for whom the deadline for such an amendment was December 31, 2006. In the first quarter of fiscal year 2006, we accounted for the impact of these option amendment agreements as a stock option modification under SFAS 123R. We will recognize additional stock-based compensation expense, with a corresponding offset to additional paid-in capital, over the vesting period of the modified options. We recorded a liability of approximately $0.7 million for the present value of the expected cash payments associated with the option amendment agreements, with a corresponding reduction in additional paid-in capital. We will recognize interest expense through the period up to each payment date.

Note 8: Goodwill

Goodwill is the amount by which the cost of acquired net assets in a business acquisition exceeded the fair value of net identifiable assets on the date of purchase. For purposes of the annual impairment test, we assigned goodwill of $11.6 million to the operating divisions comprising the OpenEdge operating segment, $56.8 million to the operating divisions comprising the Enterprise Infrastructure reporting segment and $88.9 million to the reporting unit comprising the DataDirect reporting segment.

During the first quarter of fiscal 2007, we completed our annual testing for impairment of goodwill and, based on those tests, concluded that no impairment of goodwill existed as of December 15, 2006, the goodwill impairment measurement date for fiscal 2007. The decrease in goodwill from the end of fiscal 2006 was primarily related to changes to the preliminary allocation of the purchase price from previous acquisitions.

Note 9: Segment Information

At the end of fiscal 2006, we reorganized our business into five operating units. Our principal operating unit conducts business as the OpenEdge Division. The OpenEdge Division (OED) provides the Progress® OpenEdge platform, a set of development and deployment technologies, including the OpenEdge RDBMS, one of the leading embedded databases, for building business applications. Another significant operating unit, the Enterprise Infrastructure Division (EID), is responsible for the development, marketing and sales of our Sonic, Actional, DataXtend and ObjectStore product lines. The third significant operating unit, DataDirect Technologies, provides standards-based data connectivity software. Our other two operating units are the Apama Division and the EasyAsk Division.

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

Based upon the aggregation criteria for segment reporting, we have three reportable segments: the OpenEdge segment, which includes the OED and EasyAsk Division, the Enterprise Infrastructure segment, which includes the EID and Apama Division, and the DataDirect segment. We do not manage our assets, capital expenditures, interest income or provision for income taxes by segment. We manage such items on a company basis.

At the end of fiscal 2006, we changed the composition of our reporting segments from previous disclosures. We restated the fiscal 2006 segment disclosure to conform to the current presentation.

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

	Three Months Ended Feb. 28, 2007	2006
Revenue:		
OpenEdge segment	$ 87,254	$ 79,989
Enterprise Infrastructure segment	13,535	13,847
DataDirect segment	16,305	11,905
Reconciling items	(1,865)	(1,820)
Total	$ 115,229	$ 103,921
Income (loss) from operations:		
OpenEdge segment	$ 31,245	$ 27,695
Enterprise Infrastructure segment	(6,628)	(6,805)
DataDirect segment	1,455	783
Reconciling items	(13,719)	(13,403)
Total	$ 12,353	$ 8,270

The reconciling items within revenue primarily represent intersegment sales, which are accounted for as if sold under an equivalent arms-length basis arrangement, generated by the Enterprise Infrastructure segment. Amounts included under reconciling items within income from operations represent amortization of acquired intangibles, stock-based compensation, acquisition-related expenses and certain unallocated administrative expenses.
Total revenue by significant product line, regardless of which segment generated the revenue, is as follows:
(In thousands)

	Three Months Ended Feb. 28, 2007	2006
DataDirect	$ 16,305	$ 11,905
Enterprise Infrastructure	17,122	16,056
Progress OpenEdge and other	81,802	75,960
Total	$ 115,229	$ 103,921

Note 10: Contingencies
On June 23, 2006, we received written notice that the Enforcement Staff in the Boston, Massachusetts office of the SEC had begun an informal inquiry into our option-granting practices during the period December 1, 1995 through November 30, 2002. On December 19, 2006, the SEC informed us that it had issued a formal order of investigation into our option-granting practices during the period December 1, 1995 through the present. We are unable to predict with certainty what consequences may arise from the SEC investigation. We have already incurred, and expect to continue to incur, significant legal expenses arising from the investigation. The investigation could also divert the attention of our management and harm our business. If the SEC institutes legal action, we could face significant fines and penalties and be required to take remedial actions determined by the SEC or a court. Although we have filed certain restated financial statements that we believe correct the accounting errors arising from our past option-granting practices, the filing of those financial statements did not resolve the pending SEC inquiry. The SEC has not indicated

to us whether it has reviewed our restated financial statements, and any SEC review could lead to further restatements or other modifications of our financial statements.

On August 17, 2006, a derivative complaint styled *Arkansas Teacher Retirement System, Derivatively on Behalf of Progress Software Corporation, v. Joseph Alsop et al, Civ. Act. No. 06-CA-11459 RCL* was filed in the United States District Court for the District of Massachusetts by a party identifying itself as one of our shareholders purporting to act on our behalf against our directors and certain of our present and former officers. We are also named as a nominal defendant. The complaint alleges violations of Section 10(b) of the Securities Exchange Act of

1934 and Rule 10b-5, breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from the allegedly improper backdating of certain stock option grants. The complaint seeks monetary damages, restitution, disgorgement, rescission of stock options, punitive damages and other relief. On January 23, 2007, we moved to dismiss the *Arkansas Teacher Retirement System* complaint on the grounds that the Plaintiff failed to make a proper pre-filing demand upon our Board of Directors. This motion is pending.

On January 16, 2007, another party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *Acuna, Derivatively on Behalf of Progress Software Corporation v. Joseph Alsop et al., Civ. Act. No. 07-0157* against our directors and certain of our present and former officers in Massachusetts Superior Court. We are named as a nominal defendant in this action as well. The complaint alleges breaches of fiduciary duty, aiding and abetting breaches of fiduciary duty and unjust enrichment arising from the allegedly improper backdating of certain stock option grants. The complaint seeks monetary damages and disgorgement, among other forms of relief. A Special Litigation Committee formed by our board of directors to investigate and determine the Company s response to the complaint has moved to stay the action, while the investigation is ongoing.

Further, on March 28, 2007, an additional party identifying itself as one of our shareholders purporting to act on our behalf filed a derivative complaint styled *White, Derivatively on Behalf Of Nominal Defendant Progress v. Progress Software Corporation et al.,* Civ 07-01172. This complaint involves substantially the same defendants, allegations and demands for relief as the *Acuna* complaint described above.

The ultimate outcome of any of these matters could have a material adverse effect on our results of operations. These matters could divert the attention of our management and harm our business. In addition, we have incurred, and expect to incur legal expenses arising from these matters, which may be significant, including the advancement of legal expenses to our directors and officers. We have certain indemnification obligations to our directors and officers, and the outcome of derivative or any other litigation may require that we indemnify some or all of our directors and officers for expenses they may incur in defending the litigation and other losses.

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

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

Cautionary Note Regarding Forward-Looking Statements

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

Overview

We develop, market and distribute software to simplify and accelerate the development, deployment, integration and management of business applications. Our mission is to deliver software products and services that empower partners and customers to improve their development, deployment, integration and management of quality applications worldwide. Our products include development tools, databases, application servers, messaging servers, application management tools, data connectivity products and integration products that enable the highly distributed

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deployment of responsive applications across internal networks, the Internet and occasionally-connected users. Through our various operating units, we market our products globally to a broad range of organizations in manufacturing, distribution, finance, retail, healthcare, telecommunications, government and many other fields.

We derive a significant portion of our revenue from international operations. In the first half of fiscal 2006, the strengthening of the U.S. dollar against most major currencies, primarily the euro and the British pound, negatively affected the translation of our results into U.S. dollars. In the second half of fiscal 2006 and the first quarter of fiscal 2007, the weakening of the U.S. dollar against most major currencies, primarily the euro and the British pound, positively affected the translation of our results into U.S. dollars.

Critical Accounting Policies

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

We have identified the following critical accounting policies that require the use of significant judgments and estimates in the preparation of our consolidated financial statements. This listing is not a comprehensive list of all of our accounting policies. For further information regarding the application of these and other accounting policies, see Note 1 in the Notes to Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended November 30, 2006, as well as the notes to our Consolidated Financial Statements included in Item 1 of this Form 10-Q.

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

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

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Goodwill and Intangible Assets We have goodwill and net intangible assets of approximately $228 million at February 28, 2007. We assess the impairment of goodwill and identifiable intangible assets on an annual basis and whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. We would record an impairment charge if such an assessment were to indicate that the fair value of such assets was less than the carrying value. Judgment is required in determining whether an event has occurred that may impair the value of goodwill or identifiable intangible assets. Factors that could indicate that an impairment may exist include significant underperformance relative to plan or long-term projections, changes in business strategy, significant negative industry or economic trends or a significant decline in our stock price or in the value of one of our reporting units for a sustained period of time. We utilize cash flow models to determine the fair value of our reporting units. We must make assumptions about future cash flows, future operating plans, discount rates and other factors in our models. Different assumptions and judgment determinations could yield different conclusions that would result in an impairment charge to income in the period that such change or determination was made.

Income Tax Accounting We have a net deferred tax asset of approximately $30 million at February 28, 2007. We record valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. We consider scheduled reversals of temporary differences, projected future taxable income, ongoing tax planning strategies and other matters in assessing the need for and the amount of a valuation allowance. If we were to change our assumptions or otherwise determine that we were unable to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period that such change or determination was made. On a quarterly basis we provide for income taxes based on the estimated effective tax rate for the full fiscal year.

Stock-Based Compensation We account for stock-based compensation expense in accordance with SFAS 123R. Under SFAS 123R, stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date, is recognized over the relevant service period, and is adjusted each period for anticipated forfeitures. We estimate the fair value of each stock-based award on the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. Many of these assumptions are highly subjective and require the exercise of management judgment. Our management must also apply judgment in developing an estimate of awards that may be forfeited. If our actual experience differs significantly from our estimates and we choose to employ different assumptions in the future, the stock-based compensation expense that we record in future periods may differ materially from that recorded in the current period.

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Results of Operations

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

	Percentage of Total Revenue		Period-to-Period Change
	Three Months Ended Feb. 28,		2007 Compared to 2006
	2007	2006	
Revenue:			
Software licenses	39%	41%	5%
Maintenance and services	61	59	15
Total revenue	100	100	11
Costs of revenue:			
Cost of software licenses	1	2	(24)
Cost of maintenance and services	14	14	14
Amortization of acquired intangibles for purchased technology	2	1	63
Total costs of revenue	17	17	14
Gross profit	83	83	10
Operating expenses:			
Sales and marketing	39	41	5
Product development	18	18	10
General and administrative	13	13	14
Amortization of other acquired intangibles	2	1	43
Acquisition-related expenses		2	(100)
Total operating expenses	72	75	6
Income from operations	11	8	49
Other (expense) income, net	1	1	56
Income before provision for income taxes	12	9	50
Provision for income taxes	4	3	54
Net income	8%	6%	48%

Revenue. Our total revenue increased 11% from $103.9 million in the first quarter of fiscal 2006 to $115.2 million in the first quarter of fiscal 2007. Total revenue would have increased by 6% if exchange rates had been constant in the first quarter of fiscal 2007 as compared to exchange rates in effect in the first quarter of fiscal 2006. In addition to the positive effect of changes in exchange rates, each of our major product lines experienced growth in the first quarter of fiscal 2007.

Revenue from our Progress OpenEdge product line increased from $76.0 million in the first quarter of fiscal 2006 to $81.8 million in the first quarter of fiscal 2007. Revenue derived from our Enterprise Infrastructure product line increased 7% from $16.1 million in the first quarter of fiscal 2006 to $17.1 million in the first quarter of fiscal 2007. Revenue from our DataDirect product line increased 37% from $11.9 million in the first quarter of fiscal 2006 to $16.3 million in the first quarter of fiscal 2007. Approximately half of the increase in the DataDirect product line was attributable to Shadow products which were acquired as part of the NEON acquisition in the latter part of the first quarter of fiscal 2006.

Software license revenue increased 5% from $42.8 million in the first quarter of fiscal 2006 to $44.7 million in the first quarter of fiscal 2007. Software license revenue would have been flat if exchange rates had been constant in the first quarter of fiscal 2007 as compared to exchange rates in effect in the first quarter of fiscal 2006. The DataDirect and the Enterprise Infrastructure product lines accounted for 39% of software license revenue in each of the first quarters of fiscal 2007 and fiscal 2006. Software license revenue from direct end users increased in the first quarter of fiscal 2007 as compared to the first quarter of fiscal 2006. Software license revenue from the Progress OpenEdge product set increased year over year, primarily within the development and the database products.

Maintenance and services revenue increased 15% from $61.1 million in the first quarter of fiscal 2006 to $70.5 million in the first quarter of fiscal 2007. The increase in maintenance and services revenue was primarily the result of growth in our installed customer base, renewal of maintenance agreements and greater professional services revenue. Maintenance revenue increased 12% and professional services revenue increased 33% in the first quarter of fiscal 2007 as compared to the first quarter of fiscal 2006. Maintenance and services revenue would have increased by 10% if exchange rates had been constant in the first quarter of fiscal 2007 as compared to exchange rates in effect in the first quarter of fiscal 2006.

Total revenue generated in markets outside North America increased 13% from $57.5 million in the first quarter of fiscal 2006 to $65.0 million in the first quarter of fiscal 2007 and represented 55% of total revenue in the first quarter of fiscal 2006 and 56% of total revenue in the first quarter of fiscal 2007. Revenue from the Europe, Middle East and Africa region (EMEA), and the Asia Pacific region increased in fiscal 2007 as compared to fiscal 2006, while the Latin America region was essentially flat. Total revenue generated in markets outside North America would have represented 54% of total revenue if exchange rates had been constant in the first quarter of fiscal 2007 as compared to the exchange rates in effect in the first quarter of fiscal 2006.

Cost of Software Licenses. Cost of software licenses consists primarily of costs of product media, documentation, duplication, packaging, electronic software distribution, royalties and amortization of capitalized software costs. Cost of software licenses decreased 24% from $2.2 million in the first quarter of fiscal