

PROGRESS SOFTWARE CORP /MA

Form 10-Q

April 05, 2019

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended February 28, 2019

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 0-19417

PROGRESS SOFTWARE CORPORATION  
(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes  No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Edgar Filing: PROGRESS SOFTWARE CORP /MA - Form 10-Q

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

As of March 27, 2019, there were 44,494,726 shares of the registrant's common stock, \$.01 par value per share, outstanding.

---

Table of Contents

PROGRESS SOFTWARE CORPORATION  
FORM 10-Q  
FOR THE THREE MONTHS ENDED FEBRUARY 28, 2019  
INDEX

PART I FINANCIAL INFORMATION

Item 1.	<u>Financial Statements (Unaudited)</u>	<u>3</u>
	<u>Condensed Consolidated Balance Sheets as of February 28, 2019 and November 30, 2018</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Operations for the three months ended February 28, 2019 and February 28, 2018</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Comprehensive Income for the three months ended February 28, 2019 and February 28, 2018</u>	<u>5</u>
	<u>Condensed Consolidated Statements of Shareholders' Equity for the three months ended February 28, 2019 and February 28, 2018</u>	<u>6</u>
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended February 28, 2019 and February 28, 2018</u>	<u>7</u>
	<u>Notes to Condensed Consolidated Financial Statements</u>	<u>9</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>36</u>
Item 4.	<u>Controls and Procedures</u>	<u>36</u>

PART II OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	<u>38</u>
Item 1A.	<u>Risk Factors</u>	<u>38</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>45</u>
Item 5.	<u>Other Information</u>	<u>45</u>
Item 6.	<u>Exhibits</u>	<u>46</u>
	<u>Signatures</u>	<u>47</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

## Condensed Consolidated Balance Sheets

	February 28, 2019	November 30, 2018
		As Adjusted <sup>(1)</sup>
(In thousands, except share data)		
Assets		
Current assets:		
Cash and cash equivalents	\$ 106,516	\$ 105,126
Short-term investments	26,942	34,387
Total cash, cash equivalents and short-term investments	133,458	139,513
Accounts receivable (less allowances of \$725 and \$840, respectively)	54,572	59,715
Unbilled receivables	2,121	1,421
Other current assets	19,757	25,080
Assets held for sale	5,776	5,776
Total current assets	215,684	231,505
Long-term unbilled receivables	2,581	1,811
Property and equipment, net	29,351	30,714
Intangible assets, net	50,297	58,919
Goodwill	315,010	314,992
Deferred tax assets	889	966
Other assets	2,079	5,243
Total assets	\$ 615,891	\$ 644,150
Liabilities and shareholders' equity		
Current liabilities:		
Current portion of long-term debt, net	\$ 6,593	\$ 5,819
Accounts payable	9,823	10,593
Accrued compensation and related taxes	14,984	25,500
Dividends payable to shareholders	6,939	6,998
Income taxes payable	1,233	1,228
Other accrued liabilities	11,887	12,686
Short-term deferred revenue	130,569	123,210
Total current liabilities	182,028	186,034
Long-term debt, net	108,042	110,270
Long-term deferred revenue	11,614	12,730
Deferred tax liabilities	2,665	5,799
Other noncurrent liabilities	4,840	5,315
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value; authorized, 10,000,000 shares; issued, none	—	—
Common stock, \$0.01 par value, and additional paid-in capital; authorized, 200,000,000 shares; issued and outstanding, 44,473,947 shares in 2019 and 45,114,935 shares in 2018	272,854	267,053
Retained earnings	60,462	85,125
Accumulated other comprehensive loss	(26,614)	(28,176)
Total shareholders' equity	306,702	324,002

Total liabilities and shareholders' equity	\$ 615,891	\$ 644,150
--	------------	------------

<sup>(1)</sup>The Company adopted the accounting standard related to revenue recognition ("ASC 606") effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

See notes to unaudited condensed consolidated financial statements.

3

---

Table of Contents

## Condensed Consolidated Statements of Operations

	Three Months Ended	
	February 28, 2019	February 28, 2018
(In thousands, except per share data)		As Adjusted <sup>(1)</sup>
Revenue:		
Software licenses	\$22,802	\$ 26,054
Maintenance and services	66,747	69,356
Total revenue	89,549	95,410
Costs of revenue:		
Cost of software licenses	1,167	1,261
Cost of maintenance and services	9,439	9,824
Amortization of acquired intangibles	5,433	5,818
Total costs of revenue	16,039	16,903
Gross profit	73,510	78,507
Operating expenses:		
Sales and marketing	22,323	21,428
Product development	19,890	20,245
General and administrative	12,285	11,262
Amortization of acquired intangibles	3,188	3,319
Fees related to shareholder activist	—	1,258
Restructuring expenses	415	1,821
Acquisition-related expenses	—	43
Total operating expenses	58,101	59,376
Income from operations	15,409	19,131
Other (expense) income:		
Interest expense	(1,389 )	(1,165 )
Interest income and other, net	229	408
Foreign currency loss, net	(843 )	(828 )
Total other expense, net	(2,003 )	(1,585 )
Income before income taxes	13,406	17,546
Provision for income taxes	4,004	3,814
Net income	\$9,402	\$ 13,732
Earnings per share:		
Basic	\$0.21	\$ 0.30
Diluted	\$0.21	\$ 0.29
Weighted average shares outstanding:		
Basic	44,956	46,529
Diluted	45,286	47,476

Cash dividends declared per common share \$0.155 \$ 0.140

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

See notes to unaudited condensed consolidated financial statements.



Table of Contents

## Condensed Consolidated Statements of Comprehensive Income

	Three Months Ended	
	February 28, 2019	February 28, 2018
(In thousands)		As Adjusted <sup>(1)</sup>
Net income	\$9,402	\$ 13,732
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	1,479	3,831
Unrealized gain (loss) on investments, net of tax provision of \$30 and \$39 for 2019 and 2018, respectively	83	(27 )
Total other comprehensive income, net of tax	1,562	3,804
Comprehensive income	\$10,964	\$ 17,536

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1.

Nature of Business and Basis of Presentation for further information.

See notes to unaudited condensed consolidated financial statements.



Table of Contents

## Condensed Consolidated Statements of Shareholders' Equity

(in thousands)	Common Stock Number of Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 1, 2018 As Adjusted <sup>(1)</sup>	45,115	\$ 451	\$266,602	\$85,125	\$ (28,176 )	\$ 324,002
Issuance of stock under employee stock purchase plan	38	—	997	—	—	997
Exercise of stock options	9	—	268	—	—	268
Withholding tax payments related to net issuance of restricted stock units	—	—	(5 )	—	—	(5 )
Stock-based compensation	—	—	5,806	—	—	5,806
Adjustment due to adoption of ASU 2016-16 (Note 1)	—	—	—	(3,397 )	—	(3,397 )
Dividends declared	—	—	—	(6,933 )	—	(6,933 )
Treasury stock repurchases and retirements	(688 )	(5 )	(1,260 )	(23,735 )	—	(25,000 )
Net income	—	—	—	9,402	—	9,402
Other comprehensive income	—	—	—	—	1,562	1,562
Balance, February 28, 2019	44,474	\$ 446	\$272,408	\$60,462	\$ (26,614 )	\$ 306,702

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1.

Nature of Business and Basis of Presentation for further information.

(in thousands)	Common Stock Number of Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balance, December 1, 2017 As Adjusted <sup>(1)</sup>	47,281	\$ 473	\$249,363	\$179,919	\$ (18,406 )	\$ 411,349
Issuance of stock under employee stock purchase plan	48	—	1,095	—	—	1,095
Exercise of stock options	23	—	669	—	—	669
Stock-based compensation	—	—	4,570	—	—	4,570
Adjustment due to adoption of ASU 2016-09	—	—	641	(641 )	—	—
Dividends declared	—	—	—	(6,482 )	—	(6,482 )
Treasury stock repurchases and retirements	(1,054 )	(10 )	(1,754 )	(43,236 )	—	(45,000 )
Net income	—	—	—	13,732	—	13,732
Other comprehensive income	—	—	—	—	3,804	3,804
Balance, February 28, 2018 As Adjusted <sup>(1)</sup>	46,298	\$ 463	\$254,584	\$143,292	\$ (14,602 )	\$ 383,737

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1.

Nature of Business and Basis of Presentation for further information.

Table of Contents

## Condensed Consolidated Statements of Cash Flows

(In thousands)	Three Months Ended February 28, 2019	February 28, 2018 As Adjusted <sup>(1)</sup>
Cash flows from operating activities:		
Net income	\$ 9,402	\$ 13,732
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	1,620	1,682
Amortization of acquired intangibles and other	8,866	9,620
Stock-based compensation	5,806	4,570
Loss on disposal of property and equipment	153	135
Deferred income taxes	(3,069)	137
Allowances for bad debt and sales credits	89	137
Changes in operating assets and liabilities:		
Accounts receivable	3,861	8,667
Other assets	5,147	2,382
Accounts payable and accrued liabilities	(13,128)	(17,830)
Income taxes payable	(246)	(290)
Deferred revenue	5,943	8,653
Net cash flows from operating activities	24,444	31,595
Cash flows from (used in) investing activities:		
Purchases of investments	(750)	(7,374)
Sales and maturities of investments	8,155	6,816
Purchases of property and equipment	(246)	(1,386)
Net cash flows from (used in) investing activities	7,159	(1,944)

Cash flows used in financing activities:			
Proceeds from stock-based compensation plans	1,894		2,469
Repurchases of common stock	(25,000	)	(45,000 )
Dividend payments to shareholders	(6,992	)	(6,619 )
Payment of principal on long-term debt	(1,547	)	(1,547 )
Net cash flows used in financing activities	(31,645	)	(50,697 )
Effect of exchange rate changes on cash	1,432		4,693
Net increase (decrease) in cash and cash equivalents	1,390		(16,353 )
Cash and cash equivalents, beginning of period	105,126		133,464
Cash and cash equivalents, end of period	\$ 106,516		\$ 117,111

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

Table of Contents

Condensed Consolidated Statements of Cash Flows, continued

	Three Months Ended	
	February 28, 2019	February 28, 2018
Supplemental disclosure:		
Cash paid for income taxes, net of refunds of \$166 in 2019 and \$307 in 2018	\$ 1,496	\$ 1,614
Cash paid for interest	\$ 1,169	\$ 942
Non-cash investing and financing activities:		
Total fair value of restricted stock awards, restricted stock units and deferred stock units on date vested	\$ 76	\$ 43
Dividends declared	\$ 6,939	\$ 6,482
See notes to unaudited condensed consolidated financial statements.		

## Table of Contents

### Notes to Condensed Consolidated Financial Statements

#### Note 1: Basis of Presentation

Company Overview - Progress Software Corporation ("Progress," the "Company," "we," "us," or "our") offers the leading platform for developing and deploying strategic business applications. We enable customers and partners to deliver modern, high-impact digital experiences with a fraction of the effort, time and cost. Progress offers powerful tools for easily building adaptive user experiences across any type of device or touchpoint, award-winning machine learning that enables cognitive capabilities to be a part of any application, the flexibility of a serverless cloud to deploy modern apps, business rules, web content management, plus leading data connectivity technology. Over 1,700 ISVs, 100,000 enterprise customers, and 2 million developers rely on Progress to power their applications.

Our products are generally sold as perpetual licenses, but certain products also use term licensing models and our cloud-based offerings use a subscription-based model. More than half of our worldwide license revenue is realized through relationships with indirect channel partners, principally application partners and original equipment manufacturers ("OEMs"). Application partners are ISVs that develop and market applications using our technology and resell our products in conjunction with sales of their own products that incorporate our technology. OEMs are companies that embed our products into their own software products or devices.

We operate in North America and Latin America (the "Americas"); Europe, the Middle East and Africa ("EMEA"); and the Asia Pacific region, through local subsidiaries as well as independent distributors.

Basis of Presentation and Significant Accounting Policies - We 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 ("GAAP") 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, 2018, ("Annual Report on Form 10-K for the fiscal year ended November 30, 2018").

We adopted Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASC 606") effective December 1, 2018 using the full retrospective method, which required us to retroactively adjust comparative prior periods to conform to current presentation. See "Recently Adopted Accounting Pronouncements" below for further information.

We made no material changes in the application of our significant accounting policies that were disclosed in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018, except as discussed below with respect to our adoption of ASC 606. We have prepared the accompanying unaudited condensed consolidated financial statements on the same basis as the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018, 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.

#### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an on-going basis, management evaluates its estimates and records changes in estimates in the period in which they become known. These estimates are based

on historical data and experience, as well as various other assumptions that management believes to be reasonable under the circumstances. The most significant estimates relate to: the timing and amounts of revenue recognition, including the determination of the nature and timing of the satisfaction of performance obligations, the standalone selling price of performance obligations, and the transaction price allocated to performance obligations; the realization of tax assets and estimates of tax liabilities; fair values of investments in marketable securities; assets held for sale; intangible assets and goodwill valuations; the recognition and disclosure of contingent liabilities; the collectability of accounts receivable; and assumptions used to determine the fair value of stock-based compensation. Actual results could differ from those estimates.

## Table of Contents

### Revenue Recognition

#### Revenue Policy

We derive our revenue primarily from software licenses and maintenance and services. Our license arrangements generally contain multiple performance obligations, including software maintenance services. Revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration that we expect to receive in exchange for those goods or services. When an arrangement contains multiple performance obligations, we account for individual performance obligations separately if they are distinct. We recognize revenue through the application of the following steps: (i) identification of the contract(s) with a customer; (ii) identification of the performance obligations in the contract; (iii) determination of the transaction price; (iv) allocation of the transaction price to performance obligations in the contract; and (v) recognition of revenue when or as we satisfy the performance obligations. Sales taxes collected from customers and remitted to government authorities are excluded from revenue and we do not license our software with a right of return.

#### Software Licenses

Software licenses are on-premise and fully functional when made available to the customer. As the customer can use and benefit from the license on its own, on-premise software licenses represent distinct performance obligations. Revenue is recognized upfront at the point in time when control is transferred, which is defined as the point in time when the client can use and benefit from the license. Our licenses are sold as perpetual or term licenses, and the arrangements typically contain various combinations of maintenance and services, which are generally accounted for as separate performance obligations. We use the residual approach to allocate the transaction price to our software license performance obligations because, due to the pricing of our licenses being highly variable, they do not have an observable stand-alone selling price ("SSP"). As required, we evaluate the residual approach estimate compared to all available observable data in order to conclude the estimate is representative of its SSP.

Perpetual licenses are generally invoiced upon execution of the contract and payable within 30 days. Term licenses are generally invoiced in advance on an annual basis over the term of the arrangement, which is typically one to three years. Any difference between the revenue recognized and the amount invoiced to the customer is recognized on our consolidated balance sheets as unbilled receivables until the customer is invoiced, at which point the amount is reclassified to accounts receivable.

#### Maintenance

Maintenance revenue is made up of technical support, bug fixes, and when-and-if available unspecified software upgrades. As these maintenance services are considered to be a series of distinct services that are substantially the same and have the same duration and measure of progress, we have concluded that they represent one combined performance obligation. Revenue is recognized ratably over the contract period. The SSP of maintenance services is a percentage of the net selling price of the related software license, which has remained within a tight range and is consistent with the stand-alone pricing of subsequent maintenance renewals.

Maintenance services are generally invoiced in advance on an annual basis over the term of the arrangement, which is typically one to three years.

#### Services

Services revenue primarily includes consulting and customer education services. In general, services are distinct performance obligations. Services revenue is generally recognized as the services are delivered to the customer. We

apply the practical expedient of recognizing revenue upon invoicing for time and materials-based arrangements as the invoiced amount corresponds to the value of the services provided. The SSP of services is based upon observable prices in similar transactions using the hourly rates sold in stand-alone services transactions. Services are either sold on a time and materials basis or prepaid upfront.

We also offer products via a software-as-a-service ("SaaS") model, which is a subscription-based model. Our customers can use hosted software over the contract period without taking possession of it and the cloud services are available to them throughout the entire term, even if they do not use the service. Revenue related to SaaS offerings is recognized ratably over the contract period. The SSP of SaaS performance obligations is determined based upon observable prices in stand-alone SaaS transactions. SaaS arrangements are generally invoiced in advance on a monthly, quarterly, or annual basis over the term of the arrangement, which is typically one to three years.



Table of Contents

## Arrangements with Multiple Performance Obligations

When an arrangement contains multiple performance obligations, we account for individual performance obligations separately if they are distinct. We allocate the transaction price to each performance obligation in a contract based on its relative SSP. Although we do not have a history of offering these elements, prior to allocating the transaction price to each performance obligation, we consider whether the arrangement has any discounts, material rights, or specified future upgrades that may represent additional performance obligations. Determining whether products and services are distinct performance obligations and the determination of the SSP may require significant judgment.

## Contract Balances

## Unbilled Receivables and Contract Assets

The timing of revenue recognition may differ from the timing of customer invoicing. When revenue is recognized prior to invoicing and the right to the amount due from customers is conditioned only on the passage of time, we record an unbilled receivable on our condensed consolidated balance sheets. Our multi-year term license arrangements, which are typically billed annually, result in revenue recognition in advance of invoicing and the recognition of unbilled receivables.

As of February 28, 2019, invoicing of our long-term unbilled receivables is expected to occur as follows (in thousands):

2020	\$1,048
2021	1,089
2022	444
Total	\$2,581

Contract assets, which arise when revenue is recognized prior to invoicing and the right to the amount due from customers is conditioned on something other than the passage of time, such as the completion of a related performance obligation, were minimal as of February 28, 2019 and November 30, 2018. These amounts are included in unbilled receivables or long-term unbilled receivables on our condensed consolidated balance sheets.

## Deferred Revenue

Deferred revenue is recorded when revenue is recognized subsequent to customer invoicing. Our deferred revenue balance is primarily made up of deferred maintenance from our OpenEdge and Application Development and Deployment segments.

As of February 28, 2019, the changes in deferred revenue were as follows (in thousands):

Balance, December 1, 2018 As Adjusted <sup>(1)</sup>	\$135,940
Billings and other	95,792
Revenue recognized	(89,549 )
Balance, February 28, 2019	\$142,183

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method.

Transaction price allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and amounts that will be invoiced and recognized as revenue in future periods. As of February 28, 2019, transaction price allocated to remaining performance obligations was \$143 million. We expect to recognize approximately 92% of the revenue within the next year and the remainder thereafter.



## Table of Contents

### Deferred Contract Costs

Deferred contract costs, which include certain sales incentive programs, are incremental and recoverable costs of obtaining a contract with a customer. Incremental costs of obtaining a contract with a customer are recognized as an asset if the expected benefit of those costs are longer than one year. We have applied the practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include a large majority of our sales incentive programs as we have determined that annual compensation is commensurate with annual sales activities.

Certain of our sales incentive programs do meet the requirements to be capitalized. Depending upon the sales incentive program and the related revenue arrangement, such capitalized costs are amortized over the longer of (i) the product life, which is generally three to five years; or (ii) the term of the related revenue contract. We determined that a three to five year product life represents the period of benefit that we receive from these incremental costs based on both qualitative and quantitative factors, which include customer contracts, industry norms, and product upgrades. Total deferred contract costs were minimal as of February 28, 2019 and November 30, 2018 and are included in other current assets and other assets on our condensed consolidated balance sheets. Amortization of deferred contract costs is included in sales and marketing expense on our condensed consolidated statement of operations and was minimal in all periods presented.

### Recent Accounting Pronouncements

#### Recently Adopted Accounting Pronouncements

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory ("ASU 2016-16"), which requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Under legacy GAAP, the recognition of current and deferred income taxes for an intra-entity transfer was prohibited until the asset has been sold to an outside party. We adopted this standard at the beginning of the first quarter of fiscal year 2019. Upon adoption, we reclassified approximately \$3.4 million from non-current prepaid taxes, which is included in other assets on our consolidated balance sheet, to retained earnings as of December 1, 2018.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606"). Under this standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. The standard also requires new disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers and provides guidance on the recognition of costs related to obtaining customer contracts. We adopted this ASU effective December 1, 2018 in accordance with the full retrospective approach, which required us to retrospectively adjust certain previously reported results in the comparative prior periods presented. Upon adoption, we recorded a cumulative \$31 million increase to our 2017 beginning retained earnings balance, a \$15 million decrease to deferred revenue, a \$28 million increase to unbilled receivables, and a \$12 million increase to deferred tax liabilities.

The revenue recognition related to accounting for the following transactions is most impacted by our adoption of this standard:

Revenue from term licenses with extended payment terms over the term of the agreement within our Data Connectivity and Integration segment - Under the applicable revenue recognition guidance for fiscal years 2018 and prior, these transactions were recognized when the amounts were billed to the customer. In accordance with ASC 606, revenue from term license performance obligations is recognized upon delivery and revenue from maintenance performance obligations is expected to be recognized over the contract term. To the extent that we enter into these transactions, revenue from term licenses with extended payment terms will be recognized prior to the customer being

billed and we will recognize an unbilled receivable on the balance sheet. Accordingly, the recognition of license revenue is accelerated under ASC 606 as we historically did not recognize revenue until the amounts had been billed to the customer.

Revenue from transactions with multiple elements within our Application Development and Deployment segment (i.e., sales of perpetual licenses with maintenance and/or support) - Under the applicable revenue recognition guidance for fiscal years 2018 and prior, these transactions were recognized ratably over the associated maintenance period as the Company did not have vendor specific objective evidence ("VSOE") for maintenance or support. Under ASC 606, the requirement to have VSOE for undelivered elements that existed under prior guidance is eliminated. Accordingly, the Company will recognize a portion of the sales price as revenue upon delivery of the license instead of recognizing the entire sales price ratably over the maintenance period.

Table of Contents

The impact of the adoption of this standard on our previously reported consolidated balance sheets and consolidated statements of operations is as follows:

## Consolidated Balance Sheets

(in thousands)	November 30, 2018		
	As Reported	Adjustments	As Adjusted
<b>Assets</b>			
Accounts receivable, net	\$58,450	\$ 1,265	\$59,715
Short-term unbilled receivables	—	1,421	1,421
Long-term unbilled receivables	—	1,811	1,811
Deferred tax assets	1,922	(956 )	966
Other assets <sup>(1)</sup>	580,237	—	580,237
<b>Total assets</b>	<b>\$640,609</b>	<b>\$ 3,541</b>	<b>\$644,150</b>
<b>Liabilities and shareholders' equity</b>			
Short-term deferred revenue	133,194	(9,984 )	123,210
Long-term deferred revenue	15,127	(2,397 )	12,730
Deferred tax liabilities	3,797	2,002	5,799
Other liabilities <sup>(2)</sup>	178,409	—	178,409
Retained earnings	71,242	13,883	85,125
Accumulated other comprehensive loss	(28,213 )	37	(28,176 )
Other equity <sup>(3)</sup>	267,053	—	267,053
<b>Total liabilities and shareholders' equity</b>	<b>\$640,609</b>	<b>\$ 3,541</b>	<b>\$644,150</b>

<sup>(1)</sup>Includes cash and cash equivalents, short-term investments, other current assets, assets held for sale, property and equipment, net, intangible assets, net, goodwill, and other assets.

<sup>(2)</sup>Includes current portion of long-term debt, net, accounts payable, accrued compensation and related taxes, dividends payable, income taxes payable, other accrued liabilities, long-term debt, net, and other noncurrent liabilities.

<sup>(3)</sup>Includes common stock and additional paid-in capital.

Table of Contents

## Consolidated Statements of Income

(in thousands)	February 28, 2018		
	As Reported	Adjustments	As Adjusted
Revenue:			
Software licenses	\$25,343	\$ 711	\$26,054
Maintenance and services	68,704	652	69,356
Total revenue	94,047	1,363	95,410
Costs of revenue	16,903	—	16,903
Gross Profit	77,144	1,363	78,507
Operating expenses	59,376	—	59,376
Income from operations	17,768	1,363	19,131
Other expense, net	(1,585 )	—	(1,585 )
Income before income taxes	16,183	1,363	17,546
Provision for income taxes	3,271	543	3,814
Net income	\$12,912	\$ 820	\$13,732
Earnings per share:			
Basic	\$0.28	\$ 0.02	\$0.30
Diluted	\$0.27	\$ 0.02	\$0.29
Weighted average shares outstanding:			
Basic	46,529	—	46,529
Diluted	47,476	—	47,476

The adoption of ASC 606 had no impact on total cash from or used in operating, financing, or investing activities on our consolidated cash flow statements.

## Recently Issued Accounting Pronouncements Not Yet Adopted

In August 2018, the FASB issued Accounting Standards Update No. 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract ("ASU 2018-15"). ASU 2018-15 amends current guidance to align the accounting for costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing costs associated with developing or obtaining internal-use software. Capitalized implementation costs must be expensed over the term of the hosting arrangement and presented in the same line item in the statement of income as the fees associated with the hosting element (service) of the arrangement. The guidance in ASU 2018-15 is effective for annual reporting periods beginning after December 15, 2019, with early adoption permitted. We are currently accounting for costs incurred in a cloud computing arrangement in accordance with the guidance provided in ASU 2018-15.

In August 2017, the FASB issued Accounting Standards Update No. 2017-12, Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities ("ASU 2017-12"). ASU 2017-12 intends to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance in ASU 2017-12 is required for annual reporting periods beginning after December 15, 2018, with early adoption permitted. We are currently evaluating the effect that implementation of this update will have upon adoption on our consolidated financial position and results of operations.



Table of Contents

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, Intangibles - Goodwill and Other (Topic 350), Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 amends Topic 350 to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. This update requires the performance of an annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. However, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The guidance in ASU 2017-04 is required for annual reporting periods beginning after December 15, 2019, with early adoption permitted. We are currently considering whether to adopt this update prior to the required adoption date.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which requires lessees to record most leases on their balance sheets, recognizing a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The guidance in ASU 2016-02 is required for annual reporting periods beginning after December 15, 2018, with early adoption permitted. We currently expect that most of our operating lease commitments will be subject to the update and recognized as operating lease liabilities and right-of-use assets upon adoption. However, we are currently evaluating the effect that implementation of this update will have upon adoption on our consolidated financial position and results of operations.

## Note 2: Cash, Cash Equivalents and Investments

A summary of our cash, cash equivalents and available-for-sale investments at February 28, 2019 is as follows (in thousands):

	Amortized Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash	\$94,904	\$ —	—\$ —	\$94,904
Money market funds	11,612	—	—	11,612
State and municipal bond obligations	14,406	—	(58 )	14,348
U.S. treasury bonds	4,387	—	(8 )	4,379
Corporate bonds	8,246	—	(31 )	8,215
Total	\$133,555	\$ —	—\$ (97 )	\$133,458

A summary of our cash, cash equivalents and available-for-sale investments at November 30, 2018 is as follows (in thousands):

	Amortized Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash	\$101,316	\$ —	—\$ —	\$101,316
Money market funds	3,810	—	—	3,810
State and municipal bond obligations	19,542	—	(119 )	19,423
U.S. treasury bonds	6,726	—	(21 )	6,705
Corporate bonds	8,329	—	(70 )	8,259
Total	\$139,723	\$ —	—\$ (210 )	\$139,513

Such amounts are classified on our condensed consolidated balance sheets as follows (in thousands):

February 28, 2019	November 30, 2018
Cash and Short-Term	Cash and Short-Term



	Equivalents	Investments	Equivalents	Investments
Cash	\$94,904	\$ —	\$101,316	\$ —
Money market funds	11,612	—	3,810	—
State and municipal bond obligations	—	14,348	—	19,423
U.S. treasury bonds	—	4,379	—	6,705
Corporate bonds	—	8,215	—	8,259
Total	\$106,516	\$ 26,942	\$105,126	\$ 34,387

Table of Contents

The fair value of debt securities by contractual maturity is as follows (in thousands):

	February 28, 2019	November 30, 2018
Due in one year or less	\$ 22,327	\$ 25,051
Due after one year <sup>(1)</sup>	4,615	9,336
Total	\$ 26,942	\$ 34,387

(1) Includes state and municipal bond obligations and corporate bonds, which are securities representing investments available for current operations and are classified as current on the condensed consolidated balance sheets.

We did not hold any investments with continuous unrealized losses as of February 28, 2019 or November 30, 2018.

## Note 3: Derivative Instruments

We generally use forward contracts that are not designated as hedging instruments to hedge economically the impact of the variability in exchange rates on intercompany accounts receivable and loans receivable denominated in certain foreign currencies. We generally do not hedge the net assets of our international subsidiaries.

All forward contracts are recorded at fair value on the consolidated balance sheets at the end of each reporting period and expire between 30 days and one year from the date the contract was entered. At February 28, 2019, \$0.3 million was recorded in other current assets on the condensed consolidated balance sheets. At November 30, 2018, \$0.3 million and \$0.1 million was recorded in other noncurrent liabilities and other current assets, respectively, on the condensed consolidated balance sheets. In the three months ended February 28, 2019 and February 28, 2018, realized and unrealized gains of \$0.7 million and \$3.6 million, respectively, from our forward contracts were recognized in foreign currency loss, net on the condensed consolidated statements of operations. The gains were substantially offset by realized and unrealized losses on the offsetting positions.

The table below details outstanding foreign currency forward contracts where the notional amount is determined using contract exchange rates (in thousands):

	February 28, 2019		November 30, 2018	
	Notional	Fair Value	Notional	Fair Value
Forward contracts to sell U.S. dollars	\$63,904	\$ 324	\$105,830	\$ (170 )
Forward contracts to purchase U.S. dollars	495	(2 )	240	—
Total	\$64,399	\$ 322	\$106,070	\$ (170 )

## Note 4: Fair Value Measurements

## Recurring Fair Value Measurements

The following table details the fair value measurements within the fair value hierarchy of our financial assets and liabilities at February 28, 2019 (in thousands):

Assets	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3

Edgar Filing: PROGRESS SOFTWARE CORP /MA - Form 10-Q

Money market funds	\$ 11,612	\$ 11,612	\$ —	\$ —
State and municipal bond obligations	14,348	—	14,348	—
U.S. treasury bonds	4,379	—	4,379	—
Corporate bonds	8,215	—	8,215	—
Foreign exchange derivatives	\$ 322	\$—	\$ 322	\$ —

16

---

Table of Contents

The following table details the fair value measurements within the fair value hierarchy of our financial assets and liabilities at November 30, 2018 (in thousands):

	Total Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
<b>Assets</b>				
Money market funds	\$ 3,810	\$3,810	\$—	\$ —
State and municipal bond obligations	19,423	—	19,423	—
U.S. treasury bonds	6,705	—	6,705	—
Corporate bonds	8,259	—	8,259	—
<b>Liabilities</b>				
Foreign exchange derivatives	\$ (170 )	\$—	\$(170)	\$ —

When developing fair value estimates, we maximize the use of observable inputs and minimize the use of unobservable inputs. When available, we use quoted market prices to measure fair value. The valuation technique used to measure fair value for our Level 1 and Level 2 assets is a market approach, using prices and other relevant information generated by market transactions involving identical or comparable assets. If market prices are not available, the fair value measurement is based on models that use primarily market based parameters including yield curves, volatilities, credit ratings and currency rates. In certain cases where market rate assumptions are not available, we are required to make judgments about assumptions market participants would use to estimate the fair value of a financial instrument.

**Nonrecurring Fair Value Measurements**

During the fourth quarter of fiscal year 2018, certain assets were measured at fair value on a nonrecurring basis using significant unobservable inputs (Level 3). Based on the fair value measurement, we recorded a \$5.1 million asset impairment charge as of November 30, 2018 related to certain corporate land and building assets previously reported as property and equipment, net that we reclassified to assets held for sale on our consolidated balance sheet.

The following table presents nonrecurring fair value measurements as of November 30, 2018 (in thousands):

	Total Fair Value	Total Losses
Assets held for sale	\$ 5,776	\$ 5,147

The fair value measurement of the assets held for sale were measured using third-party valuation models and were determined using an income-based valuation methodology, which includes discounted expected cash flows. As the discounted cash flows represent unobservable inputs, the fair value was classified as a Level 3 measurement within the fair value hierarchy. The expected cash flows include proceeds from the sale, offset by the costs incurred to sell the assets.

We did not have any nonrecurring fair value measurements as of February 28, 2019.

Table of Contents

## Note 5: Intangible Assets and Goodwill

## Intangible Assets

Intangible assets are comprised of the following significant classes (in thousands):

	February 28, 2019			November 30, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Purchased technology	\$146,501	\$(108,599)	\$37,902	\$154,301	\$(110,959)	\$43,342
Customer-related	67,642	(58,901)	8,741	67,802	(56,589)	11,213
Trademarks and trade names	17,740	(14,086)	3,654	17,740	(13,376)	4,364
Total	\$231,883	\$(181,586)	\$50,297	\$239,843	\$(180,924)	\$58,919

In the first quarter of fiscal years 2019 and 2018, amortization expense related to intangible assets was \$8.6 million and \$9.1 million, respectively.

Future amortization expense for intangible assets as of February 28, 2019 is as follows (in thousands):

Remainder of 2019	\$26,310
2020	10,152
2021	10,033
2022	3,802
Total	\$50,297

## Goodwill

Changes in the carrying amount of goodwill in the three months ended February 28, 2019 are as follows (in thousands):

Balance, November 30, 2018	\$314,992
Translation adjustments	18
Balance, February 28, 2019	\$315,010

Changes in the goodwill balances by reportable segment in the three months ended February 28, 2019 are as follows (in thousands):

	November 30, 2018	Translation adjustments	February 28, 2019
OpenEdge	\$ 248,987	\$ 18	\$ 249,005
Data Connectivity and Integration	19,040	—	19,040
Application Development and Deployment	46,965	—	46,965
Total goodwill	\$ 314,992	\$ 18	\$ 315,010

During the quarter ending February 28, 2019, no triggering events occurred that would indicate that it is more likely than not that the carrying values of any of our reporting units exceeded their fair values.

## Note 6: Term Loan and Line of Credit

Our credit agreement provides for a \$123.8 million secured term loan and a \$150.0 million secured revolving credit facility. The revolving credit facility may be made available in U.S. Dollars and certain other currencies and may be increased by up to an additional \$125.0 million if the existing or additional lenders are willing to make such increased commitments. The revolving credit facility has sublimits for swing line loans up to \$25.0 million and for the issuance of standby letters of credit in

18

---

Table of Contents

a face amount up to \$25.0 million. We expect to use the revolving credit facility for general corporate purposes, including acquisitions of other businesses, and may also use it for working capital.

The credit facility matures on November 20, 2022, when all amounts outstanding will be due and payable in full. The revolving credit facility does not require amortization of principal. The outstanding balance of the term loan as of February 28, 2019 was \$116.0 million, with \$7.0 million due in the next 12 months. The term loan requires repayment of principal at the end of each fiscal quarter, beginning with the fiscal quarter ended February 28, 2018. The principal repayment amounts are in accordance with the following schedule: (i) eight payments of \$1.5 million each, (ii) four payments of \$2.3 million each, (iii) four payments of \$3.1 million each, (iv) three payments of \$3.9 million each, and (v) the last payment is of the remaining principal amount. Any amounts outstanding under the term loan thereafter would be due on the maturity date. The term loan may be prepaid before maturity in whole or in part at our option without penalty or premium. As of February 28, 2019, the carrying value of the term loan approximates the fair value, based on Level 2 inputs (observable market prices in less than active markets), as the interest rate is variable over the selected interest period and is similar to current rates at which we can borrow funds. The interest rate of the credit facility as of February 28, 2019 was 4.00%.

Costs incurred to obtain our long-term debt of \$1.8 million are recorded as debt issuance costs as a direct deduction from the carrying value of the debt liability on our condensed consolidated balance sheets as of February 28, 2019. These costs are being amortized over the term of the debt agreement using the effective interest rate method. Amortization expense related to the debt issuance costs of \$0.1 million for the three months ended February 28, 2019 and February 28, 2018, respectively, is recorded in interest expense on our condensed consolidated statements of operations.

Revolving loans may be borrowed, repaid, and reborrowed until November 20, 2022, at which time all amounts outstanding must be repaid. As of February 28, 2019, there were no amounts outstanding under the revolving line and \$1.3 million of letters of credit.

As of February 28, 2019, aggregate principal payments of long-term debt for the next five years are (in thousands):

Remainder of 2019	\$4,641
2020	9,281
2021	12,375
2022	89,719
Total	\$116,016

#### Note 7: Common Stock Repurchases

We repurchased and retired 0.7 million shares of our common stock for \$25.0 million in the three months ended February 28, 2019 and 1.1 million shares for \$45.0 million in the three months ended February 28, 2018. The shares were repurchased in both periods as part of our Board of Directors authorized share repurchase program.

In September 2017, our Board of Directors increased our total share repurchase authorization to \$250.0 million. As of February 28, 2019, there was \$75.0 million remaining under this current authorization.

#### Note 8: Stock-Based Compensation

Stock-based compensation expense reflects the fair value of stock-based awards, less the present value of expected dividends, 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 the current market price of the stock, the Black-Scholes option

valuation model, or the Monte Carlo Simulation valuation model.

During fiscal year 2017, we granted performance-based restricted stock units that include a three-year market condition under a Long-Term Incentive Plan ("LTIP") where the performance measurement period is three-years. Vesting of the LTIP awards is based on our level of attainment of specified total stockholder return ("TSR") targets relative to the percentage appreciation of a specified index of companies for the respective three-year periods and is also subject to the continued employment of the grantees. In order to estimate the fair value of such awards, we used a Monte Carlo Simulation valuation model.

During the first quarter of fiscal years 2018 and 2019, we granted performance-based restricted stock units that include two performance metrics under the LTIP where the performance measurement period is three years. Vesting of the 2018 and 2019



Table of Contents

LTIP awards is as follows: (i) 50% is based on the three-year market condition as described above (TSR), and (ii) 50% is based on achievement of a three-year cumulative performance condition (operating income). In order to estimate the fair value of such awards, we used a Monte Carlo Simulation valuation model for the market condition portion of the award, and used the closing price of our common stock on the date of grant, less the present value of expected dividends, for the portion related to the performance condition.

The Black-Scholes and Monte Carlo Simulation valuation models incorporate assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. We recognize stock-based compensation expense related to options and restricted stock units on a straight-line basis over the service period of the award, which is generally 4 years for options and 3 years for restricted stock units. We recognize stock-based compensation expense related to our employee stock purchase plan using an accelerated attribution method.

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

	Three Months Ended	
	February 28, 2019	February 28, 2018
Cost of maintenance and services	\$244	\$ 246
Sales and marketing	1,048	370
Product development	1,928	2,046
General and administrative	2,586	1,908
Total stock-based compensation	\$5,806	\$ 4,570

## Note 9: Accumulated Other Comprehensive Loss

The following table summarizes the changes in accumulated balances of other comprehensive loss during the three months ended February 28, 2019 (in thousands):

	Foreign Currency Translation Adjustment	Unrealized (Losses) Gains on Investments	Accumulated Other Comprehensive (Loss) Income
Balance, December 1, 2018, as adjusted	\$ (27,973 )	\$ (203 )	\$ (28,176 )
Other comprehensive income before reclassifications, net of tax	1,479	83	1,562
Balance, February 28, 2019	\$ (26,494 )	\$ (120 )	\$ (26,614 )

The tax effect on accumulated unrealized (losses) gains on investments was minimal as of February 28, 2019 and November 30, 2018.

Table of Contents

## Note 10: Restructuring Charges

The following table provides a summary of activity for our restructuring actions, which are detailed further below (in thousands):

	Excess Facilities and Other Costs	Employee Severance and Related Benefits	Total
Balance, December 1, 2018	\$ 307	\$ 4	\$311
Costs incurred	411	4	415
Cash disbursements	(151 )	(8 )	(159 )
Translation adjustments and other	(84 )	—	(84 )
Balance, February 28, 2019	\$ 483	\$ —	\$483

During fiscal year 2017, we undertook certain operational restructuring initiatives intended to significantly reduce annual costs. As part of this action, management committed to a new strategic plan highlighted by a new product strategy and a streamlined operating approach. To execute these operational restructuring initiatives, we reduced our global workforce by over 20%. These workforce reductions occurred in substantially all functional units and across all geographies in which we operate. We also consolidated offices in various locations during fiscal years 2017 and 2018 and the first quarter of fiscal year 2019. We expect to incur additional expenses related to facility closures as part of this restructuring action through fiscal year 2019, but we do not expect these additional costs to be material.

Restructuring expenses are related to employee costs, including severance, health benefits and outplacement services (but excluding stock-based compensation), facilities costs, which include fees to terminate lease agreements and costs for unused space, net of sublease assumptions, and other costs, which include asset impairment charges.

As part of this fiscal year 2017 restructuring, for the three months ended February 28, 2019, we incurred expenses of \$0.4 million, which are recorded in restructuring expenses on the condensed consolidated statements of operations.

Cash disbursements for expenses incurred to date under this restructuring are expected to be made through fiscal year 2019. Accordingly, the balance of the restructuring reserve of \$0.5 million is included in other accrued liabilities on the condensed consolidated balance sheet at February 28, 2019.

## Note 11: Income Taxes

Our income tax provision for the three months ended February 28, 2019 and February 28, 2018 reflects our estimate of the effective tax rates expected to be applicable for the full fiscal years, adjusted for any discrete events which are recorded in the period they occur. The estimates are reevaluated each quarter based on our estimated tax expense for the full fiscal year.

The increase in our effective tax rate in the three months ended February 28, 2019 compared to the same period in the prior year is primarily due to a provisional tax benefit amount of \$1.4 million recorded in the three months ended February 28, 2018 related to the re-measurement of our U.S. deferred tax balances due to the enactment of tax reform in the U.S. that lowered the federal corporate tax rate.

Certain international provisions of the Tax Cuts and Jobs Act became effective for us in fiscal year 2019. The global intangible low-taxed income ("GILTI") provisions require us to include in our U.S. income tax base foreign subsidiary earnings in excess of an allowable return of the foreign subsidiary's tangible assets. We have forecasted that we will be subject to incremental U.S. tax resulting from GILTI inclusions in fiscal year 2019.

Our Federal income tax returns have been examined or are closed by statute for all years prior to fiscal year 2015. Our state income tax returns have been examined or are closed by statute for all years prior to fiscal year 2013.

Tax authorities for certain non-U.S. jurisdictions are also examining returns. With some exceptions, we are generally not subject to tax examinations in non-U.S. jurisdictions for years prior to fiscal year 2013.

Table of Contents

## Note 12: 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, restricted stock units and deferred stock units, using the treasury stock method. The following table sets forth the calculation of basic and diluted earnings per share on an interim basis (in thousands, except per share data):

	Three Months Ended	
	February 28, 2019	February 28, 2018
	As	
	Adjusted <sup>(1)</sup>	
Net income	\$9,402	\$ 13,732
Weighted average shares outstanding	44,956	46,529
Dilutive impact from common stock equivalents	330	947
Diluted weighted average shares outstanding	45,286	47,476
Basic earnings per share	\$0.21	\$ 0.30
Diluted earnings per share	\$0.21	\$ 0.29

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

We excluded stock awards representing approximately 911,000 shares and 344,000 shares of common stock from the calculation of diluted earnings per share in the three months ended February 28, 2019 and February 28, 2018, respectively, because these awards were anti-dilutive.

Table of Contents

## Note 13: Business Segments and International Operations

Operating segments are components of an enterprise that engage in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and assess performance. Our chief operating decision maker is our Chief Executive Officer.

We operate as three distinct business segments: OpenEdge, Data Connectivity and Integration, and Application Development and Deployment.

We do not manage our assets or capital expenditures by segment or assign other income (expense) and income taxes to segments. We manage and report such items on a consolidated company basis.

The following table provides revenue and contribution margin from our reportable segments and reconciles to the consolidated income from continuing operations before income taxes:

	Three Months Ended	
	February 28, 2019	February 28, 2018
(In thousands)		As Adjusted <sup>(1)</sup>
Segment revenue:		
OpenEdge	\$65,252	\$ 66,663
Data Connectivity and Integration	6,000	9,492
Application Development and Deployment	18,297	19,255
Total revenue	89,549	95,410
Segment costs of revenue and operating expenses:		
OpenEdge	18,315	15,762
Data Connectivity and Integration	1,500	1,629
Application Development and Deployment	5,427	6,798
Total costs of revenue and operating expenses	25,242	24,189
Segment contribution margin:		
OpenEdge	46,937	50,901
Data Connectivity and Integration	4,500	7,863
Application Development and Deployment	12,870	12,457
Total contribution margin	64,307	71,221
Other unallocated expenses <sup>(2)</sup>	48,898	52,090
Income from operations	15,409	19,131
Other expense, net	(2,003 )	(1,585 )
Income before income taxes	\$13,406	\$ 17,546

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

<sup>(2)</sup>The following expenses are not allocated to our segments as we manage and report our business in these functional areas on a consolidated basis only: certain product development and corporate sales and marketing expenses, customer support, administration, amortization of acquired intangibles, stock-based compensation, fees related to shareholder activist, restructuring, and acquisition-related expenses.



Table of Contents

Our revenues are derived from licensing our products, and from related services, which consist of maintenance, hosting services, and consulting and education. Information relating to revenue from external customers by revenue type is as follows (in thousands):

	Three Months Ended	
	February 28, 2019	February 28, 2018
(In thousands)	As	Adjusted <sup>(1)</sup>
Performance obligations transferred at a point in time:		
Software licenses	\$22,802	\$ 26,054
Performance obligations transferred over time:		
Maintenance	59,999	62,184
Services	6,748	7,172
Total revenue	\$89,549	\$ 95,410

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

In the following table, revenue attributed to North America includes sales to customers in the U.S. and sales to certain multinational organizations. Revenue from EMEA, Latin America and the Asia Pacific region includes sales to customers in each region plus sales from the U.S. to distributors in these regions. Information relating to revenue from external customers from different geographical areas is as follows (in thousands):

	Three Months Ended			
	February 28, 2019		February 28, 2018	
(In thousands)	As Adjusted <sup>(1)</sup>			
North America	\$46,498	52 %	\$52,198	55 %
EMEA	33,372	37 %	33,296	35 %
Latin America	4,461	5 %	4,942	5 %
Asia Pacific	5,218	6 %	4,974	5 %
Total revenue	\$89,549	100 %	\$95,410	100 %

<sup>(1)</sup>The Company adopted ASC 606 effective December 1, 2018 using the full retrospective method. See Note 1. Nature of Business and Basis of Presentation for further information.

No single customer, partner, or country outside of the U.S. has accounted for more than 10% of our total revenue for the three months ended February 28, 2019 and February 28, 2018. As of February 28, 2019 and November 30, 2018, no individual customer accounted for 10% or more of our net accounts receivable balance. As of February 28, 2019 and November 30, 2018, no individual foreign country accounting for 10% or more of total consolidated assets.

## Note 14: Subsequent Events

On March 28, 2019, we entered into an acquisition agreement with Ipswitch, Inc. (“Ipswitch”), pursuant to which we will acquire all of the outstanding equity interests of Ipswitch for \$225 million in cash. We will fund the transaction with existing cash on hand and funds secured under a new credit facility. Ipswitch will provide us with leading

network management and secure data file transfer capabilities for small and medium-sized businesses and enterprises. The transaction is expected to be completed in late April 2019, subject to customary regulatory approvals and conditions. Results of operations for Ipswitch will be included in our consolidated financial statements as part of the OpenEdge business segment from the date of acquisition.

In connection with the announced acquisition of Ipswitch, we intend to suspend our stock repurchase program for the remainder of fiscal 2019.



## Table of Contents

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

#### Adoption of New Accounting Standards

We adopted the new accounting standard related to revenue recognition ("ASC 606") effective December 1, 2018, using the full retrospective method, which required us to restate prior comparable periods. See Note 1. Nature of Business and Basis of Presentation for further information. Management's Discussion and Analysis of Financial Condition and Results of Operations has also been adjusted to reflect the full retrospective adoption of ASC 606.

#### Critical Accounting Policies

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 GAAP. 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 are believed to be reasonable under the circumstances. However, actual results may differ from these estimates. The most significant estimates relate to: the timing and amounts of revenue recognition, including the determination of the nature and timing of the satisfaction of performance obligations, the standalone selling price of performance obligations, and the transaction price allocated to performance obligations; the realization of tax assets and estimates of tax liabilities; fair values of investments in marketable securities; assets held for sale; intangible assets and goodwill valuations; the recognition and disclosure of contingent liabilities; the collectability of accounts receivable; and assumptions used to determine the fair value of stock-based compensation. 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 to our Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the fiscal year ended November 30, 2018.

#### Revenue Policy

Our contracts with customers often include various combinations of products and services. The determination of whether these products and services are considered to be distinct performance obligations that should be accounted for separately or if they should be combined requires significant judgment. Further, we utilize a variety of estimation methods to determine the appropriate Standalone Selling Price ("SSP") for each product and service. We use the residual approach in allocating the transaction price to each distinct performance obligation. As required, we evaluate the residual approach estimate compared to all available observable data in order to conclude the estimate is representative of its SSP. See Note 1. Nature of Business and Basis of Presentation for further information.

#### 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 "believe," "may," "could," "would," "might," "should," "expect," "intend," "plan," "target," "anticipate" and "continue," are forward-looking, as are statements concerning future financial results, product offerings or other events that have not yet occurred. There are a number of factors that could cause actual results or future events to differ materially from those anticipated by the forward-looking statements, including, without limitation: (1) Economic, geopolitical and market conditions can adversely affect our business, results of operations and financial condition, including our revenue growth and profitability, which in turn could adversely affect our stock price. (2) We may fail to achieve our financial forecasts

due to such factors as delays or size reductions in transactions, fewer large transactions in a particular quarter, fluctuations in currency exchange rates, or a decline in our renewal rates for contracts. (3) Our ability to successfully manage transitions to new business models and markets, including an increased emphasis on a cloud and subscription strategy, may not be successful. (4) If we are unable to develop new or sufficiently differentiated products and services, or to enhance and improve our existing products and services in a timely manner to meet market demand, partners and customers may not purchase new software licenses or subscriptions or purchase or renew support contracts. (5) We depend upon our extensive partner channel and we may not be successful in retaining or expanding our relationships with channel partners. (6) Our international sales and operations subject us to additional risks that can adversely affect our operating results, including risks relating to foreign currency gains and losses. (7) If the security measures for our software, services or other offerings are compromised or subject to a successful cyber-attack, or if such offerings contain significant coding or configuration errors, we may experience reputational harm, legal claims and financial exposure. (8) We have made acquisitions, and may make acquisitions in the future, and those acquisitions may not be successful, may involve

## Table of Contents

unanticipated costs or other integration issues or may disrupt our existing operations. (9) Those factors discussed in Part II, Item 1A (Risk Factors) in this Quarterly Report on Form 10-Q, and in Part I, Item 1A (Risk Factors) in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018. 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.

### Use of Constant Currency

Revenue from our international operations has historically represented a substantial portion of our total revenue. As a result, our revenue results have been impacted, and we expect will continue to be impacted, by fluctuations in foreign currency exchange rates. For example, if the local currencies of our foreign subsidiaries strengthen, our consolidated results stated in U.S. dollars are positively impacted.

As exchange rates are an important factor in understanding period to period comparisons, we believe the presentation of revenue growth rates on a constant currency basis enhances the understanding of our revenue results and evaluation of our performance in comparison to prior periods. The constant currency information presented is calculated by translating current period results using prior period weighted average foreign currency exchange rates. These results should be considered in addition to, not as a substitute for, results reported in accordance with GAAP.

### Overview

Progress Software Corporation ("Progress," the "Company," "we," "us," or "our") offers the leading platform for developing and deploying strategic business applications. We enable customers and partners to deliver modern, high-impact digital experiences with a fraction of the effort, time and cost. Progress offers powerful tools for easily building adaptive user experiences across any type of device or touchpoint, award-winning machine learning that enables cognitive capabilities to be a part of any application, the flexibility of a serverless cloud to deploy modern apps, business rules, web content management, plus leading data connectivity technology. Over 1,700 ISVs, 100,000 enterprise customers, and 2 million developers rely on Progress to power their applications. We operate as three distinct segments: OpenEdge, Data Connectivity and Integration, and Application Development and Deployment.

The key tenets of our strategic plan and operating model are as follows:

**Align Resources to Drive Profitability.** Our organizational philosophy and operating principles focus primarily on customer and partner retention and success for our core products and a streamlined operating approach in order to more efficiently drive revenue.

**Protect and Strengthen Our Core Business.** A key element of our strategy is centered on providing the platform and tools enterprises need to build “cognitive applications,” which we believe are the future of application development. We offer this platform to both new customers and partners as well as our existing partner and customer ecosystems. Our platform for cognitive applications enables developers to build the most modern applications quickly and easily, and includes:

- our leading UI development tools, which enable organizations to easily build engaging user interfaces for any device or front end;
- our NativeScript offering, which allows developers to use JavaScript to build native applications across multiple mobile platforms;
- our modern high productivity application development platform, Progress Kinvey, that is cloud-native, is secure, high-performing, and highly-scalable while supporting all modern user interfaces;

- automated and intuitive machine learning capabilities for accelerating the creation and delivery of cognitive applications;
- our data connectivity and integration capabilities;
- our business logic and rules capabilities; and
- web content management for delivering personalized and engaging digital experiences

This strategy builds on our inherent DNA and our vast experience in application development that we've acquired over the past 35 years.

Holistic Capital Allocation Approach. Pursuant to our capital allocation strategy, we have targeted to return approximately 75-80% of our annual cash flows from operations to stockholders in the form of share repurchases and through dividends. We

Table of Contents

have also adopted a disciplined approach to future mergers and acquisitions. By adopting strict financial criteria for future acquisitions, these acquisitions will enable us to drive significant stockholder returns by providing scale and increased cash flows.

In September 2017, we announced a new capital allocation strategy pursuant to which we are targeting to return approximately 75-80% of our annual cash flows from operations to stockholders in the form of share repurchases and through dividends. To that end, our Board of Directors increased our total share repurchase authorization to \$250.0 million. As of February 28, 2019, there was \$75.0 million remaining under this current authorization. As discussed further below, we intend to suspend our stock repurchase program for the remainder of fiscal 2019. We expect to resume share repurchases in fiscal 2020, at a level consistent with our publicly stated capital allocation policy.

On September 21, 2018, our Board of Directors approved an 11% increase to our quarterly cash dividend from \$0.14 to \$0.155 per share of common stock. We began paying quarterly cash dividends of \$0.125 per share of common stock to Progress stockholders in December 2016 and increased the quarterly cash dividend to \$0.14 per share in September 2017. We expect to continue paying quarterly cash dividends in subsequent quarters consistent with our capital allocation strategy. However, we may terminate or modify this program at any time. On March 19, 2019, our Board of Directors declared a quarterly dividend of \$0.155 per share of common stock that will be paid on June 17, 2019 to shareholders of record as of the close of business on June 3, 2019.

On March 28, 2019, we entered into an acquisition agreement with Ipswitch, Inc. (“Ipswitch”), pursuant to which we will acquire all of the outstanding equity interests of Ipswitch for \$225 million in cash. We will fund the transaction with existing cash on hand and funds secured under a new credit facility. Ipswitch will provide us with leading network management and secure data file transfer capabilities for small and medium-sized businesses and enterprises. Founded in 1991, Ipswitch serves approximately 24,000 customers in 170 countries. Ipswitch has approximately \$75 million in revenue, of which 75% is recurring. Ipswitch has blue-chip customers across all verticals, including finance and banking, healthcare, insurance, retail, government and biotech. The transaction is expected to be completed in late April 2019, subject to customary regulatory approvals and conditions. In connection with the announced acquisition of Ipswitch, we intend to suspend our stock repurchase program for the remainder of fiscal 2019.

We expect to continue to evaluate possible acquisitions and other strategic transactions designed to expand our business. As a result, our expected uses of cash could change, our cash position could be reduced and we may incur additional debt obligations to the extent we complete additional acquisitions. However, we believe that existing cash balances, together with funds generated from operations and amounts available under our credit facility, will be sufficient to finance our operations and meet our foreseeable cash requirements, including quarterly cash dividends and stock repurchases to Progress stockholders, through at least the next twelve months.

We derive a significant portion of our revenue from international operations, which are primarily conducted in foreign currencies. The impact of foreign exchange did not result in a material impact on revenue during fiscal years 2018 or 2017, but since approximately one-third of our revenue is denominated in foreign currency, future fluctuations in foreign currency rates may significantly impact our results.

## Results of Operations

## Revenue

	Three Months Ended	Percentage
		Change
(In thousands)	February 28, 2019	February 28, 2018
		As Reported
		Constant Currency

Revenue      \$89,549 \$ 95,410      (6)% (4 )%

Total revenue decreased in the first quarter of fiscal year 2019 as compared to the same quarter last year due to a decrease in license revenue as further described below as well as the strengthening of the U.S. dollar during the quarter, which resulted in an unfavorable impact from foreign currency exchange rates. Changes in prices from the fiscal year 2018 to 2019 did not have a significant impact on our revenue.

Table of Contents

## License Revenue

(In thousands)	Three Months Ended		Percentage Change	
	February 28, 2019	February 28, 2018	As Reported	Constant Currency
License	\$22,802	\$26,054	(12)%	(10)%
As a percentage of total revenue	25	% 27	%	%

Software license revenue decreased in the first quarter of fiscal year 2019 as compared to the same period last year due to the timing of revenue in our Data Connectivity and Integration segment, partially offset by an increase in license sales in our OpenEdge segment. Software license revenue for this quarter also decreased due to the unfavorable impact from currency exchange rates and a decrease in revenue from our Application Development and Deployment segment.

## Maintenance and Services Revenue

(In thousands)	Three Months Ended		Percentage Change	
	February 28, 2019	February 28, 2018	As Reported	Constant Currency
Maintenance	\$59,999	\$62,184	(4)%	(1)%
As a percentage of total revenue	67	% 65	%	%
Services	6,748	7,172	(6)%	(4)%
As a percentage of total revenue	8	% 8	%	%
Total maintenance and services revenue	\$66,747	\$69,356	(4)%	(1)%
As a percentage of total revenue	75	% 73	%	%

Maintenance revenue decreased in the first quarter of fiscal year 2019 as compared to the same quarter last year due to an unfavorable impact from currency exchange rates and a decrease in maintenance revenue in our OpenEdge segment. The decrease in services revenue in the first quarter of fiscal year 2019 was primarily due to lower professional services revenue from our Application Development and Deployment segment.

## Revenue by Region

(In thousands)	Three Months Ended		Percentage Change	
	February 28, 2019	February 28, 2018	As Reported	Constant Currency
North America	\$46,498	\$52,198	(11)%	(11)%
As a percentage of total revenue	52	% 55	%	%
EMEA	\$33,372	\$33,296	—	% 5
As a percentage of total revenue	37	% 35	%	%
Latin America	\$4,461	\$4,942	(10)%	(1)%
As a percentage of total revenue	5	% 5	%	%
Asia Pacific	\$5,218	\$4,974	5	% 11
As a percentage of total revenue	6	% 5	%	%

Total revenue generated in North America decreased \$5.7 million, and total revenue generated outside North America remained flat in the first quarter of fiscal year 2019 as compared to the same quarter last year. The decrease in North America was primarily due to a decrease in license revenue in our Data Connectivity and Integration segment, professional services revenue decreases in our Application Development and Deployment segment and a decline in maintenance revenue in our OpenEdge segment. The slight increase in EMEA was primarily due to higher license revenue from our Data Connectivity and Integration segment, offset by the unfavorable impact from currency exchange rates as described above. Revenue in Latin America decreased primarily due to an unfavorable impact of exchange rate fluctuations. The revenue generated in Asia Pacific increased primarily due to higher license revenue in our OpenEdge segment.



Table of Contents

Total revenue generated in markets outside North America represented 48% of total revenue in the first quarter of fiscal year 2019 compared to 45% in the same period last year. If exchange rates had remained constant in the first three months of fiscal year 2019 as compared to the exchange rates in effect in the same period of fiscal year 2018, total revenue generated in markets outside North America would have represented 49% of total revenue.

## Revenue by Segment

(In thousands)	Three Months Ended		Percentage Change	
	February 28, 2019	February 28, 2018	As Reported	Constant Currency
OpenEdge segment	\$65,252	\$ 66,663	(2 )%	1 %
Data Connectivity and Integration segment	6,000	9,492	(37)%	(37 )%
Application Development and Deployment segment	18,297	19,255	(5 )%	(5 )%
Total revenue	\$89,549	\$ 95,410	(6 )%	(4 )%

Revenue in the OpenEdge segment decreased largely due to the negative impact of exchange rate fluctuations. Data Connectivity and Integration revenue decreased compared to the prior year period due to the timing of certain renewals by original equipment manufacturers ("OEMs"). Application Development and Deployment revenue decreased primarily due to lower license and professional services revenue.

## Cost of Software Licenses

(In thousands)	Three Months Ended		Percentage Change
	February 28, 2019	February 28, 2018	
Cost of software licenses	\$1,167	\$ 1,261	(7 )%
As a percentage of software license revenue	5	% 5	%
As a percentage of total revenue	1	% 1	%

Cost of software licenses consists primarily of costs of royalties, electronic software distribution, duplication and packaging. Cost of software licenses as a percentage of software license revenue varies from period to period depending upon the relative product mix. The slight decrease in cost of software licenses in the first quarter of fiscal year 2019 was a result of lower payments of royalties to third parties as compared to the prior period.

## Cost of Maintenance and Services

(In thousands)	Three Months Ended		Percentage Change
	February 28, 2019	February 28, 2018	
Cost of maintenance and services	\$9,439	\$ 9,824	(4 )%
As a percentage of maintenance and services revenue	14	% 14	%
As a percentage of total revenue	11	% 10	%

Cost of maintenance and services consists primarily of the costs of providing customer support, consulting, and education. Cost of maintenance and services decreased slightly due to lower compensation-related costs.



Table of Contents

## Amortization of Acquired Intangibles

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Amortization of acquired intangibles	\$5,433	\$ 5,818	(7 )%
As a percentage of total revenue	6	% 6	%

Amortization of acquired intangibles included in costs of revenue primarily represents the amortization of the value assigned to technology-related intangible assets obtained in business combinations. Amortization of acquired intangibles decreased in the first quarter of fiscal year 2019 as compared to the same quarter last year. The decrease was due to the completion of amortization of certain intangible assets acquired in prior years.

## Gross Profit

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Gross profit	\$73,510	\$ 78,507	(6 )%
As a percentage of total revenue	82	% 82	%

Our gross profit decreased primarily due to the decrease of license and maintenance revenue, partially offset by lower cost of revenue and amortization of acquired intangibles, as described above.

## Sales and Marketing

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Sales and marketing	\$22,323	\$ 21,428	4 %
As a percentage of total revenue	25	% 22	%

Sales and marketing expenses increased primarily due to higher stock-based compensation expense, as well as higher compensation-related costs in the first quarter of fiscal year 2019 compared to the same quarter last year.

## Product Development

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Product development	\$19,890	\$ 20,245	(2 )%
As a percentage of total revenue	22	% 21	%

Product development expenses decreased primarily due to lower compensation-related costs from a decrease in headcount, as well as lower stock-based compensation expense in the first quarter of fiscal year 2019 compared to the same quarter last year.



Table of Contents

## General and Administrative

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
General and administrative	\$12,285	\$ 11,262	9 %
As a percentage of total revenue	14 %	12 %	

General and administrative expenses include the costs of our finance, human resources, legal, information systems, and administrative departments. General and administrative expenses increased primarily due to higher stock-based compensation expense, as well as higher compensation-related costs, partially offset by lower outside service expense in the first quarter of fiscal year 2019 compared to the same quarter last year.

## Amortization of Acquired Intangibles

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Amortization of acquired intangibles	\$3,188	\$ 3,319	(4 )%
As a percentage of total revenue	4 %	3 %	

Amortization of acquired intangibles included in operating expenses primarily represents the amortization of value assigned to intangible assets obtained in business combinations other than assets identified as purchased technology. Amortization of acquired intangibles remained flat in the first quarter of fiscal year 2019 compared to the same quarter last year.

## Fees Related to Shareholder Activist

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Fees related to shareholder activist	\$—	\$ 1,258	*
As a percentage of total revenue	— %	1 %	

\* Not meaningful

In September 2017, Praesidium Investment Management, then one of our largest stockholders, publicly announced its disagreement with our strategy in a Schedule 13D filed with the SEC and stated that it was seeking changes in the composition of our Board of Directors. In fiscal years 2017 and 2018, we incurred professional and other fees relating to Praesidium's actions. We do not expect to incur additional professional and other fees related to this matter.

## Restructuring Expenses

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Restructuring expenses	\$415	\$ 1,821	(77 )%
As a percentage of total revenue	— %	2 %	

\* Not meaningful

Restructuring expenses recorded in the first fiscal quarter of 2019 relate to the restructuring activities that occurred in fiscal year 2017. See Note 10 to the condensed consolidated financial statements for additional details, including types of expenses incurred and the timing of future expenses and cash payments. See also the Liquidity and Capital Resources section of this Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents

## Acquisition-Related Expenses

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Acquisition-related expenses	\$—	\$ 43	(100 )%
As a percentage of total revenue	—%	—	%

Acquisition-related costs are expensed as incurred and include those costs incurred as a result of a business combination. These costs consist of professional service fees, including third-party legal and valuation-related fees, as well as retention fees, including earn-out payments treated as compensation expense. Acquisition-related expenses in the first quarter of fiscal year 2019 and 2018 were minimal.

## Income from Operations

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Income from operations	\$15,409	\$ 19,131	(19 )%
As a percentage of total revenue	17 %	20 %	

Income from operations decreased in the first quarter of fiscal year 2019 as compared to the same quarter last year due to a decrease in revenue, partially offset by a decrease in costs of revenue and operating expenses as shown above. This decrease was also partially offset by lower restructuring expenses as well as professional and other fees incurred relating to Praesidium's actions in the first fiscal quarter of 2019.

## Income from Operations by Segment

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
OpenEdge segment	\$46,937	\$ 50,901	(8 )%
Data Connectivity and Integration segment	4,500	7,863	(43 )%
Application Development and Deployment segment	12,870	12,457	3 %
Other unallocated expenses	(48,898 )	(52,090 )	(6 )%
Income from operations	\$15,409	\$ 19,131	(19 )%

Note that the following expenses are not allocated to our segments as we manage and report our business in these functional areas on a consolidated basis only: certain product development and corporate sales and marketing expenses, customer support, administration, amortization of acquired intangibles, stock-based compensation, fees related to shareholder activist, restructuring, and acquisition-related expenses.

## Other (Expense) Income, net

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Interest expense	\$(1,389)	\$(1,165 )	(19 )%
Interest income and other, net	229	408	(44 )%

Edgar Filing: PROGRESS SOFTWARE CORP /MA - Form 10-Q

Foreign currency (loss) gain, net	(843 )	(828 )	(2 )%
Total other (expense) income, net	\$(2,003)	\$(1,585 )	(26 )%
As a percentage of total revenue	(2 )%	(2 )%	

32

---



Table of Contents

Other (expense) income, net decreased in the first quarter of fiscal year 2019 compared to the same quarter last year primarily due to higher interest expense and lower interest income. The change in foreign currency gains and losses is a result of movements in exchange rates and the impact in the first quarter of fiscal year 2019 on our intercompany receivables and payables denominated in currencies other than local currencies.

## Provision for Income Taxes

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Provision for income taxes	\$4,004	\$ 3,814	5 %
As a percentage of total revenue	4 %	4 %	

Our effective income tax rate was 30% in the first quarter of fiscal year 2019 compared to 22% in the first quarter of fiscal year 2018. The increase in our effective tax rate in the three months ended February 28, 2019 compared to the same period in the prior year is primarily due to a provisional tax benefit amount of \$1.4 million recorded in the three months ended February 28, 2018 related to the re-measurement of our U.S. deferred tax balance due to enactment of tax reform in the U.S. that lowered the federal corporate tax rate.

## Net Income

(In thousands)	Three Months Ended		
	February 28, 2019	February 28, 2018	Percentage Change
Net income	\$9,402	\$ 13,732	(32 )%
As a percentage of total revenue	10 %	14 %	

## Liquidity and Capital Resources

## Cash, Cash Equivalents and Short-Term Investments

(In thousands)	February 28, 2019	November 30, 2018
Cash and cash equivalents	\$ 106,516	\$ 105,126
Short-term investments	26,942	34,387
Total cash, cash equivalents and short-term investments	\$ 133,458	\$ 139,513

The decrease in cash, cash equivalents and short-term investments of \$6.1 million from the end of the fiscal year 2018 was due to repurchases of common stock of \$25.0 million, dividend payments of \$7.0 million, payments of debt obligations in the amount of \$1.5 million, and payments of capital expenditures of \$0.2 million. These cash outflows were partially offset by cash inflows from operations of \$24.4 million, \$1.9 million in cash received from the issuance of common stock, and the effect of exchange rates on cash of \$1.4 million. Except as described below, there are no limitations on our ability to access our cash, cash equivalents, and short-term investments.

As of February 28, 2019, \$38.1 million of our cash, cash equivalents and short-term investments was held by our foreign subsidiaries. Foreign cash includes unremitted foreign earnings, which are invested indefinitely outside of the U.S. As such, it is not available to fund our domestic operations. If we were to repatriate these earnings, we may be subject to income tax withholding in certain tax jurisdictions and a portion of the repatriated earnings may be subject to U.S. income tax. However, we do not anticipate that this would have a material adverse impact on our liquidity.

Share Repurchase Program

In September 2017, our Board of Directors increased our total share repurchase authorization to \$250.0 million. In fiscal year 2018, we repurchased and retired 2.9 million shares of our common stock for \$120.0 million. For the three months ended February 28, 2019, we repurchased and retired 0.7 million shares of our common stock for \$25.0 million. As of February 28,

33

---

## Table of Contents

2019, there is \$75.0 million remaining under this current authorization. In connection with the announced acquisition of Ipswitch, we intend to suspend our stock repurchase program for the remainder of fiscal 2019. We expect to resume share repurchases in fiscal 2020, at a level consistent with our publicly stated capital allocation policy.

### Dividends

On September 21, 2018, our Board of Directors approved an 11% increase to our quarterly cash dividend from \$0.14 to \$0.155 per share of common stock. We began paying quarterly cash dividends of \$0.125 per share of common stock to Progress stockholders in December 2016 and increased the quarterly cash dividend to \$0.14 per share in September 2017. We expect to continue paying quarterly cash dividends in subsequent quarters consistent with our capital allocation strategy. However, we may terminate or modify this program at any time. On March 19, 2019, our Board of Directors declared a quarterly dividend of \$0.155 per share of common stock that will be paid on June 17, 2019 to shareholders of record as of the close of business on June 3, 2019.

### Restructuring Activities

During fiscal year 2017, we undertook certain operational restructuring initiatives intended to significantly reduce annual costs. As part of this action, management committed to a new strategic plan highlighted by a new product strategy and a streamlined operating approach. To execute these operational restructuring initiatives, we reduced our global workforce by over 20%. These workforce reductions occurred in substantially all functional units and across all geographies in which we operate. We also consolidated offices in various locations during fiscal years 2017 and 2018 and the first quarter of fiscal year 2019. We expect to incur additional expenses related to facility closures as part of this restructuring action through fiscal year 2019, but we do not expect these additional costs to be material.

As part of this fiscal year 2017 restructuring, for the three months ended February 28, 2019, we incurred expenses of \$0.4 million, which are recorded in restructuring expenses on the condensed consolidated statements of operations.

### Credit Facility

Our credit agreement provides for a \$123.8 million secured term loan and a \$150.0 million secured revolving credit facility. The revolving credit facility may be made available in U.S. Dollars and certain other currencies and may be increased by up to an additional \$125.0 million if the existing or additional lenders are willing to make such increased commitments. The revolving credit facility has sublimits for swing line loans up to \$25.0 million and for the issuance of standby letters of credit in a face amount up to \$25.0 million. We expect to use the revolving credit facility for general corporate purposes, including acquisitions of other businesses, and may also use it for working capital.

The credit facility matures on November 20, 2022, when all amounts outstanding will be due and payable in full. The revolving credit facility does not require amortization of principal. The outstanding balance of the term loan as of February 28, 2019 was \$116.0 million, with \$7.0 million due in the next 12 months. The term loan requires repayment of principal at the end of each fiscal quarter, beginning with the fiscal quarter ended February 28, 2018. The principal repayment amounts are in accordance with the following schedule: (i) eight payments of \$1.5 million each, (ii) four payments of \$2.3 million each, (iii) four payments of \$3.1 million each, (iv) three payments of \$3.9 million each, and (v) the last payment is of the remaining principal amount. Any amounts outstanding under the term loan thereafter would be due on the maturity date. The term loan may be prepaid before maturity in whole or in part at our option without penalty or premium. As of February 28, 2019, the carrying value of the term loan approximates the fair value, based on Level 2 inputs (observable market prices in less than active markets), as the interest rate is variable over the selected interest period and is similar to current rates at which we can borrow funds. The interest rate of the credit facility as of February 28, 2019 was 4.00%.

Revolving loans may be borrowed, repaid, and reborrowed until November 20, 2022, at which time all amounts outstanding must be repaid. As of February 28, 2019, there were no amounts outstanding under the revolving line and \$1.3 million of letters of credit.

The credit facility contains customary affirmative and negative covenants, including covenants that limit or restrict our ability to, among other things, grant liens, make investments, make acquisitions, incur indebtedness, merge or consolidate, dispose of assets, pay dividends or make distributions, repurchase stock, change the nature of the business, enter into certain transactions with affiliates and enter into burdensome agreements, in each case subject to customary exceptions for a credit facility of this size and type. We are also required to maintain compliance with a consolidated fixed charge coverage ratio, a consolidated total leverage ratio and a consolidated senior secured leverage ratio. We are in compliance with these financial covenants as of February 28, 2019.

Table of Contents

## Cash Flows from Operating Activities

(In thousands)	Three Months Ended	
	February 28, 2019	February 28, 2018
Net income	\$9,402	\$ 13,732
Non-cash reconciling items included in net income	13,465	16,281
Changes in operating assets and liabilities	1,577	1,582
Net cash flows from operating activities	\$24,444	\$ 31,595

The decrease in cash generated from operations in the first three months of fiscal year 2019 as compared to the first three months of fiscal year 2018 was primarily due to lower operating income. Our gross accounts receivable as of February 28, 2019 decreased by \$5.3 million from the end of fiscal year 2018, however, our days sales outstanding (DSO) in accounts receivable increased to 56 days from 51 days in the fiscal first quarter of 2018 due to the timing of billings and collections. In addition, our total deferred revenue as of February 28, 2019 decreased by \$6.2 million from the end of fiscal year 2018.

## Cash Flows from (used in) Investing Activities

(In thousands)	Three Months Ended	
	February 28, 2019	February 28, 2018
Net investment activity	\$7,405	\$ (558 )
Purchases of property and equipment	(246 )	(1,386 )
Net cash flows from (used in) investing activities	\$7,159	\$ (1,944 )

Net cash outflows and inflows of our net investment activity are generally a result of the timing of our purchases and maturities of securities, which are classified as cash equivalents or short-term securities. In addition, we purchased \$0.2 million of property and equipment in the first three months of fiscal year 2019, as compared to \$1.4 million in the first three months of fiscal year 2018.

## Cash Flows from Financing Activities

(In thousands)	Three Months Ended	
	February 28, 2019	February 28, 2018
Proceeds from stock-based compensation plans	\$1,894	\$ 2,469
Repurchases of common stock	(25,000 )	(45,000 )
Payment of principal on long-term debt	(1,547 )	(1,547 )
Dividend payments to shareholders	(6,992 )	(6,619 )
Net cash flows used in financing activities	\$(31,645)	\$(50,697 )

During the first three months of fiscal year 2019, we received \$1.9 million from the exercise of stock options and the issuance of shares under our employee stock purchase plan as compared to \$2.5 million in the first three months of fiscal year 2018. Significantly, in the first three months of fiscal year 2019, we repurchased \$25.0 million of our common stock under our share repurchase plan compared to \$45.0 million in the same period of the prior year. In addition, we made dividend payments of \$7.0 million to our shareholders during the first three months of fiscal year 2019, as compared to \$6.6 million in the first three months of fiscal year 2018. We also made principal payments of

our long-term debt of \$1.5 million in both fiscal year 2019 and fiscal year 2018.

## Table of Contents

### Indemnification Obligations

We include standard intellectual property indemnification provisions in our licensing agreements in the ordinary course of business. Pursuant to our product license agreements, we will indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally business partners or customers, in connection with certain patent, copyright or other intellectual property infringement claims by third parties with respect to our products. Other agreements with our customers provide indemnification for claims relating to property damage or personal injury resulting from the performance of services by us or our subcontractors. Historically, our costs to defend lawsuits or settle claims relating to such indemnity agreements have been insignificant. Accordingly, the estimated fair value of these indemnification provisions is immaterial.

### Liquidity Outlook

We believe that existing cash balances, together with funds generated from operations and amounts available under our credit facility, will be sufficient to finance our operations and meet our foreseeable cash requirements through at least the next twelve months. We do not contemplate a need for any foreign repatriation of the earnings which are deemed invested indefinitely outside of the U.S. Our foreseeable cash needs include our planned capital expenditures, debt repayments, quarterly cash dividends, share repurchases, acquisitions, lease commitments, restructuring obligations and other long-term obligations.

### Legal and Other Regulatory Matters

See discussion regarding legal and other regulatory matters in Part II, Item 1. Legal Proceedings.

### Off-Balance Sheet Arrangements

Our only significant off-balance sheet commitments relate to operating lease obligations. Future annual minimum rental lease payments are detailed in Note 9 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018. We have no “off-balance sheet arrangements” within the meaning of Item 303(a)(4) of Regulation S-K.

### Contractual Obligations

There have been no material changes to our contractual obligations disclosed in tabular format in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018.

### Recent Accounting Pronouncements

Refer to Note 1 - Nature of Business and Basis of Presentation (Part I, Item 1 of this Form 10-Q) for further discussion.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

During the first quarter of fiscal year 2019, there were no significant changes to our quantitative and qualitative disclosures about market risk. Please refer to Part II, Item 7A. Quantitative and Qualitative Disclosures about Market Risk included in our Annual Report on Form 10-K for our fiscal year ended November 30, 2018 for a more complete discussion of the market risks we encounter.

### Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

Our management maintains disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”) that are designed to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), as appropriate, to allow for timely decisions regarding required disclosure.



Table of Contents

Our management, including our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed in the reports filed or submitted by us under the Exchange Act was recorded, processed, summarized and reported within the requisite time periods and that such information was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated our “internal control over financial reporting” as defined in Exchange Act Rule 13a-15(f) to determine whether any changes in our internal control over financial reporting occurred during the fiscal quarter ended February 28, 2019 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, there were no changes in our internal control over financial reporting during the fiscal quarter ended February 28, 2019 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of ASC 606 on our financial statements to facilitate our adoption of it on December 1, 2018. There were no material changes to our internal control over financial reporting due to the adoption of ASC 606.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond our control. There have been no material changes in our assessment of our risk factors from those set forth in our Annual Report on Form 10-K for the fiscal year ended November 30, 2018. For convenience, such risk factors are included below. The risks discussed below could materially affect our business, financial condition and future results. The risks described below are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be insignificant also may materially and adversely affect our business, financial condition or operating results in the future.

Our revenue and quarterly results may fluctuate, which could adversely affect our stock price. We have experienced, and may in the future experience, significant fluctuations in our quarterly operating results that may be caused by many factors. These factors include:

- changes in demand for our products;
- introduction, enhancement or announcement of products by us or our competitors;
- market acceptance of our new products;
- the growth rates of certain market segments in which we compete;
- size and timing of significant orders;
- a high percentage of our revenue is generated in the third month of each fiscal quarter and any failure to receive, complete or process orders at the end of any quarter could cause us to fall short of our revenue targets;
- budgeting cycles of customers;
- mix of distribution channels;
- mix of products and services sold;
  - mix of international and North American revenues;
- fluctuations in currency exchange rates;
- changes in the level of operating expenses;
- changes in management;
- restructuring programs;
- changes in our sales force;
- completion or announcement of acquisitions by us or our competitors;
- customer order deferrals in anticipation of new products announced by us or our competitors; and
- general economic conditions in regions in which we conduct business.

Revenue forecasting is uncertain, and the failure to meet our forecasts could result in a decline in our stock price. Our revenues, particularly new software license revenues, are difficult to forecast. We use a pipeline system to forecast revenues and trends in our business. Our pipeline estimates may prove to be unreliable either in a particular quarter or over a longer period of time, in part because the conversion rate of the pipeline into contracts can be difficult to

estimate and requires management judgment. A variation in the conversion rate could cause us to plan or budget incorrectly and materially adversely impact our business or our planned results of operations. Furthermore, most of our expenses are relatively fixed, including costs of personnel and facilities. Thus, an unexpected reduction in our revenue, or failure to achieve the anticipated rate of growth, would have a material adverse effect on our profitability. If our operating results do not meet our publicly stated guidance or the expectations of investors, our stock price may decline.

We recognize a substantial portion of our revenue from sales made through third parties, including our application partners, distributors/resellers, and OEMs, and adverse developments in the businesses of these third parties or in our relationships with them could harm our revenues and results of operations. Our future results depend in large part upon our continued successful distribution of our products through our application partner, distributor/reseller, and OEM channels. The activities of these third parties are not within our direct control. Our failure to manage our relationships with these third parties effectively could impair the success of our sales, marketing and support activities. A reduction in the sales efforts, technical capabilities or financial viability of these parties, a misalignment of interest between us and them, or a termination of our

## Table of Contents

relationship with a major application partner, distributor/reseller, or OEM could have a negative effect on our sales and financial results. Any adverse effect on any of our application partners', distributors'/resellers', or OEMs' businesses related to competition, pricing and other factors could also have a material adverse effect on our business, financial condition and operating results.

Changes in accounting principles and guidance, or their interpretation or implementation, may materially adversely affect our reported results of operations or financial position. We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") These principles are subject to interpretation by the SEC and various bodies formed to create and interpret appropriate accounting principles and guidance. A change in these principles or guidance, or in their interpretations, may have a significant effect on our reported results, as well as our processes and related controls.

For example, in May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606"). ASC 606 outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes prior revenue recognition guidance, including industry-specific guidance. This new standard is both technical and complex. The Company adopted ASC 606 effective December 1, 2018 and adjusted prior period consolidated financial statements to reflect full retrospective adoption, beginning with our Quarterly Report on Form 10-Q for the first quarter of 2019. Management has completed assessing the impact the adoption of this standard will have on the Company's consolidated financial statements, which will have a material impact on our consolidated financial statements, including the way we account for arrangements involving our term licenses and perpetual licenses with maintenance and/or support. In connection with the adoption of ASC 606, we implemented new processes, systems and internal controls. Such changes and any difficulties implementing such changes could materially adversely affect our reported financial results, our ability to comply with regulatory reporting requirements, and the effectiveness of our internal controls over financial reporting. For a discussion of the impact that the implementation of ASC 606 had on our consolidated financial statements and related disclosures, see Note 1. Nature of Business and Basis of Presentation.

A failure of our information technology systems, including the implementation of our new financial systems platform, could have a material adverse effect on our business. A failure or prolonged interruption in our information technology systems, or any difficulty encountered in upgrading our systems or implementing new systems, that compromises our ability to meet our customers' needs, or impairs our ability to record, process and report accurate information could have a material adverse effect on our financial condition.

We are in the process of implementing a new financial systems platform which will assist with the collection, storage, management and interpretation of data from our business activities to support future growth and to integrate significant processes. Our financial systems platform is critical to our ability to accurately maintain books and records, record transactions, provide important information to our management and prepare our consolidated financial statements. Financial systems platform implementations are complex and time-consuming and involve significant expenditures on system software and implementation activities, as well as changes in business processes.

As part of the implementation of our new financial systems platform, certain changes to our processes and procedures have and will continue to occur. These changes will result in changes to our internal control over financial reporting. This new platform is designed to strengthen our internal financial controls by automating certain manual processes and standardizing business processes and reporting across our organization. However, any disruptions, delays or deficiencies in the design and implementation of a new financial systems platform could adversely affect our ability to operate our business. Additionally, if the new platform does not operate as intended, the effectiveness of our internal control over financial reporting could be adversely affected or our ability to assess it adequately could be further impacted.

Weakness in the U.S. and international economies may result in fewer sales of our products and may otherwise harm our business. We are subject to risks arising from adverse changes in global economic conditions, especially those in the U.S., Europe and Latin America. If global economic conditions weaken, credit markets tighten and/or financial markets become unstable, customers may delay, reduce or forego technology purchases, both directly and through our application partners and OEMs. This could result in reductions in sales of our products, longer sales cycles, slower adoption of new technologies and increased price competition. Further, deteriorating economic conditions could adversely affect our customers and their ability to pay amounts owed to us. Any of these events would likely harm our business, results of operations, financial condition or cash flows.

Our international operations expose us to additional risks, and changes in global economic and political conditions could adversely affect our international operations, our revenue and our net income. Approximately 45% of our total revenue is

## Table of Contents

generated from sales outside North America. Political and/or financial instability, oil price shocks and armed conflict in various regions of the world can lead to economic uncertainty and may adversely impact our business. For example, the announcement of the Referendum of the United Kingdom's (the "U.K.") Membership of the European Union ("E.U.") (referred to as "Brexit"), advising for the exit of the U.K. from the E.U., resulted in significant volatility in global stock markets and currency exchange rate fluctuations. If customers' buying patterns, decision-making processes, timing of expected deliveries and timing of new projects unfavorably change due to economic or political conditions, there would be a material adverse effect on our business, financial condition and operating results.

Other potential risks inherent in our international business include:

- longer payment cycles;
- credit risk and higher levels of payment fraud;
- greater difficulties in accounts receivable collection;
- varying regulatory and legal requirements;
- compliance with international and local trade, labor and export control laws;
- compliance with U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting bribery and corrupt payments to government officials;
- restrictions on the transfer of funds;
- difficulties in developing, staffing, and simultaneously managing a large number of varying foreign operations as a result of distance, legal impediments and language and cultural differences;
- reduced or minimal protection of intellectual property rights in some countries;
- laws and business practices that favor local competitors or prohibit foreign ownership of certain businesses;
- changes in U.S. or foreign trade policies or practices that increase costs or restrict the distribution of products;
- seasonal reductions in business activity during the summer months in Europe and certain other parts of the world;
- economic instability in emerging markets; and
- potentially adverse tax consequences.

Any one or more of these factors could have a material adverse effect on our international operations, and, consequently, on our business, financial condition and operating results.

Fluctuations in foreign currency exchange rates could have an adverse impact on our financial condition and results of operations. Changes in the value of foreign currencies relative to the U.S. dollar could adversely affect our results of operations and financial position. For example, during periods in which the value of the U.S. dollar strengthens in comparison to certain foreign currencies, particularly in Europe, Brazil and Australia, our reported international revenue is reduced because foreign currencies translate into fewer U.S. dollars. As approximately one-third of our revenue is denominated in foreign currencies, our revenue results have been impacted, and we expect will continue to be impacted, by fluctuations in foreign currency exchange rates.

We seek to reduce our exposure to fluctuations in exchange rates by entering into foreign exchange forward contracts to hedge certain actual and forecasted transactions of selected currencies (mainly in Europe, Brazil, India and Australia). Our currency hedging transactions may not be effective in reducing any adverse impact of fluctuations in foreign currency exchange rates. Further, the imposition of exchange or price controls or other restrictions on the conversion of foreign currencies could have a material adverse effect on our business.

Technology and customer requirements evolve rapidly in our industry, and if we do not continue to develop new products and enhance our existing products in response to these changes, our business could be harmed. Ongoing enhancements to our product sets will be required to enable us to maintain our competitive position and the competitive position of our application partners, distributors/resellers, and OEMs. We may not be successful in developing and marketing enhancements to our products on a timely basis, and any enhancements we develop may

not adequately address the changing needs of the marketplace. Overlaying the risks associated with our existing products and enhancements are ongoing technological developments and rapid changes in customer and partner requirements. Our future success will depend upon our ability to develop and introduce in a timely manner new products that take advantage of technological advances and respond to new customer and partner requirements. We may not be successful in developing new products incorporating new technology on a timely basis, and any new products we develop may not adequately address the changing needs of the marketplace or may not be accepted by the market. Failure to develop new products and product enhancements that meet market needs in a timely manner could have a material adverse effect on our business, financial condition and operating results.

We are substantially dependent on our Progress OpenEdge products. We derive a significant portion of our revenue from software license and maintenance revenue attributable to our Progress OpenEdge product set. Accordingly, our future results

## Table of Contents

depend on continued market acceptance of OpenEdge. If new technologies emerge that are superior to, or are more responsive to customer requirements than, OpenEdge such that we are unable to maintain OpenEdge's competitive position within its marketplace, our business, financial condition and operating results may be materially adversely affected.

We have made significant investments in furtherance of our cognitive applications strategy and these investments may not generate the revenues we expect, which could adversely affect our business and financial results. Our cognitive applications strategy is focused on providing the platform and tools enterprises need to build next generation applications that drive their businesses, known as "cognitive applications." Beginning in 2017, we have made significant investments in furtherance of our cognitive applications strategy, including two acquisitions.

We cannot guarantee that our cognitive applications strategy is the right one or that we will be effective in executing this strategy. Our strategy may not succeed for a number of reasons, including, but not limited to: general economic risks, execution risks with acquisitions, competitiveness in and the dynamic nature of the markets in which we operate, execution risks around product development, market acceptance of new products and services and risks associated with the adoption of, and demand for, our model in general. If one or more of the foregoing risks were to materialize, our business, results of operations and ability to achieve sustained profitability could be adversely affected.

The increased emphasis on a cloud strategy may give rise to risks that could harm our business. We are devoting significant resources to the development of cloud-based technologies and service offerings where we have a limited operating history. Our cloud strategy requires continued investment in product development and cloud operations as well as a change in the way we price and deliver our products. Many of our competitors may have advantages over us due to their larger presence, larger developer network, deeper experience in the cloud-based computing market, and greater sales and marketing resources. It is uncertain whether these strategies will prove successful or whether we will be able to develop the infrastructure and business models more quickly than our competitors. Our cloud strategy may give rise to a number of risks, including the following:

- if new or current customers desire only perpetual licenses, we may not be successful in selling subscriptions; although we intend to continue to support our perpetual license business, the increased emphasis on a cloud strategy may raise concerns among our installed customer base;
- we may be unsuccessful in achieving our target pricing;
- our revenues might decline over the short or long term as a result of this strategy;
- our relationships with existing partners that resell perpetual licenses may be damaged;
- increased risk of security breaches; and
- we may incur costs at a higher than forecasted rate as we enhance and expand our cloud operations.

We face various risks in connection with our proposed acquisition of Ipswitch, Inc. On March 28, 2019, we entered into an agreement to acquire Ipswitch, Inc. We face various risks in connection with our proposed acquisition of Ipswitch, including the effects of disruption from the transaction making it more difficult to maintain relationships with employees, licensees, other business partners or governmental entities, other business effects, including the effects of industry, economic or political conditions outside of our or Ipswitch's control, transaction costs, actual or contingent liabilities, diversion of management, uncertainties as to whether anticipated synergies will be realized and uncertainties as to whether Ipswitch's business will be successfully integrated with our business. Any one or more of these factors could have a material adverse effect on the combined business, our results of operations and our financial condition.

We may make additional acquisitions or investments in new businesses, products or technologies that involve additional risks, which could disrupt our business or harm our financial condition, results of operations or cash flows.



We may make acquisitions of businesses or investments in companies that offer complementary products, services and technologies. Any acquisitions that we do complete involve a number of risks, including the risks of assimilating the operations and personnel of acquired companies, realizing the value of the acquired assets relative to the price paid, distraction of management from our ongoing businesses and potential product disruptions associated with the sale of the acquired company's products. In addition, an acquisition may not further our business strategy as we expected, may not result in revenue growth to the degree we expected or at all or may not achieve expected synergies, any of which could adversely affect our business or operating results and potentially cause impairment to assets that we recorded as a part of an acquisition including intangible assets and goodwill. These factors could have a material adverse effect on our business, financial condition, operating results and cash flows. The consideration we pay for any future acquisitions could include our stock. As a result, future acquisitions could cause dilution to existing stockholders and to earnings per share.

The segments of the software industry in which we participate are intensely competitive, and our inability to compete effectively could harm our business. We experience significant competition from a variety of sources with respect to the marketing and distribution of our products. Many of our competitors have greater financial, marketing or technical resources

Table of Contents

than we do and may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than we can. Increased competition could make it more difficult for us to maintain our market presence or lead to downward pricing pressure.

In addition, the marketplace for new products is intensely competitive and characterized by low barriers to entry. For example, an increase in market acceptance of open source software may cause downward pricing pressures. As a result, new competitors possessing technological, marketing or other competitive advantages may emerge and rapidly acquire market share. In addition, current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties, thereby increasing their ability to deliver products that better address the needs of our prospective customers. Current and potential competitors may also be more successful than we are in having their products or technologies widely accepted. We may be unable to compete successfully against current and future competitors, and our failure to do so could have a material adverse effect on our business, prospects, financial condition and operating results.

We rely on the experience and expertise of our skilled employees, and must continue to attract and retain qualified technical, marketing and managerial personnel in order to succeed. Our future success will depend in a large part upon our ability to attract and retain highly skilled technical, managerial, sales and marketing personnel. There is significant competition for such personnel in the software industry. We may not continue to be successful in attracting and retaining the personnel we require to develop new and enhanced products and to continue to grow and operate profitably.

Our periodic workforce restructurings can be disruptive. We have in the past restructured or made other adjustments to our workforce in response to management changes, product changes, performance issues, changes in strategy, acquisitions and other internal and external considerations. In the past, these restructurings have resulted in increased restructuring costs and have temporarily reduced productivity. These effects could recur in connection with any future restructurings or we may not achieve or sustain the expected growth or cost savings benefits of any such restructurings, or do so within the expected timeframe. As a result, our revenues and other results of operations could be negatively affected.

The loss of technology licensed from third parties could adversely affect our ability to deliver our products. We utilize certain technology that we license from third parties, including software that is integrated with internally developed software and used in our products to perform key functions. This technology, or functionally similar technology, may not continue to be available on commercially reasonable terms in the future, or at all. The loss of any significant third-party technology license could cause delays in our ability to deliver our products or services until equivalent technology is developed internally or equivalent third-party technology, if available, is identified, licensed and integrated.

Our business practices with respect to the collection, use and management of personal information could give rise to operational interruption, liabilities or reputational harm as a result of governmental regulation, legal requirements or industry standards relating to consumer privacy and data protection. As regulatory focus on privacy issues continues to increase and worldwide laws and regulations concerning the handling of personal information expand and become more complex, potential risks related to data collection and use within our business will intensify. For example, the E.U. and the United States ("U.S.") formally entered into a new framework in July 2016 that provides a mechanism for companies to transfer data from E.U. member states to the U.S. This new framework, called the Privacy Shield, is intended to address shortcomings identified by the Court of Justice of the E.U. in the previous E.U.-U.S. Safe Harbor Framework, which the Court of Justice invalidated in October 2015. The Privacy Shield and other data transfer mechanisms are likely to be reviewed by the European courts, which may lead to uncertainty about the legal basis for data transfers to the U.S. or interruption of such transfers. In the event any court blocks transfers to or from a particular jurisdiction on the basis that no transfer mechanisms are legally adequate, this could give rise to operational

interruption in the performance of services for customers and internal processing of employee information, regulatory liabilities or reputational harm. In addition, U.S. and foreign governments have enacted or are considering enacting legislation or regulations, or may in the near future interpret existing legislation or regulations, in a manner that could significantly impact our ability and the ability of our customers and data partners to collect, augment, analyze, use, transfer and share personal and other information that is integral to certain services we provide.

Regulators globally are also imposing greater monetary fines for privacy violations. For example, in 2016, the E.U. adopted a new law governing data practices and privacy called the General Data Protection Regulation (GDPR), which became effective in May 2018. The law establishes new requirements regarding the handling of personal data. Non-compliance with the GDPR may result in monetary penalties of up to 4% of worldwide revenue. The GDPR and other changes in laws or regulations associated with the enhanced protection of certain types of sensitive data, such as healthcare data or other personal information, could greatly increase our cost of providing our products and services or even prevent us from offering certain services in jurisdictions that we operate.

## Table of Contents

Additionally, public perception and standards related to the privacy of personal information can shift rapidly, in ways that may affect our reputation or influence regulators to enact regulations and laws that may limit our ability to provide certain products. Any failure, or perceived failure, by us to comply with U.S. federal, state, or foreign laws and regulations, including laws and regulations regulating privacy, data security, or consumer protection, or other policies, public perception, standards, self-regulatory requirements or legal obligations, could result in lost or restricted business, proceedings, actions or fines brought against us or levied by governmental entities or others, or could adversely affect our business and harm our reputation.

If our products contain software defects or security flaws, it could harm our revenues and expose us to litigation. Our products, despite extensive testing and quality control, may contain defects or security flaws, especially when we first introduce them or when new versions are released. We may need to issue corrective releases of our software products to fix any defects or errors. The detection and correction of any security flaws can be time consuming and costly. Errors in our software products could affect the ability of our products to work with other hardware or software products, delay the development or release of new products or new versions of products, adversely affect market acceptance of our products and expose us to potential litigation. If we experience errors or delays in releasing new products or new versions of products, such errors or delays could have a material adverse effect on our revenue.

We could incur substantial cost in protecting our proprietary software technology or if we fail to protect our technology, which would harm our business. We rely principally on a combination of contract provisions and copyright, trademark, patent and trade secret laws to protect our proprietary technology. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Policing unauthorized use of our products is difficult. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. This litigation could result in substantial costs and diversion of resources, whether or not we ultimately prevail on the merits. The steps we take to protect our proprietary rights may be inadequate to prevent misappropriation of our technology; moreover, others could independently develop similar technology.

We could be subject to claims that we infringe intellectual property rights of others, which could harm our business, financial condition, results of operations or cash flows. Third parties could assert infringement claims in the future with respect to our products and technology, and such claims might be successful. Litigation relating to any such claims could result in substantial costs and diversion of resources, whether or not we ultimately prevail on the merits. Any such litigation could also result in our being prohibited from selling one or more of our products, unanticipated royalty payments, reluctance by potential customers to purchase our products, or liability to our customers and could have a material adverse effect on our business, financial condition, operating results and cash flows.

If our security measures are breached, our products and services may be perceived as not being secure, customers may curtail or stop using our products and services, and we may incur significant legal and financial exposure. Our products and services involve the storage and transmission of our customers' proprietary information and may be vulnerable to unauthorized access, computer viruses, cyber-attacks, distributed denial of service attacks and other disruptive problems. Due to the actions of outside parties, employee error, malfeasance, or otherwise, an unauthorized party may obtain access to our data or our customers' data, which could result in its theft, destruction or misappropriation. Security risks in recent years have increased significantly given the increased sophistication and activities of hackers, organized crime, including state-sponsored organizations and nation-states, and other outside parties. Cyber threats are continuously evolving, increasing the difficulty of defending against them. While we have implemented security procedures and controls to address these threats, our security measures could be compromised or could fail. Any security breach or unauthorized access could result in significant legal and financial exposure, increased costs to defend litigation, indemnity and other contractual obligations, government fines and penalties, damage to our reputation and our brand, and a loss of confidence in the security of our products and services that

could potentially have an adverse effect on our business and results of operations. Breaches of our network could disrupt our internal systems and business applications, including services provided to our customers. Additionally, data breaches could compromise technical and proprietary information, harming our competitive position. We may need to spend significant capital or allocate significant resources to ensure effective ongoing protection against the threat of security breaches or to address security related concerns. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose customers. In addition, our insurance coverage may not be adequate to cover all costs related to cybersecurity incidents and the disruptions resulting from such events.

We may have exposure to additional tax liabilities. As a multinational corporation, we are subject to income taxes in the U.S. and various foreign jurisdictions. Significant judgment is required in determining our global provision for income taxes and other tax liabilities. In the ordinary course of a global business, there are many intercompany transactions and calculations where the ultimate tax determination is uncertain. Our income tax returns are routinely subject to audits by tax authorities. Although we regularly assess the likelihood of adverse outcomes resulting from these examinations to determine our tax

Table of Contents

estimates, a final determination of tax audits that is inconsistent with such assessments or tax disputes could have an adverse effect on our financial condition, results of operations and cash flows.

We are also subject to non-income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes in the U.S. and various foreign jurisdictions. We are regularly under audit by tax authorities with respect to these non-income taxes and may have exposure to additional non-income tax liabilities, which could have an adverse effect on our results of operations, financial condition and cash flows.

In addition, our future effective tax rates could be favorably or unfavorably affected by changes in tax rates, changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws or their interpretation. Such changes could have a material adverse impact on our financial results.

We are required to comply with certain financial and operating covenants under our credit facility and to make scheduled debt payments as they become due; any failure to comply with those covenants or to make scheduled payments could cause amounts borrowed under the facility to become immediately due and payable or prevent us from borrowing under the facility. In November 2017, we entered into an amended and restated credit agreement, which consists of a \$123.8 million term loan and a \$150.0 million revolving loan (which may be increased by an additional \$125.0 million if the existing or additional lenders are willing to make such increased commitments). This facility matures in November 2022, at which time any amounts outstanding will be due and payable in full. We may wish to borrow additional amounts under the facility in the future to support our operations, including for strategic acquisitions and share repurchases.

We are required to comply with specified financial and operating covenants and to make scheduled repayments of our term loan, which may limit our ability to operate our business as we otherwise might operate it. Our failure to comply with any of these covenants or to meet any payment obligations under the facility could result in an event of default which, if not cured or waived, would result in any amounts outstanding, including any accrued interest and unpaid fees, becoming immediately due and payable. We might not have sufficient working capital or liquidity to satisfy any repayment obligations in the event of an acceleration of those obligations. In addition, if we are not in compliance with the financial and operating covenants at the time we wish to borrow funds, we will be unable to borrow funds.

Our annual operating cash flows may not be sufficient to enable us to meet our targeted capital allocation policy, which could decrease our investors expected return on investment in Progress stock. In September 2017, we announced a new capital allocation strategy in which we are targeting to return approximately 75-80% of annual cash flows from operations to stockholders through share repurchases and through dividends. Meeting these targets requires us to generate consistent cash flow and have available capital in an amount sufficient to enable us to continue investing in our business. We may not meet these targets if we do not generate the operating cash flows we expect, if we use our available cash to satisfy other priorities, if we have insufficient funds available to make such repurchases and/or dividends or if we are unable to borrow funds under our credit facility.

Our common stock price may continue to be volatile, which could result in losses for investors. The market price of our common stock, like that of other technology companies, is volatile and is subject to wide fluctuations in response to quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, changes in financial estimates by securities analysts or other events or factors. Our stock price may also be affected by broader market trends unrelated to our performance. As a result, purchasers of our common stock may be unable at any given time to sell their shares at or above the price they paid for them.

Table of Contents

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Items 2(a) and 2(b) are not applicable.

## (c) Stock Repurchases

Information related to the repurchases of our common stock by month in the first quarter of fiscal year 2019 is as follows (in thousands, except per share and share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs <sup>(1)</sup>
December 2018	—	\$ —	—	\$ 100,000
January 2019	247,186	35.38	247,186	91,249
February 2019	440,732	36.85	440,732	75,000
Total	687,918	\$ 36.32	687,918	\$ 75,000

In September 2017, our Board of Directors increased our total share repurchase authorization to \$250.0 million. As of February 28, 2019, there was \$75.0 million remaining under this authorization. In connection with the (1) announced acquisition of Ipswitch, we intend to suspend our stock repurchase program for the remainder of fiscal 2019. We expect to resume share repurchases in fiscal 2020, at a level consistent with our publicly stated capital allocation policy.

## Item 5. Other Information

On March 19, 2019, the Board of Directors adopted the 2019 Fiscal Year Compensation Program for Non-Employee Directors (the “2019 Plan”), which provides for the payment of cash and equity compensation to non-employee members of our Board of Directors in connection with their service to Progress. The 2019 Plan is identical to the compensation plan applicable to directors in 2018.

Under the 2019 Plan, our non-employee directors will be paid an annual retainer of \$250,000. This annual retainer will be paid \$50,000 in cash and \$200,000 in equity (with the equity paid in the form of deferred stock units which convert to shares of common stock only upon a change in control of the Company or the cessation of service on the Board of Directors). The non-executive Chairman of the Board will be paid an additional cash retainer of \$50,000. With respect to service on the committees of our Board of Directors, the following fees will be paid:

- Audit Committee - \$25,000 for the Chairman and \$20,000 for the other members;
- Compensation Committee - \$25,000 for the Chairman and \$15,000 for the other members;
- Nominating and Corporate Governance Committee - \$12,500 for the Chairman and \$10,000 for the other members;
- and
- Mergers and Acquisitions Committee - \$12,500 for the Chairman and \$10,000 for the other members.

On March 28, 2019, we entered into an acquisition agreement with Ipswitch, Inc. (“Ipswitch”), pursuant to which we will acquire all of the outstanding equity interests of Ipswitch for \$225 million in cash. We will fund the transaction with existing cash on hand and funds secured under a new credit facility. Ipswitch will provide us with leading network management and secure data file transfer capabilities for small and medium-sized businesses and enterprises. Founded in 1991, Ipswitch serves approximately 24,000 customers in 170 countries. Ipswitch has approximately \$75 million in revenue, of which 75% is recurring. Ipswitch has blue-chip customers across all verticals, including finance and banking, healthcare, insurance, retail, government and biotech. The transaction is expected to be completed in late April 2019, subject to customary regulatory approvals and conditions. In connection with the announced acquisition of Ipswitch, we intend to suspend our stock repurchase program for the remainder of fiscal 2019. We expect to resume share repurchases in fiscal 2020, at a level consistent with our publicly stated capital allocation policy.



Table of Contents

Item 6. Exhibits

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

Exhibit No. Description

- 10.1\* 2019 Fiscal Year Compensation Program for Non-Employee Directors
- 31.1\* Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act – Yogesh K. Gupta
- 31.2\* Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act – Paul A. Jalbert
- 32.1\*\* Certification Pursuant to Section 906 of the Sarbanes-Oxley Act

101 The following materials from Progress Software Corporation's Quarterly Report on Form 10-Q for the three months ended February 28, 2019, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets as of February 28, 2019 and November 30, 2018; (ii) Condensed Consolidated Statements of Income for the three months ended February 28, 2019 and February 28, 2018; (iii) Condensed Consolidated Statements of Comprehensive Income for the three months ended February 28, 2019 and February 28, 2018; (iv) Condensed Consolidated Statements of Shareholders' Equity for the three months ended February 28, 2019 and February 28, 2018; (v) Condensed Consolidated Statements of Cash Flows for the three months ended February 28, 2019 and February 28, 2018; and (vi) Notes to Condensed Consolidated Financial Statements.

\* Filed herewith

\*\*Furnished herewith

Table of Contents

SIGNATURES

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

PROGRESS SOFTWARE CORPORATION  
(Registrant)

Dated: April 5, 2019 /s/ YOGESH K. GUPTA  
Yogesh K. Gupta  
President and Chief Executive Officer  
(Principal Executive Officer)

Dated: April 5, 2019 /s/ PAUL A. JALBERT  
Paul A. Jalbert  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)