The following table presents revenue by geography (in thousands):

	Three Months Ended July 31, 2004	Three Months Ended July 31, 2003	Nine Months Ended July 31, 2004	Nine Months Ended July 31, 2003
Revenue:				
Americas	$ 6,277	$ 14,265	$ 18,927	$ 36,649
International	4,928	5,790	13,807	18,315
Total revenue	$ 11,205	$ 20,055	$ 32,734	$ 54,964

Intangible assets, which consist of our reseller channel, trade name and technology, have been assigned to our UNIX and SCOsource segments and consist of the following as of July 31, 2004 (in thousands):

	July 31, 2004
Intangible assets:	
UNIX (reseller channel and trade name)	$ 5,333
SCOsource (technology)	757
Total intangible assets	$ 6,090

(10) SUBSEQUENT EVENTS

BayStar Capital

On August 24, 2004, the Company delivered to BayStar $13,000,000 in cash and a stock certificate representing 2,105,263 common shares of the Company's common stock. The Company delivered cash and stock consideration in connection with its repurchase of BayStar's 40,000 Series A-1 Shares pursuant to a stock repurchase agreement entered into between them on May 31, 2004 (as described in Note 5 above). The closing of the repurchase transaction occurred on July 21, 2004. As of July 31, 2004, prior to BayStar's acceptance of the consideration, the Company classified this cash as restricted cash and recorded a payable to BayStar.

Agreement with Boies, Schiller & Flexner, LLP

On August 31, 2004, the Company announced it had entered into a nonbinding letter of intent with BSF, to revise the existing fee agreement with BSF to limit the Company's overall future cash costs of legal fees, including accrued legal fees to BSF as of July 31, 2004, associated with the Company's pending intellectual property litigation to a total of $31,000,000. In addition, the nonbinding letter of intent contemplates that BSF will lead the Company's intellectual property legal efforts through the duration and completion of the pending litigation. In return for the new fee arrangement, the nonbinding letter of intent provides that the contingency fee payable to BSF and other law firms associated with any settlement or judgment award will vary on a scaled basis from 20 to 33 percent, depending on the size of the award. The revised fee agreement is subject to the Company and BSF entering into a definitive revised fee agreement.

Stockholder Rights Plan

On August 10, 2004, the Company's Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan") designed to deter coercive takeover tactics, including accumulation of shares in the open market or through private transactions and to prevent an acquirer from gaining control of the Company without offering a fair price to all of the Company's stockholders.

Under the terms of the Rights Plan, Series A Junior Participating Preferred Stock purchase rights will be distributed as a dividend at the rate of one right for each share of common stock of the Company held by stockholders of record as of the close of business on August 30, 2004. The Rights Plan would be triggered if a person or group acquired beneficial ownership of 15 percent or more of the Company's common stock other than pursuant to a board-approved tender or exchange offer or commences, or publicly announces an intention to commence, a tender or exchange offer upon consummation of which such person or group would beneficially own 15 percent or more of the Company's common stock.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this quarterly report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "intends," "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those set forth below under "Forward-Looking Statements" and "Risk Factors" and elsewhere in this Form 10-Q. The following discussion should be read in conjunction with our consolidated financial statements and notes thereto included in this Form 10-Q and our annual report on Form 10-K for the year ended October 31, 2003 filed with the Securities and Exchange Commission, including the audited financial statements and management's discussion and analysis contained therein. All information presented herein is based on the three and nine months ended July 31, 2004. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

Historical Background. We originally incorporated as Caldera Systems, Inc., a Utah corporation ("Caldera Systems"), and reincorporated as a Delaware corporation on March 6, 2000. In March 2000, we completed an initial public offering of our common stock. On May 7, 2001, we formed a new holding company in Delaware under the name of Caldera International, Inc. to acquire substantially all of the assets and operations of the server and professional services groups of The Santa Cruz Operation (now Tarantella, Inc.). In connection with this acquisition, Caldera Systems became a wholly-owned subsidiary of Caldera International, Inc. Former holders of shares and options to purchase shares of Caldera Systems received an equal number of shares and options to purchase shares in Caldera International, Inc. On May 16, 2003, our stockholders approved our corporate name change to The SCO Group, Inc.

Recent Developments. On August 31, 2004, we announced we had entered into a nonbinding letter of intent with Boies, Schiller & Flexner, LLP ("BSF"), to revise the existing fee agreement with BSF to limit our overall future cash costs of legal fees, including accrued legal fees to BSF as of July 31, 2004, associated with our pending intellectual property litigation to a total of $31,000,000. In addition, the nonbinding letter of intent contemplates that BSF will lead our intellectual property legal efforts through the duration and completion of the pending litigation. In return for the new fee arrangement, the nonbinding letter of intent provides that the contingency fee payable to BSF and other law firms associated with any settlement or judgment award will vary on a scaled basis from 20 to 33 percent, depending on the size of the award. The revised fee agreement is subject to the Company and BSF entering into a definitive revised fee agreement.

On August 10, 2004, our Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan") designed to deter coercive takeover tactics, including accumulation of shares in the open market or through private transactions and to prevent an acquirer from gaining control of our company without offering a fair price to all of our stockholders.

Under the terms of the Rights Plan, preferred stock purchase rights will be distributed as a dividend at the rate of one right for each share of common stock of the Company held by stockholders of record as of the close of business on August 30, 2004. The Rights Plan would be triggered if a person or group acquired beneficial ownership of 15 percent or more of our common stock other than pursuant to a board-approved tender or exchange offer or commences, or publicly announces an intention to commence, a tender or exchange offer upon consummation of which such person or group would beneficially own 15 percent or more of our common stock. The adoption of the Rights Plan had no impact on the financial statements for the third quarter or first three quarters of fiscal year 2004. However, if a triggering event occurs in the future, there may be an impact to the financial statements at the time a triggering event occurs.

On May 31, 2004, we entered into an agreement with BayStar to repurchase and retire BayStar's 40,000 Series A-1 shares. Terms of the agreement required us to pay to BayStar $13,000,000 in cash and issue 2,105,263 shares of our common stock, which consideration was payable and issuable upon closing, which was the effectiveness of a registration statement covering the resale of the common stock issued to BayStar. The registration statement was declared effective by the SEC on July 21, 2004, the transaction closed as of that date, all Series A-1 shares were cancelled and retired and the rights and preferences of the Series A-1 shares were terminated. The transaction also eliminated BayStar's contractual rights and includes a general release by both parties. The Company delivered the $13,000,000 in cash and 2,105,263 common shares to BayStar on August 24, 2004.

On May 5, 2004, we received a notice from RBC of its election to convert 10,000 shares of our Series A-1 Convertible Preferred Stock into a total of 740,740 shares of our common stock. Additionally, RBC informed us that it sold its remaining 20,000 Series A-1 shares to BayStar, making BayStar the sole holder of all 40,000 outstanding Series A-1 shares.

On February 5, 2004, we completed a transaction pursuant to an exchange agreement among us, BayStar Capital II, L.P. ("BayStar") and Royal Bank of Canada ("RBC") in which each outstanding share of our then-outstanding redeemable Series A Convertible Preferred Stock was exchanged for one share of our new redeemable Series A-1 Convertible Preferred Stock.

With respect to our legal action against IBM, on March 3, 2004, the U.S. Magistrate Judge issued an order addressing certain discovery matters relating to both IBM and us. We filed a motion to dismiss IBM's tenth counterclaim for a declaratory judgment of non-infringement of copyrights and a motion to amend the scheduling order and a motion to bifurcate IBM's patent counterclaims into another action. We filed, on May 28, 2004, a reply brief in connection with its motion to amend the scheduling order, in which we set forth detailed and specific responses to IBM's claims made in connection with that motion. A hearing for these motions was held on June 8, 2004, and the court issued its ruling on June 10, 2004. The court granted our motion to amend the scheduling order, with certain changes. The amended scheduling order now provides, among other things, that the deadline for completing fact discovery is February 11, 2005 (previously August 4, 2004), the deadline for completing expert discovery is April 22, 2005 (previously October 22, 2004), and the trial will begin on November 1, 2005 (previously April 11, 2005). The court also denied our motion to bifurcate IBM's patent counterclaims without prejudice to our right to request a bifurcation again at a later date. IBM has also filed a motion for partial summary judgment on its tenth counterclaim for a declaration of non-infringement of our copyrights. A hearing regarding our motion to dismiss and IBM's motion for partial summary judgment on IBM's tenth counterclaim for a declaration of non-infringement is currently scheduled for September 15, 2004. We plan to vigorously oppose IBM's motion. The Company has filed various motions seeking additional discovery from IBM. IBM has filed two additional motions for summary judgment which the Company will vigorously oppose. In addition to the materials that have been publicly filed with the court, certain information has been filed under seal in accordance with the protective order entered in the case.

On or about January 20, 2004, we brought suit against Novell, Inc. ("Novell") for slander of title seeking relief for Novell's alleged bad faith efforts to interfere with our ownership of copyrights related to our UNIX source code and derivative works and our UnixWare product. In the lawsuit, we request preliminary and permanent injunctive relief as well as damages. Through our claims, we seek to require Novell to assign to us all copyrights that we believe Novell has wrongfully registered, prevent Novell from representing any ownership interest in those copyrights and require Novell to retract or withdraw all representations it has made regarding its purported ownership of those copyrights. On June 10, 2004, the court issued a memorandum decision and order which denied our motion to remand the case to state court. The memorandum decision also denied Novell's motion to dismiss in part on claims of falsity. However, the court granted Novell's motion to dismiss regarding our allegations of special damages, but granted us 30 days leave to amend our complaint and plead special damages with more specificity. The Company has filed its amended complaint and Novell has responded with another motion to dismiss claiming that Novell's alleged slanderous statements are privileged under the law.

On or about March 2, 2004, we brought suit against AutoZone, Inc. for its alleged violations of our UNIX copyrights through its use of Linux. Specifically, the lawsuit alleges that AutoZone is infringing our UNIX copyrights by, among other things, running versions of the Linux operating system that contain code, structure, sequence and/or organization from our proprietary UNIX System V code in violation of our copyrights. The lawsuit filed in U.S. District Court in Nevada requests injunctive relief against AutoZone's further use or copying of any part of our copyrighted materials and also requests damages as a result of AutoZone's infringement in an amount to be proven at trial. On April 23, 2004, AutoZone filed a motion to transfer the case to Tennessee or to stay the case. On August 6, 2004, the federal court in Nevada entered an order granting AutoZone's motion to stay the case with 90 days status reports to the court. The court denied without prejudice AutoZone's motion for a more definite statement and its motion to transfer the case to Tennessee. The court also is allowing the parties to take limited expedited discovery relating to the issue of preliminary injunctive relief requested by us. We are undertaking that discovery process.

On or about March 3, 2004, we brought suit against DaimlerChrysler Corporation for its alleged violations of its UNIX software agreement with us. Specifically, the lawsuit alleges that DaimlerChrysler breached its UNIX software agreement with us by failing to voluntarily certify by January 31, 2004 its compliance with its UNIX software agreement as required by us. The lawsuit, filed in Oakland County Circuit Court in the State of Michigan, requests the court to declare that DaimlerChrysler has violated the certification requirements of its UNIX software agreement, permanently enjoin DaimlerChrysler from further violations of the UNIX software agreement, issue a mandatory injunction requiring DaimlerChrysler to remedy the effects of its past violations of the UNIX software agreement and award us damages in amount to be determined at trial together with costs, attorneys' fees and any such other or different relief that the Court may deem to be equitable and just. On April 15, 2004, DaimlerChrysler filed a motion to dismiss our claims. DaimlerChrysler's motion was heard on July 21, 2004 and the court granted DaimlerChrysler's motion as to the substance of DaimlerChrysler's certification, but denied the motion as to whether the certification was timely. We are currently evaluating this matter and potential further actions we may take.

In March 2004, our board of directors authorized management, in its discretion, to purchase up to 1,500,000 shares of our common stock over a 24-month period. Shares may be purchased in open market transactions, block purchases or privately negotiated transactions. Any repurchased shares will be held as treasury stock and will be available for general corporate purposes. During the quarter ended April 30, 2004, we purchased 290,000 shares of our common stock in open market purchases for a total cost of $2,414,000. We did not purchase any shares of our common stock during the quarter ended July 31, 2004.

Business Focus

We generate revenue primarily from two sources: product and services revenue from our UNIX business and license fees from our SCOsource business.

UNIX Business. Our UNIX business serves the needs of small-to-medium sized businesses, including replicated site franchisees of Fortune 1000 companies, by providing reliable, cost effective UNIX operating systems and software products to power computers running on Intel architecture. Our largest source of UNIX business revenue is derived from existing customers through our worldwide, indirect, leveraged channel of partners which includes distributors and independent solution providers. We have local offices in a number of countries that provide support and services to customers and resellers in these countries. The other principal channel for selling and marketing our UNIX products is through existing customers that have a large number of replicated sites or franchisees. We access these corporations through their information technology or purchasing departments with our Area Sales Managers in the United States and through our reseller channel in countries outside the United States. In addition, we also sell our operating system products to OEMs. Our sales of UNIX products and services during the third quarter and first three quarters of fiscal year 2004 were primarily to pre-existing UNIX customers, and not newly acquired customers. Our UNIX business revenue depends significantly on our ability to market our products to existing customers and to generate upgrades from existing customers. The following table shows the operating results of the UNIX business for the three and nine months ended July 31, 2004 and 2003 (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2004	2003	2004	2003
Revenue	$ 10,527	$ 12,775	$ 32,025	$ 39,434
Cost of revenue	1,619	2,738	5,637	8,430
Gross margin	8,908	10,037	26,388	31,004
Sales and marketing	3,740	5,930	12,868	18,421
Research and development	2,361	2,950	7,838	8,142
General and administrative	1,761	1,413	6,325	4,525
Other	863	1,818	4,980	3,720
Total operating expenses	8,725	12,111	32,011	34,808
Income (loss) from operations	$ 183	$ (2,074)	$ (5,623)	$ (3,804)

Revenue from our UNIX business decreased by $2,248,000, or 18 percent, for the third quarter of fiscal year 2004 compared to the third quarter of fiscal year 2003, and revenue from our UNIX business decreased by $7,409,000, or 19 percent, for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003. The revenue from this business has been declining over the last several quarters primarily as a result of increased competition from alternative operating systems, particularly Linux, and lower information technology spending for UNIX products. Until the third quarter of fiscal year 2004, our UNIX business had generated losses from operations for several quarters. If revenue from our UNIX business continues to decline and we are unable to generate and sustain positive cash flow and profitable operations, our UNIX operations may be adversely impacted.

In an effort to attain profitability in our UNIX business, we have decreased our operating costs and increased our gross margin percentage over the last two quarters. Operating costs for our UNIX business decreased from $12,111,000 for the third quarter of fiscal year 2003 to $8,725,000 for the third quarter of fiscal year 2004, and decreased from $34,808,000 for the first three quarters of fiscal year 2003 to $32,011,000 for the first three quarters of fiscal year 2004. These cost reductions have primarily been attributable to reduced headcount and continued operational efficiencies generated in our UNIX business. We have reduced the number of employees in our UNIX business from 324 as of July 31, 2003 to 223 as of July 31, 2004, eliminated redundant facilities and reduced other discretionary spending while still preserving our worldwide infrastructure. During the fourth quarter of fiscal year 2004, we plan to take additional cost reduction actions, which will include reductions in staff as well as certain reductions and consolidation in office space, which will further decrease the operating costs of our UNIX business. We estimate that the restructure cost associated with these actions may be approximately $2,000,000, but the actual cost associated with these actions may differ from this estimate.

Our gross margin percentage from our UNIX business also increased from 79 percent in the third quarter of fiscal year 2003 to 85 percent in the third quarter of fiscal year 2004. We may not be able to sustain profitability in our UNIX business through additional operating cost reductions.

The decline in our UNIX business revenue may be accelerated if industry partners withdraw their support as a result of our SCOsource initiatives and in particular any lawsuits against end users violating our intellectual property and contractual rights. The decline in our UNIX business and our SCOsource initiatives, particularly lawsuits against such end users, may cause industry partners, developers and hardware and software vendors to choose not to support or certify to our UNIX operating system products. This would lead to an accelerated decline in our UNIX products and services revenue.

An important initiative for our UNIX business for the 2004 fiscal year has been our continued investment in and commitment to our UNIX operating systems. As part of this initiative, we released a new version of our UnixWare operating system in June 2004 and anticipate releasing a new version of our OpenServer operating system in the first calendar quarter of 2005 and will provide these products with increased system reliability, backward compatibility with existing applications and software, increased application and hardware support, integration with widely used internet applications and increased system performance. These enhancements will not have a direct impact on our short-term UNIX revenue because of the long adoption cycle for new operating system purchases and our long operating system product sales cycle, but we believe that they will help prolong our UNIX revenue stream for future quarters.

SCOsource Business. During the 2003 fiscal year, we became aware that our UNIX code and derivative works had been inappropriately included in the Linux operating system. We believe the inclusion of our UNIX code and derivative works in Linux has been a major contributor to the decline in our UNIX business because users of Linux generally do not pay for the operating system but only minimal fees, if any, for service and maintenance. The Linux operating system competes directly with our OpenServer and UnixWare products and has taken significant market share from these products.

In an effort to protect our UNIX intellectual property, we initiated our SCOsource licensing initiatives. These initiatives now include seeking to enter into license agreements with UNIX vendors and offering SCOsource intellectual property ("IP") licenses to Linux end users allowing them to continue to use our UNIX source code and derivative works found in Linux. Our SCOsource efforts resulted in the execution of two significant vendor license agreements during fiscal year 2003.

During fiscal year 2004, we began allocating resources and reviewing financial information for SCOsource business. The following table shows the results of operations for the SCOsource business for the third quarter and first three quarters of fiscal year 2004 as well as for the third quarter and first three quarters of fiscal year 2003 had the SCOsource business existed. There were no direct costs associated with selling, marketing, research and development and general and administration for the 2003 periods. The following table shows the operating results of the SCOsource business for the three and nine months ended July 31, 2004 and 2003 (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2004	2003	2004	2003
Revenue	$ 678	$ 7,280	$ 709	$ 15,530
Cost of revenue	7,396	1,796	15,486	4,129
Gross margin	(6,718)	5,484	(14,777)	11,401
Sales and marketing	493	—	1,084	—
Research and development	231	—	329	—
General and administrative	128	—	150	—
Other	—	—	—	—
Total operating expenses	852	—	1,563	—
Income (loss) from operations	$ (7,570)	$ 5,484	$ (16,340)	$ 11,401

Our future success with our SCOsource initiatives and future revenue from SCOsource licenses will depend on our ability to protect our UNIX intellectual property. We will continue to devote resources to our SCOsource initiatives, but we expect quarterly legal fees and other SCOsource related costs to vary from quarter to quarter depending upon the level of, and activity surrounding, our intellectual property claims, and therefore are difficult to predict. As explained above in this Item 2 under the caption "Recent Developments," we have entered into a nonbinding letter of intent with BSF, our outside litigation legal counsel, to revise the existing fee agreement with BSF. Upon completing the revised agreement, we expect we will limit our future cash costs of legal fees, including accrued legal fees to BSF as of July 31, 2004, associated with our pending intellectual property litigation to a total of $31,000,000. In addition, the nonbinding letter of intent contemplates that the contingency fee payable to BSF and other law firms associated with any settlement or judgment award, which is currently set at 20 percent, will vary on a scaled basis from 20 to 33 percent, depending on the size of the award. Events that may trigger a contingency fee may include settlements, judgments, licensing fees, subject to certain exceptions, and a sale of our company during the pendancy of litigation or through settlement, subject to agreed upon credits for amounts received as discounted hourly fees and unused retainer fees. Additionally, our current agreement with our law firms may also be construed to include contingency fee payments in connection with any issuance of our equity securities, although we intend to eliminate this contingency in the revised fee agreement. The revised fee agreement is subject to BSF entering into a definitive revised fee agreement with us.

Because of the uncertainties related to our SCOsource business, we are unable to estimate the amount and timing of future SCOsource licensing revenue as well as predict the ultimate level of spending on our lawsuits. This uncertainty represents a significant risk and challenge for us, both in the short and long term. If we do receive revenue from this source, it may be sporadic and fluctuate from quarter to quarter. Our SCOsource initiatives are unlikely to produce a stable or predictable revenue stream for the foreseeable future. Additionally, the success of these initiatives may depend on the strength of our intellectual property rights and contractual claims regarding UNIX, including the strength of our claim that unauthorized UNIX source code and derivative works are prevalent in Linux.

Critical Accounting Policies

Our critical accounting policies and estimates include the following:

- Revenue recognition;

- Deferred income taxes and related valuation allowances;
- Fair value of derivative financial instrument and our now retired Series A-1 Convertible Preferred Stock;
- Impairment of long-lived assets; and
- Allowances for doubtful accounts.

Revenue Recognition . We recognize revenue in accordance with Statement of Accounting Position ("SOP") 97-2, as amended, and Staff Accounting Bulletin ("SAB") 104. Revenue recognition in accordance with these pronouncements can be complex due to the nature and variability of our sales transactions. We recognize products revenue and SCOsource revenue upon shipment if a signed contract exists, the fee is fixed and determinable, collection of the resulting receivable is probable and product returns are reasonably estimable, except for sales to distributors, which are recognized upon sale by the distributor to resellers or end users. We recognize product revenue from royalty payments upon receipt of quarterly royalty reports from OEMs related to their product sales.

The majority of our revenue transactions relate to product sales only. On occasion we have revenue transactions that include multiple elements (such as delivered and undelivered elements including maintenance, support and other services). For invoices or contracts involving multiple elements, we allocate revenue to each component of the contract based on objective evidence of its fair value. The fair value of each element is based on amounts charged when such elements are sold in separate transactions. We recognize revenue allocated to undelivered products when the criteria for revenue recognition set forth above have been met.

Estimates used in our revenue recognition include the determination of credit-worthiness and verification of sales-out reporting to end users through our two-tier distribution channel. We also provide reserves against revenue based on historical trends and experience. To the extent these estimates were incorrect our recognized revenue would be adversely impacted and would harm our results of operations. Additionally, if our business conditions change or our revenue contracts begin to contain more multiple elements, our revenue recognition in future periods may be impacted because a larger component of revenue may be deferred. As of July 31, 2004, our deferred revenue balance was $5,936,000 and related primarily to product maintenance and support contracts.

Deferred Income Taxes and Related Valuation Allowance . The amount, and ultimate realization, of our deferred income tax assets depends, in part, upon the tax laws in effect, our future earnings and other future events, the effects of which cannot be determined. We have provided a valuation allowance of $52,908,000 against our entire net deferred tax asset as of October 31, 2003. The valuation allowance was recorded because of our history of net operating losses and the uncertainties regarding our future operating profitability and taxable income.

Fair Value of Derivative Financial Instrument and Our Retired Series A-1 Convertible Preferred Stock . On October 16, 2003, we issued 50,000 shares of our redeemable Series A Convertible Preferred Stock for $1,000 per share. The net proceeds from the sale of the preferred stock were $47,740,000. The terms of the preferred stock included conversion and a number of redemption provisions that represented a derivative financial instrument under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. We determined that the conversion feature allowing the holders of the preferred stock to acquire common shares is an embedded derivative financial instrument that does not qualify as a scope exemption under the provisions of Emerging Issues Task Force ("EITF") 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in a Company's Own Stock."

As of October 16, 2003, through the assistance of an independent valuation firm, we determined the initial fair value of the derivative was $18,069,000 and the value of the preferred stock was $29,671,000. We were required to account for the conversion feature as an embedded derivative since the preferred stock instrument did not entitle the holders to equity features such as voting rights and board representation. As of October 31, 2003, the fair value of the derivative was $15,224,000 and the decrease in fair value of $2,845,000 was recorded as change in fair value of derivative in other income in the statement of operations for fiscal year 2003. As of January 31, 2004, the fair value of the derivative was $11,600,000 and the decrease in fair value of $3,624,000 was recorded as change in fair value of derivative in other income in our condensed consolidated statement of operations for the three months ended January 31, 2004.

On February 5, 2004, we completed an exchange transaction in which each outstanding Series A share was exchanged for one share of redeemable Series A-1 Convertible Preferred Stock. We received no additional proceeds in the exchange. The exchange transaction eliminated the derivative related to the Series A shares that was initially recorded as a current liability on our balance sheet and eliminated the charge in our quarterly statements of operations for the change in the fair value of the derivative related to the Series A shares. The derivative was eliminated due to certain rights and privileges included in the new Series A-1 shares, such as voting rights and rights to board representation, among others, that were not included in the Series A shares.

We recorded $2,300,000 as change in fair value of derivative in other income in the second quarter of fiscal year 2004 related to the change in the fair value of the derivative between January 31, 2004 and February 5, 2004, the time at which the exchange agreement was executed. Through the assistance of an independent valuation firm, we determined the fair value of the Series A-1 shares to be $45,276,000 as of February 5, 2004. We recorded a dividend in the second quarter of fiscal year 2004 of $6,305,000 related to the difference between the fair value of the Series A-1 shares and the carrying value of the previously issued Series A shares and related derivative. This dividend reduced earnings to common stockholders. The estimated fair value of the Series A-1 shares as of February 5 was calculated using a binomial model. Specific assumptions used included: 2.7 years to maturity, 11 percent equivalent bond yield, risk-free rate of 2.4 percent, volatility of 130 percent. As described elsewhere in this filing, we repurchased all outstanding Series A-1 shares on July 21, 2004.

Impairment of Long-lived Assets . We review our long-lived assets for impairment when events or changes in circumstances indicate that the book value of an asset may not be recoverable. We evaluate, at each balance sheet date, whether events and circumstances have occurred which indicate possible impairment. The carrying value of a long-lived asset is considered impaired when the anticipated cumulative undiscounted cash flows of the related asset or group of assets is less than the carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the estimated fair market value of the long-lived asset.

We performed an impairment analysis as of April 30, 2004 in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," and determined that the goodwill and intangible assets related to the Vultus technology, which we acquired from Vultus, Inc. ("Vultus") in June 2003, had been impaired. We concluded that an impairment-triggering event occurred during the second quarter of fiscal year 2004 as an impending partnership that would solidify the Vultus revenue and cash flow opportunities did not materialize. Additionally, we had a reduction in force that impacted our ability to move the Vultus initiative forward on a stand-alone basis. Consequently, we have concluded that no significant future cash flows related to our Vultus assets would be realized. As a result of these analyses, we wrote-down the carrying value of our goodwill related to the Vultus acquisition from $1,166,000 to $0 and wrote-down intangible assets related to our Vultus acquisition from $973,000 to $0.

Write-downs of intangible assets may be necessary if the future fair value of these assets is less than carrying value. If the operating trends for our UNIX or SCOsource businesses continue to decline or the value of our common stock were to significantly decrease, we may be required to record an impairment charge in a future period related to the carrying value of our intangible assets with finite lives.

Allowance for Doubtful Accounts . We offer credit terms on the sale of our products to a majority of our customers and require no collateral from these customers. We perform ongoing credit evaluations of our customers' financial condition and maintain an allowance for doubtful accounts based upon our historical collection experience and expected collectibility of all accounts receivable and have applied these policies consistently throughout the three and nine months ended July 31, 2004. Our allowance for doubtful accounts, which is determined based on our historical experience and a specific review of customer balances, was $126,000 as of July 31, 2004. Our past experience has resulted in minimal differences from the actual amounts provided for bad debts and our recorded estimates. However, our actual bad debts in future periods may differ from our current estimates and the differences may be material, which may have an adverse impact on our future accounts receivable and cash position.

Results of Operations

The following table presents our results of operations for the three and nine months ended July 31, 2004 and 2003 (in thousands):

Statement of Operations Data:	**Three Months Ended July 31, 2004**	**Three Months Ended July 31, 2003**	**Nine Months Ended July 31, 2004**	**Nine Months Ended July 31, 2003**
Revenue:				
Products	$ 8,929	$ 10,804	$ 27,056	$ 33,016
SCOsource licensing	678	7,280	709	15,530
Services	1,598	1,971	4,969	6,418
Total revenue	11,205	20,055	32,734	54,964
Cost of revenue:				
Products	741	1,200	2,364	3,422
SCOsource licensing	7,396	1,796	15,486	4,129
Services	878	1,538	3,273	5,008
Total cost of revenue	9,015	4,534	21,123	12,559
Gross margin	2,190	15,521	11,611	42,405
Operating expenses:				
Sales and marketing	4,233	5,930	13,952	18,421
Research and development	2,592	2,950	8,167	8,142
General and administrative	1,889	1,413	6,475	4,525
Loss on impairment of long-lived assets	—	—	2,139	—
Restructuring charges	—	614	—	498
Amortization of intangibles	593	895	1,973	2,295
Stock-based compensation	270	309	868	927
Total operating expenses	9,577	12,111	33,574	34,808
Income (loss) from operations	(7,387)	3,410	(21,963)	7,597
Equity in income (losses) of affiliates	41	(71)	115	(171)
Other income (expense), net	99	(55)	6,284	(59)
Provision for income taxes	(176)	(188)	(1,270)	(495)
Net income (loss)	(7,423)	3,096	(16,834)	6,872
Dividends on redeemable convertible preferred stock	14,924	—	7,123	—
Net income (loss) applicable to common stockholders	$ 7,501	$ 3,096	$ (9,711)	$ 6,872

THREE AND NINE MONTHS ENDED JULY 31, 2004 AND 2003

Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Revenue	$ 11,205,000	(44)%	$ 20,055,000

	Nine Months Ended July 31,		
	2004	Change	2003
Revenue	$ 32,734,000	(40)%	$ 54,964,000

Revenue for the third quarter of fiscal year 2004 decreased by $8,850,000 or 44 percent, from the third quarter of fiscal year 2003, and revenue for the first three quarters of fiscal year 2004 decreased by $22,230,000 or 40 percent, from the first three quarters of fiscal year 2003. These decreases were primarily attributable to decreased revenue from our UNIX products and services as a result of competition from other operating systems, primarily Linux, and minimal SCOsource licensing revenue in the first three quarters of fiscal year 2004 compared to SCOsource revenue of $7,280,000 in the third quarter of fiscal year 2003 and SCOsource revenue of $15,530,000 in the first three quarters of fiscal year 2003.

Revenue generated from our UNIX business and our SCOsource business was as follows:

	Three Months Ended July 31,		
	2004	Change	2003
UNIX revenue	$ 10,527,000	(18)%	$ 12,775,000
Percent of total revenue	94%		64%
SCOsource revenue	678,000	(91)%	7,280,000
Percent of total revenue	6%		36%

	Nine Months Ended July 31,		
	2004	Change	2003
UNIX revenue	$ 32,025,000	(19)%	$ 39,434,000
Percent of total revenue	98%		72%
SCOsource revenue	709,000	(95)%	15,530,000
Percent of total revenue	2%		28%

The decrease in revenue in the UNIX business for the third quarter and first three quarters of fiscal year 2004 compared to the third quarter and first three quarters of fiscal year 2003 was primarily attributable to continued competition from other operating systems, particularly Linux, as well as a decrease in revenue from corporate accounts and a decrease from our distribution channel. We anticipate for the fourth quarter of 2004 fiscal year that total UNIX revenue will be consistent with or slightly lower than revenue generated in the third quarter of fiscal year 2004.

The decrease in SCOsource licensing revenue in the third quarter and first three quarters of fiscal year 2004 from the comparable period of the prior fiscal year was primarily attributable to minimal vendor licensing revenue in the 2004 fiscal year periods when compared to $7,280,000 in SCOsource revenue in the third quarter and $15,530,000 in SCOsource revenue in the first three quarters of fiscal year 2003. The SCOsource revenue generated in the third quarter and first three quarters of fiscal year 2003 was from two contracts executed with Sun Microsystems ("Sun") and Microsoft Corporation ("Microsoft").

Sales of our UNIX products and services during the third quarter and first three quarters of fiscal year 2004 were primarily to pre-existing customers. Our UNIX business revenue depends significantly on our ability to market our products to existing customers and to generate upgrades from existing customers. Our UNIX revenue may be lower than currently anticipated if we are not successful with our existing customers or if we lose the support of any of our existing hardware and software vendors or our key industry partners withdraw their marketing and certification support or direct their support to our competitors. This may occur as a result of the decline of our UNIX business and our SCOsource initiatives and in particular as a result of any lawsuits we have brought against end users violating our intellectual property and contractual rights or as a result of any adverse changes to our UNIX business.

Products Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Products revenue	$ 8,929,000	(17)%	$ 10,804,000
Percent of total revenue	80%		54%

	Nine Months Ended July 31,		
	2004	Change	2003
Products revenue	$ 27,056,000	(18)%	$ 33,016,000
Percent of total revenue	83%		60%

Our products revenue consists of software licenses of our UNIX products, primarily OpenServer and UnixWare, as well as sales of UNIX-related products. Products revenue includes revenue derived from OEMs, channel and distribution partners and large corporate accounts. We rely heavily on our two-tier distribution channel and any disruption in our distribution channel could adversely impact our future products revenue.

The decrease in products revenue in the third quarter and first three quarters of fiscal year 2004 as compared with the third quarter and first three quarters of fiscal year 2003 was primarily attributable to decreased sales of UnixWare and OpenServer products primarily resulting from increased competition in the operating system market, particularly Linux, and from a decrease in information technology spending for UNIX products compared to other operating system products. This negative impact was felt in all of our distribution channels, and we believe that the competition from Linux will continue in future periods.

Our products revenue was derived primarily from sales of our OpenServer and UnixWare products. Other products revenue consists mainly of product maintenance and other UNIX-related products. Revenue for these product lines was as follows:

	Three Months Ended July 31,		
	2004	Change	2003
OpenServer revenue	$ 4,496,000	(14)%	$ 5,243,000
Percent of products revenue	50%		49%
UnixWare revenue	2,984,000	(14)%	3,452,000
Percent of products revenue	34%		32%
Other products revenue	1,449,000	(31)%	2,109,000
Percent of products revenue	16%		19%

	Nine Months Ended July 31,		
	2004	Change	2003
OpenServer revenue	$ 14,278,000	(9)%	$ 15,734,000
Percent of products revenue	53%		48%
UnixWare revenue	8,240,000	(25)%	10,956,000
Percent of products revenue	30%		33%
Other products revenue	4,538,000	(28)%	6,326,000
Percent of products revenue	17%		19%

Sales of our OpenServer and UnixWare products as well as other products are primarily generated from existing customers. As our existing customers have slowed purchasing decisions, decreased purchasing levels or moved to other operating systems, including Linux, our products revenue has declined.

SCOsource Licensing Revenue

	Three Months Ended July 31,		
	2004	Change	2003
SCOsource licensing revenue	$ 678,000	(91)%	$ 7,280,000
Percent of total revenue	6%		36%

	Nine Months Ended July 31,		
	2004	Change	2003
SCOsource licensing revenue	$ 709,000	(95)%	$ 15,530,000
Percent of total revenue	2%		28%

SCOsource licensing revenue consists of revenue generated from vendor licenses to use our proprietary UNIX System V code as well as from intellectual property licenses. SCOsource licensing revenue was $678,000 for third quarter of fiscal year 2004 as compared to $7,280,000 in SCOsource revenue in the third quarter of fiscal year 2003, and SCOsource revenue was $709,000 for the first three quarters of fiscal year 2004 as compared to $15,530,000 in SCOsource revenue for the first three quarters of fiscal year 2003. The SCOsource revenue generated in the third quarter and first three quarters of fiscal year 2003 was from two significant contracts executed with Sun and Microsoft.

Due to a lack of historical experience and the uncertainties related to our SCOsource licensing revenue, we are unable to estimate the amount and timing of future revenue. If we do receive revenue from this source, it may be sporadic and fluctuate from quarter to quarter or year to year. Our SCOsource initiatives are unlikely to produce stable, predictable revenue for the foreseeable future.

Services Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Services revenue	$ 1,598,000	(19)%	$ 1,971,000
Percent of total revenue	14%		10%

	Nine Months Ended July 31,		
	2004	Change	2003
Services revenue	$ 4,969,000	(23)%	$ 6,418,000
Percent of total revenue	15%		12%

Services revenue consists primarily of annual and incident support fees, engineering services fees, professional services and education fees. These fees are typically charged and invoiced separately from UNIX product sales. The decrease in services revenue of $373,000, or 19 percent, in the third quarter of fiscal year 2004 as compared to the third quarter of fiscal year 2003 and the decrease in services revenue of $1,449,000, or 23 percent, in the first three quarters of fiscal year 2004 as compared to the first three quarters of fiscal year 2003 was in part due to a decrease in professional services revenue resulting from a decrease in the demand for our custom enterprise-level projects as well as from a decrease in our support services, engineering services and team services agreements and generally from a decrease in overall UNIX product revenue.

Services revenue during the third quarter and first three quarters of fiscal year 2004 was generated primarily from pre-existing customers. Our UNIX business services revenue depends significantly on our ability to market our services to existing customers. Additionally, our future level of services revenue depends on our ability to generate UNIX products revenue from existing customers and on the renewal of certain annual support and services agreements with existing customers.

Cost of Products Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Cost of products revenue	$ 741,000	(38)%	$ 1,200,000
Percentage of products revenue	8%		11%

	Nine Months Ended July 31,		
	2004	Change	2003
Cost of products revenue	$ 2,364,000	(31)%	$ 3,422,000
Percentage of products revenue	9%		10%

Cost of products revenue primarily includes overhead costs, manufacturing costs, royalties to third-party vendors and technology costs. Cost of products revenue decreased by $459,000, or 38 percent, in the third quarter of fiscal year 2004 compared to the third quarter of fiscal year 2003 and decreased by $1,058,000, or 31 percent, in the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003. This decrease was primarily attributable to reduced product revenue and reduced overhead and manufacturing costs resulting from our cost reduction efforts.

For the fourth quarter of fiscal year 2004, we expect the dollar amount of our cost of products revenue to be generally consistent to our cost of products revenue incurred in the third quarter of fiscal year 2004.

Cost of SCOsource Licensing Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Cost of SCOsource licensing revenue	$ 7,396,000	312%	$ 1,796,000
Percentage of SCOsource licensing revenue	1091%		25%

	Nine Months Ended July 31,		
	2004	Change	2003
Cost of SCOsource licensing revenue	$ 15,486,000	275%	$ 4,129,000
Percentage of SCOsource licensing revenue	2184%		27%

Cost of SCOsource licensing revenue includes the salaries and related personnel costs of employees dedicated to the SCOsource licensing initiatives, legal and professional fees incurred in connection with our SCOsource initiatives, and an allocation of corporate costs.

Cost of SCOsource licensing revenue increased significantly in the third quarter and first three quarters of fiscal year 2004 compared to the third quarter and first three quarters of fiscal year 2003. The increased costs in the 2004 periods compared to the 2003 periods was primarily attributable to increased legal fees incurred in connection with our ongoing litigation with IBM, Novell, AutoZone and DaimlerChrysler as well as our continued pursuit of intellectual property licenses. We expect that legal fees will vary from quarter to quarter depending on the level of, and activity surrounding, our intellectual property claims, and therefore are difficult to predict. Additionally, the cost of SCOsource licensing revenue likely will fluctuate from quarter to quarter due in part to the unpredictability of the related SCOsource revenue. Although we currently intend to cap our potential legal expenses by revising our fee agreement with BSF, as described below, legal expenses could increase over time depending on developments in our ongoing litigation. Legal expenses may also include contingency payments made to BSF and the other law firms engaged by us to protect our intellectual property rights, which at this time we are unable to predict the amount or timing of such contingency fees. Additionally, we are unable to predict the percentage of cost of SCOsource licensing revenue for future quarters due to the unpredictability of the related licensing revenue.

On August 31, 2004, we announced we had entered into a nonbinding letter of intent with BSF, to revise the existing fee agreement with BSF to limit our overall future cash costs of legal fees, including accrued legal fees as of July 31, 2004, associated with our pending intellectual property litigation to a total of $31,000,000. In addition, the nonbinding letter of intent contemplates that BSF will lead our intellectual property legal efforts through the duration and completion of the pending litigation. In return for the new fee arrangement, the letter of intent provides that the contingency fee payable to BSF and other law firms associated with any settlement or judgment award will vary on a scaled basis from 20 to 33 percent, depending on the size of the award. The revised fee agreement is subject to the Company and BSF entering into a definitive revised fee agreement. These developments, if completed, will allow us to better predict future cost of SCOsource licensing revenue.

Cost of Services Revenue

	Three Months Ended July 31,		
	2004	Change	2003
Cost of services revenue	$ 878,000	(43)%	$ 1,538,000
Percentage of services revenue	55%		78%

	Nine Months Ended July 31,		
	2004	Change	2003
Cost of services revenue	$ 3,273,000	(35)%	$ 5,008,000
Percentage of services revenue	66%		78%

Cost of services revenue includes the salaries and related personnel costs of employees delivering services revenue as well as third-party service agreements. Cost of services revenue decreased by $660,000, or 43 percent, for the third quarter of fiscal year 2004 compared to the third quarter of fiscal year 2003 and decreased by $1,735,000, or 35 percent, for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003. This decrease was attributable in part to lower services revenue, reduced employee and related costs in our support services and professional services groups as well as the elimination of certain third-party support contracts in order to increase the gross margin for these groups.

For the fourth quarter of fiscal year 2004, we expect the dollar amount of our cost of services revenue to be lower than our cost of services revenue incurred in the third quarter of fiscal year 2004.

Sales and Marketing

	Three Months Ended July 31,		
	2004	Change	2003
Sales and marketing expense	$ 4,233,000	(29)%	$ 5,930,000
Percentage of total revenue	38%		30%

	Nine Months Ended July 31,		
	2004	Change	2003
Sales and marketing expense	$ 13,952,000	(24)%	$ 18,421,000
Percentage of total revenue	43%		34%

Sales and marketing expenses consist of the salaries, commissions and other personnel costs of employees involved in the revenue generation process, as well as advertising and corporate allocations. The decrease in sales and marketing expenses from the third quarter of fiscal year 2003 to the third quarter of fiscal year 2004 of $1,697,000, or 29 percent, and the decrease in sales and marketing expense from the first three quarters of fiscal year 2003 to the first three quarters of fiscal year 2004 of $4,469,000, or 24 percent, was primarily attributable to reductions in sales and marketing employees, reduced travel expenses, and lower commissions. Our sales and marketing expenses as a percentage of total revenue were higher in the fiscal year 2004 periods compared to the fiscal year 2003 periods primarily as a result of lower total revenue in the 2004 periods. Our sales and marketing headcount decreased from 124 as of July 31, 2003, to 72 as of July 31, 2004.

For the fourth quarter of fiscal year 2004, we anticipate the dollar amount of sales and marketing expenses will decrease compared to the third quarter of fiscal year 2004.

Research and Development

	Three Months Ended July 31,		
	2004	Change	2003
Research and development expense	$ 2,592,000	(12)%	$ 2,950,000
Percentage of total revenue	23%		15%

	Nine Months Ended July 31,		
	2004	Change	2003
Research and development expense	$ 8,167,000	0%	$ 8,142,000
Percentage of total revenue	25%		15%

Research and development expenses consist of the salaries and benefits of software engineers, consulting expenses as well as corporate allocations. The decrease in research and development expense in the third quarter of fiscal year 2004 of $358,000, or 12 percent, compared to the third quarter of fiscal year 2003 was primarily attributable to reductions in research and development employees and related employee costs. Research and development expenses for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003 were flat. Our research and development expenses as a percentage of total revenue were higher in the fiscal year 2004 periods compared to the fiscal year 2003 periods primarily as a result of lower total revenue in the 2004 periods. Our research and development personnel decreased from 84 as of July 31, 2003, to 75 as of July 31, 2004.

For the fourth quarter of fiscal year 2004, we anticipate the dollar amount of research and development expenses will decrease compared to the third quarter of fiscal year 2004 due to recently implemented cost reductions.

General and Administrative

	Three Months Ended July 31,		
	2004	Change	2003
General and administrative expense	$ 1,889,000	34%	$ 1,413,000
Percentage of total revenue	17%		7%

	Nine Months Ended July 31,		
	2004	Change	2003
General and administrative expense	$ 6,475,000	43%	$ 4,525,000
Percentage of total revenue	20%		8%

General and administrative expenses consist of the salaries and benefits of finance, human resources and executive management and expenses for external professional services as well as corporate allocations. Included in general and administrative expense for the first three quarters of fiscal year 2004 are $682,000 in payments made in connection with the elimination of approximately 16 percent of our workforce which occurred during the second quarter of fiscal year 2004.

The increase in general and administrative expense from the third quarter and first three quarters of fiscal year 2003 of $476,000 and $1,950,000, respectively, compared to the third quarter and first three quarters of fiscal year 2004, exclusive of the above mentioned termination payments, was attributable to increased legal costs as a result of corporate and regulatory legal matters and increased fees from other non-legal professional service providers, even though our general and administrative headcount decreased from 52 as of July 31, 2003 to 41 as of July 31, 2004. Our general and administrative expenses as a percentage of total revenue were higher in the fiscal year 2004 periods compared to the fiscal year 2003 periods in part due to lower total revenue in the 2004 periods.

For the fourth quarter of fiscal year 2004, we anticipate the dollar amount of general and administrative expenses will be consistent with the third quarter of fiscal year 2004.

Restructuring Charges

	Three Months Ended July 31,		
	2004	Change	2003
Restructuring charges	$ —	n/a	$ 614,000
Percentage of total revenue	0%		3%

	Nine Months Ended July 31,		
	2004	Change	2003
Restructuring charges	$ —	n/a	$ 498,000
Percentage of total revenue	0%		1%

We did not incur any restructuring charges during the third quarter or first three quarters of fiscal year 2004. During the third quarter of fiscal year 2003, the Company incurred a restructuring charge of $614,000 in connection with the termination of employment for certain positions. The restructuring charge of $498,000 for the first three quarters of fiscal year 2003 was comprised of the action described above for the third quarter of fiscal year 2003, the closing of the Company's UK subsidiary, offset by adjustments to previously recorded accruals.

During the fourth quarter of fiscal year 2004, we plan to take additional cost reduction actions, which will include reductions in staff as well as certain reductions and consolidation in office space, which will further decrease our operating costs. We estimate that the restructure costs associated with these actions may be approximately $2,000,000, but the actual costs associated with these actions may differ from this estimate.

Amortization of Intangibles

	Three Months Ended July 31,		
	2004	Change	2003
Amortization of intangibles	$ 593,000	(34)%	$ 895,000
Percentage of total revenue	5%		4%

	Nine Months Ended July 31,		
	2004	Change	2003
Amortization of intangibles	$ 1,973,000	(14)%	$ 2,295,000
Percentage of total revenue	6%		4%

Amortization of intangibles is the expensing of previously recorded amounts for assets recorded in prior acquisitions with finite lives. The decrease in amortization of intangibles of $302,000 for the third quarter of fiscal year 2004 compared to the third quarter of fiscal year 2003 and the decrease of $322,000 for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003 was primarily attributable to reduced amortization expense recorded on certain assets and technology acquired from The Santa Cruz Operation (now Tarantella, Inc.).

Loss on Impairment of Long-lived Assets

We did not have any impairment charges during the third quarter of fiscal year 2004. However, we recorded a loss on impairment of long-lived assets totaling $2,139,000 for the first three quarters of fiscal year 2004. The impairment related to goodwill and intangible assets acquired in connection with our acquisition of Vultus in June 2003. We concluded that an impairment triggering event occurred as an impending partnership that would solidify the Vultus revenue and cash flow opportunities did not materialize. Consequently, we have concluded that no significant future cash flows related to our Vultus assets will be realized. We performed an impairment analysis of our recorded goodwill related to the Vultus reporting unit in accordance with SFAS No. 142. Additionally, an impairment analysis of the intangible assets was performed in accordance with SFAS No. 144. As a result of these analyses, we wrote-down the carrying value of our goodwill related to our Vultus acquisition from $1,166,000 to $0, and wrote-down the intangible assets related to our Vultus acquisition from $973,000 to $0. We did not incur any impairment charges in the third quarter or first three quarters of fiscal year 2003.

Stock-based Compensation

	Three Months Ended July 31, 2004	Change	2003
Stock-based compensation	$ 270,000	(13)%	$ 309,000
Percentage of total revenue	2%		2%

	Nine Months Ended July 31, 2004	Change	2003
Stock-based compensation	$ 868,000	(6)%	$ 927,000
Percentage of total revenue	3%		2%

Stock-based compensation consisted of the following components for the three and nine months ended July 31, 2004 and 2003 (in thousands):

	Three Months Ended July 31, 2004	2003	Nine Months Ended July 31, 2004	2003
Amortization of stock-based compensation	$ 51	$ 235	$ 274	$ 631
Options and shares for services	219	74	502	296
Modifications to options	—	—	92	—
Total	$ 270	$ 309	$ 868	$ 927

Equity in Income (Losses) of Affiliates

We account for our ownership interests in companies that we own at least 20 percent and less than 50 percent using the equity method of accounting. Under the equity method, we record our portion of the entities' net income or net loss in our condensed consolidated statements of operations. During the third quarter and first three quarters of fiscal year 2004 we recorded income of $41,000 and $115,000, respectively, primarily related to income from our joint venture in China compared to a loss of $71,000 and $171,000, respectively, in the third quarter and first three quarters of fiscal year 2003 primarily related to our investment in Vista, Inc. ("Vista"). We disposed of our investment in Vista in fiscal year 2003.

Other Income (Expense), net

Other income (expense) consisted of the following components for the three and nine months ended July 31, 2004 and 2003 (in thousands):

	Three Months Ended July 31, 2004	2003	Nine Months Ended July 31, 2004	2003
Interest income	$ 186	$ 42	$ 698	$ 92
Interest expense	—	(3)	—	(3)
Change in fair value of derivative	—	—	5,924	—
Other expense, net	(87)	(94)	(338)	(148)
Total other income (expense), net	$ 99	$ (55)	$ 6,284	$ (59)

Interest income increased by $144,000 for the third quarter of fiscal year 2004 compared to the third quarter of fiscal year 2003 and increased by $606,000 for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003 as a result of interest earned on higher cash balances. The income recorded for the first three quarters of fiscal year 2004 of $5,924,000 on the change in fair value of the derivative related to the decreasing fair value of this instrument and marking it to market at each balance sheet date . The derivative financial instrument was eliminated during the second quarter of fiscal year 2004.

Provision for Income Taxes

The provision for income taxes was $176,000 in the third quarter of fiscal year 2004 and $188,000 in the third quarter of fiscal year 2003 and $1,270,000 for the first three quarters of fiscal year 2004 and $495,000 for the first three quarters of fiscal year 2003. The increase in the provision for income taxes for the first three quarters of fiscal year 2004 compared to the first three quarters of fiscal year 2003 was primarily attributable to accruals for withholding taxes that are estimated to be paid in connection with the operations of the Indian branch of our United Kingdom subsidiary, The SCO Group, Ltd.

Dividends Related to Redeemable Convertible Preferred Stock

In connection with completing the February 5, 2004 exchange of Series A-1 shares for Series A shares, we removed the carrying value of the Series A shares and related derivative and recorded the fair value of the Series A-1 shares issued in the exchange transaction. The difference between these two amounts was $6,305,000 and was recorded as a non-cash dividend for the first three quarters of fiscal year 2004.

With the completion of the repurchase transaction with BayStar during the third quarter of fiscal year 2004, we will not be required to continue to accrue or pay any dividends on the Series A-1 shares, which are now retired and no longer issued and outstanding. As a result of completing the repurchase transaction with BayStar, we recorded a capital contribution in the amount of $15,475,000, which represented the difference in the carrying value of the Series A-1 shares and accrued dividends less the fair value of the 2,105,263 shares of common stock and the $13,000,000 in cash. We had no dividends accrued or payable in the third quarter or first three quarters of fiscal year 2003.

If the repurchase had not occurred, dividends on the Series A-1 shares would have been paid after October 16, 2004, the first anniversary of the original Series A private placement, quarterly at a rate of 8 percent per annum, subject to annual increases of 2 percent per annum, not to exceed 12 percent per annum. Although we accrued dividends of $551,000 for the third quarter of fiscal year 2004 and $2,047,000 for the first three quarters of fiscal year 2004, which reduced earnings to common stockholders, we will no longer accrue dividends on preferred stock because the repurchase transaction with BayStar closed. We never paid any dividends on the Series A or Series A-1 shares.

The following table details the components of the dividends (in thousands):

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2004	**2003**	**2004**	**2003**
Accrual of dividends on preferred stock	$ (551)	$ —	$ (2,047)	$ —
Exchange of Series A shares for Series A-1 shares	—	—	(6,305)	—
Repurchase of Series A-1 shares from BayStar	15,475	—	15,475	—
Total	$ 14,924	$ —	$ 7,123	$ —

Liquidity and Capital Resources

Our cash and equivalents and available-for-sale securities balances decreased from $68,523,000 as of October 31, 2003 to $43,027,000 as of July 31, 2004 and our working capital decreased from $37,168,000 as of October 31, 2003 to $20,374,000 as of July 31, 2004. Our cash and equivalents decreased from $64,428,000 as of October 31, 2003 to $15,982,000 as of July 31, 2004, primarily as a result of purchases of available-for-sale securities, cash denoted as restricted cash to fund the BayStar stock repurchase and from cash used in operations.

During fiscal year 2003, we completed a private placement of 50,000 Series A shares for net proceeds of $47,740,000 in October 2003, which shares were exchanged for Series A-1 shares in February 2004 and which in turn we repurchased from BayStar in July 2004. Because we repurchased the outstanding Series A-1 shares, the net proceeds received in our private placement are reduced by the $13,000,000 cash component of the repurchase price. We intend to use the net proceeds from our preferred stock financing as well as our other cash resources to pursue our SCOsource initiatives and fund other cash needs of our business. During the first three quarters of fiscal year 2004, we used $10,703,000 of cash in our operations. We believe that we will have sufficient cash resources to fund our current operations for at least the next 12 months.

Our net cash used in operations for the first three quarters of fiscal year 2004 was $10,703,000 compared to cash generated from operations of $6,776,000 for the first three quarters of fiscal year 2003. Cash used in operations in the first three quarters of fiscal year 2004 included a net loss of $16,834,000, non-cash expenses of $180,000 and changes in operating assets and liabilities of $6,311,000.

Our net accounts receivable balance decreased by $3,328,000 from $9,282,000 as of October 31, 2003 to $5,954,000 as of July 31, 2004. This decrease was primarily attributable to the collection of year-end receivables and lower invoicing during the third quarter of fiscal year 2004. The majority of our accounts receivable are current and our allowance for doubtful accounts was approximately $126,000 as of July 31, 2004, which represented approximately 2 percent of our gross accounts receivable balance. This allowance as a percentage of gross accounts receivable is consistent with our experience in prior periods, and we expect this trend to continue. Our write-offs of uncollectible accounts during the third quarter of fiscal year 2004 were not significant. Our current liabilities decreased from $45,112,000 as of October 31, 2003 to $44,579,000 as of July 31, 2004 primarily related to the elimination of the fair-value of the derivative related to our now retired Series A shares and the decrease in accrued compensation to law firms, which were offset by an increase in accrued liabilities and an increase in the payable to BayStar in connection with the Series A-1 repurchase transaction.

Our investing activities have historically consisted of equipment purchases, investing in strategic partners and the purchase and sale of available-for-sale securities. During the first three quarters of fiscal year 2004, cash used in investing activities was $23,650,000, which was primarily a result of our purchase of available-for-sale securities (net of sales) of $23,110,000, equipment purchases of $331,000 and cash used to acquire the outstanding minority interest in our Japanese subsidiary of $209,000. Cash used in investing activities was $1,474,000 for the first three quarters of fiscal year 2003 and was attributable to equipment purchases of $524,000 and an investment in non-marketable securities of $950,000.

Our financing activities used $14,224,000 during the first three quarters of fiscal year 2004 and consisted primarily of $13,000,000 in cash reserved to fund the repurchase of Series A-1