PROGRESS SOFTWARE CORP /MA
Form 10-Q
October 12, 2010

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

FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended August 31, 2010

OR

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

Commission File Number: 033-41752

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of September 30, 2010, there were 43,287,000 shares of the registrant s common stock, $.01 par value per share, outstanding.

PROGRESS SOFTWARE CORPORATION
FORM 10-Q
FOR THE NINE MONTHS ENDED AUGUST 31, 2010
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PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements
Condensed Consolidated Balance Sheets (unaudited)

(In thousands)

	August 31, 2010	November 30, 2009
Assets		
Current assets:		
Cash and equivalents	$ 255,049	$ 175,873
Short-term investments	14,164	48,248
Total cash and short-term investments	269,213	224,121
Accounts receivable, net	84,966	98,872
Other current assets	25,266	20,193
Deferred income taxes	14,932	14,433
Total current assets	394,377	357,619
Property and equipment, net	57,963	59,625
Acquired intangible assets, net	90,646	86,389
Goodwill	239,471	218,498
Deferred income taxes	33,520	30,638
Long-term investments and other	44,343	46,081
Total	$ 860,320	$ 798,850
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion, long-term debt	$ 380	$ 358
Accounts payable	6,337	12,400
Accrued compensation and related taxes	36,699	44,472
Income taxes payable	1,538	4,082
Other accrued liabilities	34,217	24,369
Short-term deferred revenue	134,334	141,243
Total current liabilities	213,505	226,924
Long-term debt, less current portion	377	664
Long-term deferred revenue	3,342	4,511
Deferred income taxes	3,262	3,445
Other non-current liabilities	6,696	7,854

Commitments and contingencies		
Shareholders equity:		
Common stock and additional paid-in capital; authorized, 100,000 shares; issued and outstanding, 43,044 shares in 2010 and 40,604 shares in 2009	314,563	247,265
Retained earnings, including accumulated other comprehensive losses of $(10,020) in 2010 and $(3,385) in 2009	318,575	308,187
Total shareholders equity	633,138	555,452
Total	$ 860,320	$ 798,850

See notes to unaudited condensed consolidated financial statements.

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Condensed Consolidated Statements of Operations (unaudited)

(In thousands, except per share data)

	Three Months Ended Aug. 31,		Nine Months Ended Aug. 31,	
	2010	2009	2010	2009
Revenue:				
Software licenses	$ 44,748	$ 39,173	$ 136,093	$ 123,538
Maintenance and services	83,989	80,260	247,847	233,802
Total revenue	128,737	119,433	383,940	357,340
Costs of revenue:				
Cost of software licenses	2,025	1,758	5,633	5,602
Cost of maintenance and services	17,845	15,957	53,086	49,287
Amortization of acquired intangibles for purchased technology	4,839	4,811	15,222	14,609
Total costs of revenue	24,709	22,526	73,941	69,498
Gross profit	104,028	96,907	309,999	287,842
Operating expenses:				
Sales and marketing	39,362	45,511	122,707	133,331
Product development	21,941	22,378	68,481	70,320
General and administrative	11,937	17,717	38,167	46,123
Amortization of other acquired intangibles	2,733	2,310	7,833	7,149
Restructuring expense	11,533	(211)	37,508	5,237
Acquisition-related expenses	53	110	468	330
Total operating expenses	87,559	87,815	275,164	262,490
Income from operations	16,469	9,092	34,835	25,352
Other income (expense):				
Interest income and other	615	560	2,677	2,192
Foreign currency gain (loss)	(2,335)	(747)	2,278	(1,610)
Total other income (expense), net	(1,720)	(187)	4,955	582
Income before provision for income taxes	14,749	8,905	39,790	25,934
Provision for income taxes	5,505	3,384	12,495	9,855
Net income	$ 9,244	$ 5,521	$ 27,295	$ 16,079

Earnings per share:				
Basic	$ 0.21	$ 0.14	$ 0.65	$ 0.40
Diluted	$ 0.21	$ 0.13	$ 0.62	$ 0.39
Weighted average shares outstanding:				
Basic	43,224	40,117	42,280	40,018
Diluted	44,424	41,261	43,782	40,826

See notes to unaudited condensed consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows (unaudited)

(In thousands)

	Nine Months Ended August 31, 2010	2009
Cash flows from operating activities:		
Net income	$ 27,295	$ 16,079
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	8,296	8,794
Amortization of acquired intangible assets	23,055	21,757
Stock-based compensation	13,201	16,914
Deferred income taxes	(1,155)	(3,753)
Tax benefit from stock plans	6,058	(508)
Excess tax benefit from stock plans	(3,486)	(13)
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	13,342	15,205
Other current assets	(3,296)	740
Accounts payable and accrued liabilities	(2,999)	(32,000)
Income taxes payable	(6,717)	965
Deferred revenue	(3,059)	(8,458)
Net cash provided by operating activities	70,535	35,722
Cash flows from investing activities:		
Purchases of investments available for sale	(14,552)	(70,063)
Sales and maturities of investments available for sale	30,896	35,584
Redemptions and repurchases of auction rate securities	18,990	7,050
Purchases of property and equipment	(7,091)	(6,061)
Acquisitions	(49,186)	
Decrease (increase) in other non-current assets	280	(499)
Net cash used for investing activities	(20,663)	(33,989)
Cash flows from financing activities:		
Issuance of common stock	67,814	7,407
Excess tax benefit from stock plans	3,486	13
Withholding tax payments related to net issuance of restricted stock units	(711)	
Payment of long-term debt	(266)	(244)
Repurchase of common stock	(29,336)	(5,145)
Net cash provided by financing activities	40,987	2,031
Effect of exchange rate changes on cash	(11,683)	11,870
Net increase in cash and equivalents	79,176	15,634

Cash and equivalents, beginning of period	175,873	96,485
Cash and equivalents, end of period	$ 255,049	$ 112,119

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 these unaudited financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

We have made no significant changes in the application of our significant accounting policies other than required changes that were disclosed in our Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

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.

We evaluated subsequent events through the date and time our condensed consolidated financial statements were issued.

Note 2: Revenue Recognition

We recognize software license revenue upon shipment of the product or, if delivered electronically, when the customer has the right to access the software, provided that the license fee is fixed or determinable, persuasive evidence of an arrangement exists and collection is probable. We do not 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. If software licenses are sold on a subscription basis, we recognize the license fee ratably over the subscription period. 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.

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Note 3: Earnings Per Share

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

(In thousands, except per share data)

	Three Months Ended Aug. 31,		Nine Months Ended Aug. 31,	
	2010	2009	2010	2009
Net income	$ 9,244	$ 5,521	$ 27,295	$ 16,079
Weighted average shares outstanding	43,224	40,117	42,280	40,018
Dilutive impact from common stock equivalents	1,200	1,144	1,502	808
Diluted weighted average shares outstanding	44,424	41,261	43,782	40,826
Earnings per share:				
Basic	$ 0.21	$ 0.14	$ 0.65	$ 0.40
Diluted	$ 0.21	$ 0.13	$ 0.62	$ 0.39

We excluded stock awards representing approximately 3,296,000 shares and 5,894,000 shares of common stock from the calculation of diluted earnings per share in the third quarter of fiscal years 2010 and 2009, respectively, because these awards were anti-dilutive. We excluded stock awards representing approximately 2,931,000 shares and 7,012,000 shares of common stock from the calculation of diluted earnings per share in the first nine months of fiscal years 2010 and 2009, respectively, because these awards were anti-dilutive.

Note 4: Stock-based Compensation

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant service period. We estimate the fair value of each stock-based award on the measurement date using either the current market price or 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. We recognize stock-based compensation expense ratably over the service period of the award, which is generally five years for options, and three years for restricted stock units and restricted stock awards.

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

(In thousands)

	Three Months Ended Aug. 31,		Nine Months Ended Aug. 31,	
	2010	2009	2010	2009
Cost of software licenses	$ 7	$ 8	$ 22	$ 28
Cost of maintenance and services	225	238	684	706
Sales and marketing	1,340	1,445	4,132	4,331
Product development	1,066	1,037	3,139	2,984
General and administrative	1,351	6,121	4,689	8,865

Restructuring	210		535	
Total stock-based compensation expense	$ 4,199	$ 8,849	$ 13,201	$ 16,914

Note 5: Income Taxes

We provide for deferred income taxes resulting from temporary differences between financial and taxable income. 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.

Our federal income tax returns are closed by statute for all years prior to fiscal 2006 and we are no longer subject to audit for those periods. Certain state taxing authorities are currently examining our income tax returns for years through fiscal 2008.

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Our state income tax returns have been examined or are closed by statute for all years prior to fiscal 2005. Tax authorities for certain non-U.S. jurisdictions are also examining returns affecting unrecognized tax benefits, none of which are material to our balance sheet, cash flows or statements of operations. With some exceptions, we are generally no longer subject to tax examinations in non-U.S. jurisdictions for years prior to fiscal 2003.

In the first nine months of fiscal 2010, we recorded a nonrecurring tax benefit of $2.5 million. The nonrecurring tax benefit related to a change in estimate of the magnitude of our foreign earnings and profits utilized to determine the tax characterization of certain international cash repatriation (based on the completion of a comprehensive earnings and profits study), partially offset by resolution of certain of our uncertain tax positions related to netting of intercompany balances.

We believe that we have adequately provided for any reasonably foreseeable outcomes related to our tax audits and that any settlement will not have a material adverse effect on our consolidated financial position or results of operations. However, there can be no assurances as to the possible outcomes.

Note 6: Investments

A summary of our available for sale investments by major security type at August 31, 2010 is as follows:

(In thousands)

Security Type	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
State and municipal bond obligations	$ 10,408	$ 306	$	$ 10,714
US government and agency securities	9,999			9,999
Auction rate securities municipal bonds	27,200		(3,883)	23,317
Auction rate securities student loans	19,000		(2,613)	16,387
Certificates of deposit	2,424			2,424
Total	$ 69,031	$ 306	$ (6,496)	$ 62,841

Such amounts are classified on our balance sheet at August 31, 2010 as follows:

(In thousands)

Security Type	Cash Equivalents	Short-term Investments	Long-term Investments
State and municipal bond obligations	$	$ 10,714	$
US government and agency securities	7,499	2,500	
Auction rate securities municipal bonds			23,317
Auction rate securities student loans			16,387
Certificates of deposit	1,474	950	
Total	$ 8,973	$ 14,164	$ 39,704

For each of the auction rate securities (ARS) , we evaluated the risks related to the structure, collateral and liquidity of the investment, and forecasted the probability of issuer default, auction failure and a successful auction at par or a redemption at par for each future auction period. The weighted average cash flow for each period was then discounted back to present value for each security. Based on this methodology, we determined that the fair value of our non-current ARS investments is $39.7 million, and the temporary impairment charge recorded at August 31, 2010 in accumulated other comprehensive loss to reduce the value of our available-for-sale ARS investments was

$6.5 million.

We will not be able to access these remaining funds until a future auction for these ARS is successful, we sell the securities in a secondary market, or they are redeemed by the issuer. As such, these remaining investments currently lack short-term liquidity and are therefore classified as long-term investments on the balance sheet at August 31, 2010. However, based on our cash and short-term investments balance of $269.2 million and expected operating cash flows, we do not anticipate the lack of liquidity associated with these ARS to adversely affect our ability to conduct business and believe we have the ability to hold the affected securities throughout the currently estimated recovery period. Therefore, the impairment on these securities is considered only temporary in nature. If the credit rating of either the security issuer or the third-party insurer underlying the investments deteriorates significantly, we may be required to adjust the carrying value of the ARS through an other-than-temporary impairment charge to earnings.

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A summary of our investments by major security type at November 30, 2009 is as follows:

(In thousands)

Security Type	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
State and municipal bond obligations	$ 10,371	$ 272	$ (3)	$ 10,640
US government and agency securities	11,072			11,072
Auction rate securities municipal bonds	27,950		(4,205)	23,745
Auction rate securities student loans	19,500		(2,531)	16,969
Certificates of deposit	11,653		(1)	11,652
Subtotal available-for-sale securities	80,546	272	(6,740)	74,078
Put option related to ARS rights offering		1,596		1,596
Auction rate securities student loans	17,740		(1,596)	16,144
Subtotal trading securities	17,740	1,596	(1,596)	17,740
Total	$ 98,286	$ 1,868	$ (8,336)	$ 91,818

Such amounts are classified on our balance sheet at November 30, 2009 as follows:

(In thousands)

Security Type	Cash Equivalents	Short-term Investments	Long-term Investments
State and municipal bond obligations	$	$ 10,640	$
US government and agency securities	2,500	8,572	
Auction rate securities municipal bonds			23,745
Auction rate securities student loans			16,969
Certificates of deposit	356	11,296	
Subtotal available-for-sale securities	2,856	30,508	40,714
Put option related to ARS rights offering		1,596	
Auction rate securities student loans		16,144	
Subtotal trading securities		17,740	
Total	$ 2,856	$ 48,248	$ 40,714

The put option related to the ARS rights offering was exercisable beginning on June 30, 2010. On such date, we exercised the put option and our remaining portfolio of ARS trading securities was repurchased at par by UBS, the investment firm that brokered the original purchase of these ARS.

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The fair value of our investments at August 31, 2010 and November 30, 2009, by contractual maturity, is as follows:

(In thousands)

	Aug. 31, 2010	Nov. 30, 2009
Due in one year or less (1)	$ 54,929	$ 80,396
Due after one year	7,912	9,826
Total	$ 62,841	$ 90,222

(1) Includes ARS which are tendered for interest-rate setting purposes periodically throughout the year. Beginning in February 2008, auctions for these securities began to fail, and therefore these investments currently lack short-term liquidity. The remaining contractual maturities of these securities range from 6 to 37 years.

Investments with continuous unrealized losses for less than twelve months and twelve months or greater and their related fair values are as follows at August 31, 2010:

(In thousands)

Security Type	Fair Value	Less Than 12 Months Unrealized Losses	Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses

State and municipal bond obligations	$	$	$	$	$	$
US government and agency securities						