SCANSOFT INC
Form 10-Q/A
August 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE PERIOD ENDED MARCH 31, 2002

OR

TRANSITION REPORT PURSUANT SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 0-27038

SCANSOFT, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	94-3156479
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(IRS EMPLOYER IDENTIFICATION NUMBER)

9 CENTENNIAL DRIVE
PEABODY, MA 01960
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)

(978) 977-2000
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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. X Yes No

64,087,679 shares of the registrant's Common Stock, $0.001 par value, were outstanding as of April 30, 2002.

SCANSOFT, INC.

FORM 10-Q/A
THREE MONTHS ENDED MARCH 31, 2002

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As more fully discussed in Note 2 of the Notes to Unaudited Consolidated Financial Statements, the Company is restating its consolidated financial statements as of and for the three months ended March 31, 2002 to reclassify to goodwill from tangible and other intangible assets a portion of the purchase price consideration paid in connection with the Company's acquisition of certain assets of Lernout & Hauspie N.V. on December 12, 2001 and to reduce the related amortization expense. This restatement is as a result of the change in the accounting for the transaction as an acquisition of a business rather than as an acquisition of assets as previously reported. As a result of this restatement, our reported net loss for the three months ended March 31, 2002 decreased from $3,494,000 or $0.06 per share to $2,882,000 or $0.05 per share as a result of recording lower amortization expense for that period. The restatement had no effect on our reported cash flows from operations.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SCANSOFT, INC.

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	MARCH 31, 2002 (UNAUDITED) (AS RESTATED)	DE
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 12,783	$
Accounts receivable, less allowances of $7,333 and $6,273, respectively	13,790	
Inventory	1,188	
Prepaid expenses and other current assets	2,310	
Total current assets	30,071	
Goodwill, net	65,231	
Other intangible assets, net	40,476	
Property and equipment, net	2,582	
Other assets	591	
TOTAL ASSETS	$ 138,951	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 6,744	$
Accrued expenses	13,856	
Deferred revenue	1,021	
Note payable	627	
Other current liabilities	1,853	
Total current liabilities	24,101	
Deferred revenue	348	
Long-term notes payable, net of current portion	3,218	
Other liabilities	1,638	
Total liabilities	29,305	
Stockholders' equity:		
Preferred stock, $0.001 par value; 40,000,000 shares authorized; 3,562,238 shares issued and outstanding (liquidation preference $4,631)	4,631	
Common stock, $0.001 par value; 140,000,000 shares authorized; 63,596,748 and 62,754,211 shares issued and 62,940,748 and 62,098,211 shares outstanding, respectively	64	
Additional paid-in capital	262,831	
Treasury stock, at cost (656,000 shares)	(1,031)	
Deferred compensation	(250)	
Accumulated other comprehensive loss	(458)	
Accumulated deficit	(156,141)	

Total stockholders' equity	109,646	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 138,951	$

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31, 2002 (AS RESTATED)	2001
Net revenue	$ 23,765	$ 12,501
Costs and expenses:		
Cost of revenue	4,129	2,890
Research and development	6,986	3,197
Selling, general and administrative	9,711	6,286
Amortization of goodwill and other intangible assets	4,499	6,834
Restructuring and other charges	1,041	--
Total costs and expenses	26,366	19,207
Loss from operations	(2,601)	(6,706)
Other income (expense), net	(75)	(133)
Loss before income taxes	(2,676)	(6,839)
Provision for income taxes	206	61
Net loss	$ (2,882)	$ (6,900)
Net loss per share: basic and diluted	$ (0.05)	$ (0.15)
Weighted average common shares outstanding: basic and diluted	62,304	46,100

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2002 (AS RESTATED)	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (2,882)	$(6,900)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	450	489
Amortization of goodwill and other intangible assets	4,499	6,834
Accounts receivable and sales allowances	1,060	(1,249)
Non-cash portion of restructuring and other charges	113	--
Net gain on sale of property and equipment	--	(92)
Other	26	--
Changes in operating assets and liabilities:		
Accounts receivable	(624)	4,004
Inventory	(688)	117
Prepaid expenses and other current assets	(754)	166
Other assets	121	167
Accounts payable	1,593	(1,699)
Accrued expenses	(175)	(668)
Deferred revenue	(2,540)	(217)
Net cash provided by (used in) operating activities	199	952
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures for property and equipment	(661)	(146)
Proceeds from sale of property and equipment	--	344
Payment of notes payable related to acquisition	(55)	--
Deferred payment agreement	(1,000)	--
Payment of acquisition related liabilities	(662)	--
Acquisition of intangible assets	(500)	--
Net cash provided by (used in) investing activities	(2,878)	198
CASH FLOWS FROM FINANCING ACTIVITIES:		
Short-term bank borrowings, net	--	(825)
Payment of capital lease obligation	(105)	--
Proceeds from the issuance of common stock	1,240	63
Net cash provided by (used in) financing activities	1,135	(762)
Effects of exchange rate changes on cash and cash equivalents	3	(182)
Net increase (decrease) in cash and cash equivalents	(1,541)	206
Cash and cash equivalents at beginning of period	14,324	2,571

Cash and cash equivalents at end of period	$ 12,783	$ 2,777

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of ScanSoft, Inc. (the "Company", "we" or "ScanSoft") have been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position, results of operations, and cash flows at March 31, 2002, and for the three months ended March 31, 2002 and 2001. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in the footnotes prepared in accordance with generally accepted accounting principles has been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001 filed with the Securities and Exchange Commission on April 1, 2002.

The results for the three months ended March 31, 2002, are not necessarily indicative of the results that may be expected for the year ending December 31, 2002, or any future period.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities on the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant estimates included in the financial statements are accounts receivable and sales allowances, the useful lives and recoverability of intangible assets including goodwill, and the valuation allowances on deferred tax assets. Actual results could differ from those estimates.

(2) RESTATEMENT OF ACCOUNTING FOR ACQUISITION

On December 12, 2001, the Company acquired certain assets of Lernout & Hauspie N.V. On December 27, 2001, the Company filed a Form 8-K reporting the transaction as an acquisition of assets. As previously disclosed, the Company has had ongoing discussions with the SEC regarding historical financial statement requirements related to the acquisition. Following these discussions, the Company has concluded that, for purposes of Rule 3-05 of Regulation S-X, the L&H transaction was an acquisition of a business and not an acquisition of assets. In connection with these discussions, and as previously disclosed, the Company has also concluded that the transaction should be reported as the acquisition of a business for accounting purposes rather than the acquisition of assets, as previously reported. As a result, $23.0 million of the purchase price previously allocated to tangible and other intangible assets has been reclassified to goodwill and amortization expense has been reduced by $0.6 million.

A summary of the impact of this restatement on the consolidated financial statements as of and for the unaudited three-month period ended March 31, 2002 is as follows:

(IN THOUSANDS, EXCEPT PER SHARE DATA)	THREE MONTHS ENDED, MARCH 31, 2002	
	AS PREVIOUSLY REPORTED	AS RESTATED
Statement of Operations:		
Amortization of goodwill and other intangible assets	$ 5,111	$ 4,499
Loss from operations	$(3,213)	$(2,601)
Net loss	$(3,494)	$(2,882)
Net loss per share - basic and diluted	$ (0.06)	$ (0.05)

	MARCH 31, 2002	
	AS PREVIOUSLY REPORTED	AS RESTATED
Balance Sheet:		
Goodwill, net	$ 42,200	$ 65,231
Other intangible assets, net	$ 62,638	$ 40,476
Property and equipment, net	$ 2,838	$ 2,582
Accumulated deficit	$(156,753)	$(156,141)

(3) RECLASSIFICATIONS

Certain prior year financial statement amounts have been reclassified to conform with the current year presentation.

(4) ACQUISITION OF LERNOUT & HAUSPIE (L&H) SPEECH PRODUCTS N.V. ASSETS:

On December 7, 2001, the Company entered into a definitive asset purchase agreement (the "Purchase Agreement") to acquire certain assets and intellectual property relating to the former L&H entities that were in bankruptcy under the jurisdiction of both the U.S. Bankruptcy Court for the District of Delaware and the Commercial Court of Ieper, Belgium. We purchased these assets in a closed auction proceeding administered by the creditors committee of the former entities and approved by both the U.S. and Belgium courts on December 11, 2001. The transaction was completed on December 12, 2001 and the Company's results from operations include L&H activities since that date.

Pursuant to the Purchase Agreement, the Company acquired patents, trademarks, tradenames, product and customer contracts associated with certain of the speech and language technology assets of L&H. In addition, the Company obtained rights to accounts receivable related to the customer contracts acquired and fixed assets. The Company also hired 223 employees from L&H. The Company paid $41.3 million in total consideration to the creditors as follows:

$10.0 million in cash, 7.4 million shares of the Company's common stock valued at $27.8 million (based on the average of the closing share price of our stock 3 days before and after the proposed acquisition was announced) and a 9% promissory note in the principal amount of $3.5 million, to be repaid in installments of $0.1 million of principal and interest quarterly commencing on March 15, 2002, for a total of eleven (11) payments. All remaining principal and interest shall become due on December 15, 2004. The Company incurred approximately $1.0 million of acquisition related costs.

The purchase price was allocated to the tangible and intangible assets acquired (patents and core technology and trade names and trademarks) and liabilities assumed based on their respective fair market values. The total identifiable tangible assets amounted to $21.0 million. The excess of the purchase price over the fair value of the identifiable intangible assets and net liabilities assumed amounted to $23.0 million and was allocated to goodwill. Accordingly, the purchase price including acquisition costs was allocated as follows (in thousands):

Identifiable intangible assets.............................	$20,970
Goodwill...	23,031
Net current liabilities assumed............................	(1,701)
	$42,300

The information above has been updated to reflect the adjustments made as a result of the restatement discussed in Note 2.

The values of the patents, core technology and trade names and trademarks were determined using the income approach. The income approach requires a projection of revenues and expenses specifically attributed to the intangible assets. The discounted cash flow ("DCF") method is then applied to the potential income streams after making necessary adjustments with respect to such factors as the wasting nature of the identifiable intangible assets and the allowance of a fair return on the net tangible assets and other intangible assets employed. There are several variations on the income approach, including the relief-from-royalty method, the avoided cost method and the lost profits method. The relief-from-royalty method was used to value the patents, core technology and trade names and trademarks. The relief-from-royalty method is used to estimate the cost savings that accrue to the owner of the intangible assets that would otherwise have to pay royalties or licensee fees on revenues earned through the use of the asset. The royalty rate used in the analysis is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets.

Typically, revenue is projected over the expected remaining useful life of the intangible asset. The market-derived royalty rate is

then applied to estimate the royalty savings. The key assumptions used in valuing the patents and core technology are as follows: royalty rate 5%, discount rate 15%, tax rate 40% and estimated life of 10 years. The key assumptions used in valuing the trade names and trademarks are as follows: observed royalty rate 1%, discount rate 15%, tax rate 40% and estimated life of 12 years.

OEM contracts and customer relationships, as well as completed technology, were determined to have de minimus values and, accordingly, no amount of the purchase price was allocated to these intangible assets. A discounted cash flow method was used to estimate the residual cash flows attributable to OEM contracts and customer relationships. The projections included negative cash flows over the early years of the relationship and, when combined with the contributory asset charged for the other technology-based assets, such as patents and core technology which are required to realize revenue under these arrangements, resulted in de minimus value for the OEM contracts and the customer relationships. The completed technology was valued using individual cash flow projections for each technology, adjusted for capital charges, and discounted to present value using a weighted average cost of capital. Cash flow projections and operating profits are negative for the initial years and when considered with the short life cycle of the application-based completed technology, the value ascribable to the completed technology was de minimus.

In connection with the acquisition, we assumed certain liabilities for products which were sold prior to the acquisition date and which are expected to be upgraded with newer versions in 2002 and liabilities for development contracts with customers. The actual amount of the liabilities may differ from the estimated amounts. Differences between the actual and estimated amounts, if any, will be recorded as an adjustment to the liability and goodwill.

The following table identifies the intangible assets acquired and their respective lives over which the assets will be amortized on a straight-line basis:

	AMOUNT (IN THOUSANDS)	LIFE (IN YEARS)
Patents and core technology	$17,870	10
Trade names and trademarks	3,100	12
	$20,970	

The information above has been updated to reflect the adjustments made as a result of the restatement discussed in Note 2.

(5) BALANCE SHEET COMPONENTS

The following table summarizes key balance sheet components (in thousands):

	MARCH 31, 2002	DECEMBER 31, 2001
Inventory:		
Raw materials	$ 268	$ 107
Finished goods	920	400
	$ 1,188	$ 507
Other accrued expenses:		
Accrued compensation	$ 1,457	$ 2,775
Accrued sales and marketing	1,073	1,160
Accrued restructuring	1,440	634
Accrued royalties	742	750
Accrued professional fees	442	571
Accrued acquisition liabilities	5,905	6,065
Accrued transaction costs	369	882
Accrued taxes and other	2,428	1,634

	$ 13,856	$ 14,471
	=========	=========

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(6) GOODWILL AND OTHER INTANGIBLE ASSETS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives.

The Company adopted SFAS 142 on January 1, 2002 and discontinued the amortization of goodwill (including acquired workforce) of approximately $65.2 million. Upon adoption, the Company reclassified $31,000 of previously amortizable acquired workforce to goodwill. The Company had previously been recording amortization expense on goodwill and acquired workforce of $10.4 million annually or $2.6 million per quarter.

Intangible assets are amortized on a straight-line basis over their estimated useful lives of three to twelve years. As required by SFAS 142, the Company has reassessed the useful lives of its intangible assets, and has determined that no adjustments are required.

SFAS 142 requires the Company to complete a transitional goodwill impairment test within six months from the date of adoption. The Company has not yet completed the impairment test, but does not expect the completion of the test to result in an impairment charge.

The following summary reflects the condensed consolidated results of operations as if SFAS 142 had been adopted at the beginning of the periods presented (in thousands, except net loss per share amounts):

	THREE MONTHS ENDED, MARCH 31,	
	2002	2001
	(RESTATED)	
Net loss:		
Reported net loss	$ (2,882)	$ (6,900)
Effect of goodwill amortization	--	2,597
Adjusted net loss	$ (2,882)	$ (4,303)
Basic and diluted net loss per share:		
Reported basic and diluted net loss per share	$ (0.05)	$ (0.15)
Effect of goodwill amortization	--	0.06
Adjusted basic and diluted net loss per share	$ (0.05)	$ (0.09)

Amortized intangible assets consist of the following:

MARCH 31, 2002 (IN THOUSANDS)	GROSS CARRYING AMOUNT (RESTATED)	ACCUMULATED AMORTIZATION (RESTATED)	NET CARRYING AMOUNT (RESTATED)
Core technology	$ 48,130	$ 13,589	$ 34,541
Developed technology	16,340	16,340	--
Trademarks and patents	7,461	2,047	5,414
Non-competition agreement	4,048	4,048	--
Acquired favorable lease	553	553	--
OEM relationships	1,100	596	504
Other	200	183	17
	$ 77,832	$ 37,356	$ 40,476

DECEMBER 31, 2001 (IN THOUSANDS)	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT
Core technology	$ 46,456	$ 11,771	$ 34,685
Developed technology	16,340	14,714	1,626
Trademarks and patents	7,461	1,784	5,677
Non-competition agreement	4,048	3,646	402
Acquired favorable lease	553	355	198
OEM relationships	1,100	524	576
Assembled workforce	374	270	104
Other	200	167	33
	$ 76,532	$ 33,231	$ 43,301

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Aggregate amortization expense for the quarter ended March 31, 2002 was $4.5 million. Estimated amortization expense for each of the five succeeding fiscal years is as follows:

YEAR ENDING (IN THOUSANDS)	AMOUNT (RESTATED)
2002	$ 11,152
2003	8,847
2004	7,977
2005	3,576
2006	2,327
Thereafter	11,096

(7) REVENUE RECOGNITION

In November 2001, the Emerging Issues Task Force ("EITF"), a committee of the FASB, reached a consensus on EITF Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer or Reseller of the Vendor's Products" ("EITF 01-9"). EITF 01-9 presumes that consideration from a vendor to a customer or reseller of the vendor's products is a reduction of the selling prices of the vendor's products and, therefore, should be characterized as a reduction of revenue when recognized in the vendor's income statement and could lead to negative revenue under certain circumstances. Revenue reduction is required unless consideration relates to a separate identifiable benefit and the benefit's fair value can be established, in which case such amounts may be recorded as operating expenses. The Company implemented EITF 01-9 on January 1, 2002. The implementation resulted in a $0.1 million reduction to net revenue for the three months ended March 31, 2002 and the reclassification of $0.3 million from selling, general and administrative expenses to net revenue for the period ended March 31, 2001.

(8) RESTRUCTURING AND OTHER CHARGES

In January 2002, the Company announced and in March 2002 completed a restructuring plan to consolidate facilities, world-wide sales organizations, research and development teams and other personnel following the December 12, 2001 acquisition of the L&H assets. As a result, the Company exited facilities in both North America and Europe eliminating 21 employee positions including 12 in research and development and 9 in selling, general and administrative functions. In the first quarter of 2002, the Company recorded a restructuring charge in the amount of $0.6 million for severance payments to these employees, and a restructuring charge of $0.4 million for certain termination fees to be incurred as a result of exiting the facilities.

For the quarter ended March 31, 2002, the Company paid a total of $0.1 million in severance payments, of which $70,000 relates to the March 2002 restructuring with the balance of $50,000 relating to severance paid to the former Caere President and CEO.

At March 31, 2002, the remaining restructuring accrual from the current and prior restructuring activities amounted to $1.4 million. This balance is comprised of $0.8 million of severance and lease exit costs resulting from the 2002 restructuring and $0.6 million of severance to the former Caere President and CEO. All amounts relating to the 2002 restructuring will be paid in full over the course of 2002. The severance due to the former Caere President and CEO will be paid through March 2005.

The following table sets forth the 2002 and 2000 restructuring reserve activity (in thousands):

RESTRUCTURING AND OTHER CHARGES RESERVE	EMPLOYEE RELATED	LEASE EXIT COSTS	TOT
Balance at December 31, 2001	$ 634	$ --	$
Restructuring and other charges for March 2002 restructuring	576	465	1,
Non cash write-offs	--	(113)	(
Cash payments	(122)	--	(

Balance at March 31, 2002	$ 1,088	$ 352	$ 1,

(9) DEFERRED PAYMENT AGREEMENT

In connection with the Caere acquisition and pursuant to a concurrent non-competition and consulting agreement, the Company agreed to pay in cash the former Caere President and CEO on the second anniversary of the merger, March 13, 2002, the difference between $13.50 and the closing price per share of ScanSoft common stock at that time, multiplied by 486,548. On March 5, 2002, the Company negotiated a deferred payment agreement with the former Caere President and CEO to terminate this agreement. Under the terms of the deferred payment agreement, the Company paid $1.0 million in cash on March 5, 2002, with remaining amounts payable in equal quarterly installments of approximately $0.4 million over the next two years.

The total consideration of this agreement was accounted for in the original Caere purchase price and had no effect on operating income. As of March 31, 2002, the Company reclassified $4.3 million from additional paid-in capital to other liabilities.

(10) NOTE PAYABLE

In connection with the purchase of the L&H audiomining assets in March 2002, the Company issued a $0.4 million promissory note to L&H Holdings USA. The note bears interest at 9% per annum, with principal and interest to be repaid in full on July 31, 2002.

(11) NET LOSS PER SHARE

Diluted net loss per share excludes the weighted-average effect of options and warrants to purchase common stock as well as the conversion of the Company's Series B preferred stock, of 10,356,614 shares and 4,503,570 shares for the three months ended March 31, 2002 and 2001, respectively. These potential common shares were excluded from the calculation of diluted net loss per share as their inclusion would have been anti-dilutive for all periods presented.

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(12) COMPREHENSIVE LOSS

Total comprehensive loss, net of taxes, was approximately $2.9 million, as restated, and $7.1 million for the three months ended March 31, 2002 and 2001, respectively. Total comprehensive losses consisted of net losses and foreign currency translation adjustments for the respective periods.

(13) CONTINGENCIES

As a normal incidence of the nature of the Company's business, various claims, charges and litigation have been asserted or commenced against the Company arising from or related to employee relations and other business matters. Management does not believe these claims will have a material effect on the financial position or results of operations of the Company.

(14) SUBSEQUENT EVENT

On April 12, 2002, the Company completed a private placement of 1.0 million shares of common stock at a purchase price of $6.00 per share with a new institutional investor, resulting in gross proceeds of $6.0 million.

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

FORWARD-LOOKING STATEMENTS

Certain statements made in this report as well as oral statements made by ScanSoft from time to time, which are prefaced with words such as, "expects", "anticipates", "believes", "projects", "intends", "plans", and similar words and other statements of similar sense, are forward-looking statements within the meaning of the federal securities laws. These statements are based on ScanSoft's current expectations and estimates as to prospective events and circumstances, which may or may not be in ScanSoft's control and as to which there can be no firm assurance given.

In this quarterly report, forward-looking statements include those concerning the following: ScanSoft's expectations regarding revenue mix, cost of revenue, research and development expenses and selling, general and administrative expenses for the period ending December 31, 2002; ScanSoft's beliefs and expectations regarding future positive cash flow and the sufficiency of future cash levels; and ScanSoft's ability to reduce expenses as necessary or to find additional sources of liquidity as needed. These forward-looking statements, like any other forward-looking statement, involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties are outlined later in this document and should not be construed as exhaustive. ScanSoft disclaims any obligation to subsequently revise forward-looking statements or to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Further discussions of risk factors are also available in ScanSoft's registration statements filed with the Securities and Exchange Commission. ScanSoft wishes to caution readers not to place undue reliance upon such forward-looking statements, which speak only as of the date made.

OVERVIEW

ScanSoft is a leading supplier of imaging, speech and language solutions that make businesses more productive. Our portfolio of solutions and technologies automate a range of manual processes to help consumers, professionals and enterprises save time, increase productivity and improve customer service.

Historically, ScanSoft has been a leader in paper-to-digital solutions and document imaging applications and technologies. Our optical character recognition, digital paper management and eForms applications are used by leading corporations, government organizations and technology vendors to instantly convert paper documents into digital information.

With the acquisition of certain Lernout & Hauspie ("L&H") assets in December 2001, ScanSoft added speech and language solutions to its portfolio of productivity-enhancing applications and technologies. The group of assets acquired includes the RealSpeak text-to-speech technology, Dragon speech recognition software and other speech and voice-related technologies aimed at the rapidly growing telecommunications, automotive and mobile device markets. ScanSoft believes that its speech-based technology and intellectual property is widely considered the finest in the industry.

ScanSoft, Inc. was incorporated as Visioneer, Inc. in March 1992 and through December 1998, developed and sold scanner hardware and software products. On January 6, 1999, Visioneer sold the hardware business and the Visioneer brand name to Primax Electronics, Ltd., and on March 2, 1999, Visioneer acquired ScanSoft, in a cash election merger, from Xerox Corporation. The corporate entity "Visioneer" survived the merger, but changed its name to "ScanSoft, Inc." In addition, Visioneer changed the ticker symbol for its common stock that trades on the NASDAQ, to "SSFT."

Our success in the future will depend on our ability to maintain and improve software gross margins and to increase sales of our software products. This will depend in part on our ability and the ability of our distributors, resellers and OEM partners to convince end-users to adopt paper and image input systems for the desktop and to educate end-users about the benefits of our products. Since the Caere acquisition in the first quarter of 2000, we have experienced quarterly operating losses. There can be no assurance that we will be able to reach quarterly profitability or attain annual profitability in the near future. As of March 31, 2002, we had an accumulated deficit of $156.1 million.

As discussed in Note 2 to the Notes to Unaudited Consolidated Financial Statements, the Company is restating its consolidated financial statements as of and for the three months ended March 31, 2002 to reclassify to goodwill from other tangible and intangible assets a portion of the purchase price consideration paid in connection with the Company's acquisition of certain assets of Lernout & Hauspie N.V. on December 12, 2001 and to reduce the related amortization expense. This restatement is a result of the change in the accounting for the acquisition as a business rather than as the acquisition of assets as previously reported. As a result of this restatement, our reported net loss for the three months ended March 31, 2002 decreased from $3,494,000 or $0.06 per share to $2,882,000 or $0.05 per share as a result of recording lower amortization expense for that period. The restatement had no effect on our reported cash flows from operations. The accompanying Management's Discussion and Analysis has been revised to reflect the effects of this restatement.

RECENT DEVELOPMENTS

On January 1, 2002, the Company adopted EITF 01-9, which requires amounts paid to resellers to be treated as a reduction of revenue, unless the consideration relates to an identifiable benefit, in which case such consideration may be recorded as an operating expense. The Company evaluates its marketing programs quarterly to ensure criteria are met for expense classification.

RESULTS OF OPERATIONS

The following table presents, as a percentage of net revenue, certain selected financial data for the three months ended March 31, 2002 and 2001:

	THREE MONTHS ENDED MARCH 31,	
	2002 (RESTATED)	2001
Net revenue	100.0%	100.0%
Cost and expenses:		
Cost of revenue	17.4%	23.1%
Research and development	29.3%	25.6%
Selling, general and administrative	40.9%	50.3%

Amortization of goodwill and other intangible assets...	18.9%	54.6%
Restructuring and other charges, net..................	4.4%	0.0%
Total costs and expenses...........................	110.9%	153.6%
Loss from operations....................................	(10.9)%	(53.6)%
Other income (expense), net.............................	(0.3)%	(1.1)%
Loss before income taxes................................	(11.2)%	(54.7)%
Provision for income taxes..............................	0.9%	0.5%
Net loss..	(12.1)%	(55.2)%

NET REVENUE

Net revenue of $23.8 million for the three months ended March 31, 2002 increased by $11.3 million or 90% from the comparable period in 2001. Revenue growth resulted primarily from revenues generated by the speech and language technology assets acquired

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from L&H on December 12, 2001, particularly from sales of Dragon Naturally Speaking products. Revenue growth in our digital imaging products came from increased sales of the Company's OmniPage Pro 11 and PaperPort Deluxe products and the recognition of revenue previously deferred on a significant long-term OEM contract. Additionally, fees from licensing our RealSpeak text-to-speech technology and embedded ASR revenues grew steadily throughout the quarter.

Geographic revenue classification is based on the country in which the sale is invoiced. Revenue for the three months ended March 31, 2002 was 78% North America and 22% international versus 77% and 23%, respectively for the comparable period in 2001. A number of the Company's OEM partners distribute their products throughout the world and do not provide us with the geographical dispersion of their products. However, based on an estimate of our OEM partners' geographical revenue mix to our revenues generated from these OEM partners, revenue for the three months ended March 31, 2002 and 2001 was 70% North America and 30% international.

The breakdown of net revenue for the three months ended March 31, 2002 was 40% VAR/retail, 14% direct and 46% licensing.

This compared to 54% VAR/retail, 12% direct and 34% licensing for the same period in 2001. The change in the revenue mix for the three months ended March 31, 2002 as compared to the same period in 2001 is the result of the commitment of additional resources to licensing, including an increased sales force hired in connection with the L&H asset acquisition.

COST OF REVENUE

Cost of revenue consists primarily of material costs, third party royalties, fulfillment, and salaries for product support personnel and related costs associated with contracts, which are accounted for under the percentage of completion method. Cost of revenue for the three months ended March 31, 2002 was $4.1 million or 17% of revenue, compared to $2.9 million or 23% of revenue in the comparable period of 2001. The decrease in cost of revenue as a percentage of revenue is due to higher proportion of OEM and corporate licensing revenues as well as higher product revenues over a relatively fixed cost base for certain manufacturing costs. We anticipate that cost of revenue as a percentage of revenue will continue to decline over the course of 2002, as a result of our productivity initiatives and lower direct fulfillment costs.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist primarily of salary and benefit costs of engineers. Research and development costs were $7.0 million or 29% of revenue in the three months ended March 31, 2002, compared to $3.2 million or 26% of revenue for the same three months in 2001. The increase in research and development expenses as a percentage of revenue and in absolute dollars for the period ended March 31, 2002 is the result of increased headcount and costs associated with the L&H asset acquisition that was completed on December 12, 2001. We increased headcount by approximately 138 employees with the L&H asset acquisition. We anticipate that research and development expenses as a percentage of revenue for the remainder of 2002 will decline slightly compared to the three month period ended March 31, 2002, as a result of future cost savings associated with the restructuring action.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling expenses include salaries, commissions, advertising, direct mail, public relations, trade shows, travel and other related sales and marketing expenses. General and administrative expenses include personnel costs for administration, finance, human resources, information systems, and general management in addition to legal, accounting and other professional services.

Selling, general and administrative expenses were $9.7 million or 41% of revenue in the three months ended March 31, 2002, compared to $6.3 million or 50% of revenue for the same three months in 2001. The decrease in selling, general and administrative expenses as a percentage of revenue is the result of synergies associated with the L&H asset acquisition, focused marketing spending and revenue growth. The decrease was partially offset by increased headcount and added facility costs associated with the L&H asset acquisition. We increased headcount by approximately 74 employees with the L&H asset acquisition. We anticipate selling, general and administrative expenses as a percentage of revenue for the remainder of 2002 to remain consistent with the three month period ended March 31, 2002.

AMORTIZATION OF GOODWILL AND OTHER INTANGIBLE ASSETS

Amortization of goodwill and intangible assets for the three months ended March 31, 2002 was $4.5 million compared to $6.8 million for the comparable period in 2001. The decrease in amortization of intangible assets of $2.3 million is a result of the adoption

of SFAS 142, upon which the Company ceased amortization of goodwill, which amounted to approximately $2.6 million per quarter. This reduction was offset by $0.5 million of amortization expense associated with the L&H asset acquisition.

RESTRUCTURING AND OTHER CHARGES

In January 2002, the Company announced and in March 2002 completed a restructuring plan to consolidate facilities, world-wide sales organizations, research and development teams and other personnel following the December 12, 2001 acquisition of the L&H assets. As a result, the Company exited facilities in both North America and Europe eliminating 21 employee positions including 12 in research and development and 9 in selling, general and administrative functions. In the first quarter of 2002, the Company recorded a restructuring charge in the amount of $0.6 million for severance payments to these employees, and a restructuring charge of $0.4 million for certain termination fees to be incurred as a result of exiting the facilities.

For the quarter ended March 31, 2002, the Company paid a total of $0.1 million in severance payments, of which $70,000 relates to the March 2002 restructuring with the balance of $50,000 relating to severance paid to the former Caere President and CEO.

At March 31, 2002, the remaining restructuring accrual from the current and prior restructuring activities amounted to $1.4 million. This balance is comprised of $0.8 million of severance and lease exit costs resulting from the 2002 restructuring and $0.6 million of severance to the former Caere President and CEO. All amounts relating to the 2002 restructuring will be paid in full over the course of 2002. The severance due to the former Caere President and CEO will be paid through March 2005.

The Company anticipates that the 2002 restructuring action will provide future cost savings through December 31, 2002 of $1.3 million, of which $1.0 million relates to employee related costs and $0.3 million relates to lease exit costs.

OTHER INCOME (EXPENSE), NET

Other income (expense), net consists primarily of interest earned on cash and cash equivalents and short-term investments offset by interest incurred for borrowings under credit facilities and notes payable, and currency exchange gains and losses.

Interest income was $54,000 and $39,000 for the three-month period ended March 31, 2002 and 2001, respectively. The increase in interest income was the result of significantly higher cash and cash equivalents. Interest expense was $85,000 and $129,000 for the three-month period ended March 31, 2002 and 2001, respectively. The decrease in interest expense resulted from the repayment of all bank borrowings under the bank credit facility during May 2001. This was offset by interest expense on the L&H promissory notes issued in connection with the L&H asset acquisitions that were completed in 2002 and 2001. The remaining balance in other income (expense), net for the three months ended March 31, 2002 consists primarily of foreign currency losses. Other income (expense), net for the three months ended March 31, 2001 includes foreign currency losses offset by a gain on the sale of property and equipment.

TAXATION

The tax provision of $206,000 and $61,000 for the three months ended March 31, 2002 and 2001, respectively, represent taxes for foreign and state jurisdictions in which the Company does business and for which no operating loss carryforwards are available.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2002, we had cash and cash equivalents of $12.8 million and net working capital of $5.9 million, as compared to $14.3 million in cash and cash equivalents and net working capital of $9.3 million at December 31, 2001.

Net cash provided in operating activities for the three months ended March 31, 2002 was $0.2 million as compared to $1.0 million cash provided for the same period in 2001. The cash provided in operations in 2002 came primarily from operating results which included the recognition of revenue on a long-term contract that was classified as deferred revenue at December 31, 2001 and for which cash was collected in a prior period as well as higher balances in accounts payable and other assets, which was offset by higher balances in inventory and prepaid expenses.

Net cash used in investing activities during the three months ended March 31, 2002, was $2.9 million as compared to $0.2 million cash provided for the same period in 2001. Net cash used in investing activities during 2002 consisted of $0.7 million in capital expenditures to build-out facilities in both North America and Europe, $0.5 million for the acquisition of the L&H audiomining assets, $0.7 million related to the payment of acquisition related liabilities and $55,000 in principal on a note payable that was issued in connection with the acquisition of the L&H assets. Additionally, the

Company paid $1.0 million to the former Caere President and CEO in connection with the settlement of the non-competition and consulting agreement. The comparable period in 2001 included capital expenditures of $0.1 million, offset by $0.3 million in proceeds from the sale of property and equipment.

Net cash provided by financing activities for the three months ended March 31, 2002 was $1.1 million as compared to $0.8 million used in financing activities for the same period in 2001. Net cash provided by financing activities during 2002 consisted of proceeds of $1.2 million from the exercise of stock options, offset by a $0.1 million payment on our capital lease obligation. The comparable period in 2001 included payments of $0.8 million on our line of credit and proceeds of $60,000 from issuance of common stock.

On April 12, 2002, the Company completed the private placement of 1.0 million shares of common stock at a purchase price of $6.00 per share with a new institutional investor, resulting in gross proceeds of approximately $6.0 million.

The Company has sustained recurring losses and had an accumulated deficit of $156.1 million at March 31, 2002. We believe that operating expense levels in combination with expected future revenues will result in positive cash flows from operations for 2002. We also believe that we have the ability to reduce operating expenses to levels commensurate with revenues to maintain positive cash flows from operations. Therefore, we believe that cash flows from future operations in addition to cash on hand will be sufficient to meet our working capital, investing, financing and contractual obligations as they become due, including stock repurchase programs and potential business or asset acquisitions, for the foreseeable future.

FOREIGN OPERATIONS

We develop and sell our products throughout the world. As a result of the Caere acquisition in March 2000, and the L&H acquisition in December 2001, we significantly increased our presence in Europe and added operations in Asia. With our increased international presence in a number of geographic locations and with international revenues projected to increase in 2002, we are exposed to changes in foreign currencies including the Euro, Japanese Yen and the Hungarian Forint. Changes in the value of the Euro or other foreign currencies relative to the value of the U.S. Dollar could adversely affect future revenues and operating results. We do not generally hedge any of our foreign-currency denominated transactions.

FACTORS THAT MAY AFFECT FUTURE RESULTS

ScanSoft's business operates in an intensely competitive environment and operations are subject to risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) the loss of, or a significant curtailment of, purchases by any one or more principal customers; (2) the cyclicality of the retail software industry; (3) the inability to protect ScanSoft's proprietary technology and intellectual property; (4) the inability to attract or retain skilled employees; (5) technological obsolescence of current products and the inability to develop new products; (6) the inability to respond to competitive technology and competitive pricing pressures; and (7) the ability to sustain product revenues upon the introduction of new products. Our quarterly operating results may fluctuate and differ materially from one quarter to the next which could have an impact on our stock price.

There can be no assurance that any cash generated by operations will be sufficient to satisfy our liquidity requirements, and we may be required to sell additional equity or debt securities, or obtain lines of credit. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders. It may be difficult to sell additional equity or obtain debt financing, and this could result in significant constraints on ScanSoft's ongoing investments to grow revenue and develop new products.

For further discussion regarding these and other risks, refer to ScanSoft's Annual Report on Form 10-K for the year ended December 31, 2001 filed with the Securities and Exchange Commission on April 1, 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We develop our products in the United States, Belgium and Hungary. We sell our products globally, primarily through an indirect reseller channel. As a result, our financial results are affected by factors such as changes in foreign currency exchange rates and weak economic conditions in foreign markets.

We collect a portion of our revenue and pay a portion of our operating expenses in foreign currencies. As a result, changes in currency exchange rates from time to time may affect our operating results. Currently, we do not engage in hedging transactions to reduce our exposure to changes in currency exchange rates, although we may do so in the future.

PART II. OTHER INFORMATION

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

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The exhibits listed on the Exhibit Index hereto are filed or incorporated by reference (as stated therein) as part of this report on Form 10-Q/A*.

(b) Reports on Form 8-K

Settlement of the non-competition and consulting agreement with former Caere President and CEO, dated as of March 5, 2002*.

* Previously filed

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the Registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Peabody, State of Massachusetts, on August 14, 2002.

SCANSOFT, INC.

By: /s/ GERALD C. KENT, JR.

Gerald C. Kent, Jr.
Vice President, Chief Accounting Officer and Controller

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EXHIBIT INDEX

Exhibits (numbered in accordance with Item 601 of Regulation S-K)

EXHIBIT NO.	DESCRIPTION OF EXHIBITS
2.1(1)	Agreement and Plan of Merger dated December 2, 1998, between Visioneer, Inc., a Delaware corporation, and ScanSoft, Inc., a Delaware corporation.
2.2(2)	Agreement and Plan of Reorganization, dated January 15, 2000, by and among ScanSoft, Inc., a Delaware corporation, Scorpion Acquisitions Corporation, a Delaware corporation and a wholly-owned subsidiary of ScanSoft, and Caere Corporation, a Delaware corporation.
3.1(3)	Bylaws of Registrant.
3.2(6)	Amended and Restated Certificate of Incorporation of Registrant.
4.1(4)	Specimen Common Stock Certificate.
4.2(5)	Preferred Shares Rights Agreement, dated as of October 23, 1996, between the Registrant and U.S. Stock Transfer Corporation, including the Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock, the form of Rights Certificate and Summary of Rights attached thereto as Exhibits A, B and C, respectively.
4.3(1)	Common Stock Purchase Warrant.
4.4(1)	Registration Rights Agreement dated March 2, 1999, between the Registrant and Xerox Corporation.
10.1(7)	Termination Agreement, dated March 5, 2002, by and between ScanSoft, Inc., a Delaware corporation and Robert Teresi
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Incorporated by reference from the Registrant's Registration Statement on Form S-4 (No. 333-70603) filed with the Commission on January 14, 1999.

(2) Incorporated by reference from the Registrant's Registration Statement on Form S-4 (No. 333-96487) filed with the Commission on February 9, 2000.

(3) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (No. 333-98356) filed with the Commission on October 19, 1995.

(4) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (No. 33-98356) filed with the Commission on October 19, 1995.

(5) Incorporated by reference from the Registrant's Current Report on Form 8-K dated October 31, 1996.

(6) Incorporated by reference from the Registrant's Current Report on Form 10-Q dated May 11, 2001.

(7) Incorporated by reference from the Registrant's Current Report on Form 8-K dated March 7, 2002.