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SCOX - Q2 2004 The SCO Group Earnings Conference Call

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Bert Young

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Client Server NEWS - Analyst

Stephen Shankland

CNET - Analyst

Terry Tillman

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PRESENTATION

Operator

Good day everyone, and welcome to The SCO Group second-quarter 2004 earnings conference call. At this time everyone is in a listen-only mode. Later a question-and-answer session will be opened. Today's call is being recorded. Participating on the call today are Darl McBride, President and Chief Executive Officer and Bert Young, Chief Financial Officer. Each of you should have a copy of the press release issued this morning containing our second-quarter year-to-date results for the fiscal year 2004, which we will be discussing in further detail in this call.

I wish to point out to the participants on today's conference call that the information provided during this call will include forward-looking statements within the meaning of Private Securities Litigation Reform Act of 1995. These act (ph) forward-looking statements are made only as far as the date of this conference call, and we undertake no obligation to update or revise the projections of the revenue or earnings or other forward-looking information. Whether as a result of new information, future developments or otherwise our performance is subject to a significant risk and uncertainties and known as the unknown that could cause our actual results to differ materially from those that may be anticipated by the forward-looking statements.

These risks and uncertainties may cause our actual results level of activity, performance of achievements to materially differ from any other projections of future results implied by these forward-looking statements. In particular, our projections of third-quarter revenue for 2004 contain revenue from our SCOsource license initiative. We have limited experience with this initiative to date and underlying intellectual property of this subject of pending litigations, all of which makes the projection of this revenue particularly difficult and subject to both known and unforeseen risks.

Accordingly you should not place undue reliance on these projections of the future revenue and results or other forward-looking statements. For a full discussion of this and other risks, please see our annual report form 10-K for the fiscal year ended October 31, 2003. And our quarterly report on form 10-Q for the first quarter ended January 31, 2004 and other reports we have filed with the SEC, all available at www.SCO.com.

I will turn the call over to Darl McBride, President and Chief Executive Officer of SCO Group, Inc.

Darl McBride - The SCO Group - President & CEO

Okay, thank you very much, and thank you all for joining us today. As we begin the call, I want to formally welcome Bert Young, our CFO who joined SCO in April of this year. Bert brings to SCO a seasoned background and executive level management responsibilities from a variety of information technology companies, including worldwide finance operations and M&A expertise. Today we will be discussing ways in which Bert has already assessed the Company's operations and has driven additional efficiencies in these operations.

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In addition to the appointment of our new CFO we this quarter also announced that Bob Bench will assume the responsibilities of acting Vice President of corporate development. Bench has been the Company's CFO for the past 3.5 years, and will now focus on external growth opportunities in industry partnerships. As we look to the future these changes in executive management responsibilities will allow significant focus on efficient, internal operations, ongoing development of our current product lines and the addition of technologies and products through licensing and partnerships.

During Q2 we remain focused on the protection of our UNIX intellectual property and during today's call we will give you some update on the status of our intellectual property enforcement activities. Additionally, the Company is committed to the profitability of our core UNIX business, and we will review our plans to increase our core business efficiencies, release new versions of our major product offerings and both of these initiatives are focused on generating cash positive operations for the UNIX division as we move forward.

On today's call we will also provide an update on our recent announcements concerning our series A1 financing in BayStar Capital. As we proceed with the review of the second-quarter results and review our progress against our key objectives for 2004 I am confident that you will see that we are committed to taking advantage of the strength of our intellectual property assets, loyal UNIX installed customer base and longtime industry partners. However, before I comment any further I would like to ask Bert to review our second-quarter financial results in more detail.

Bert Young - The SCO Group - CFO

Thanks, Darl. Good morning, everyone. Revenue for the second quarter of fiscal year 2004 was 10.1 million. Second-quarter revenue was primarily attributable to our UNIX division. We believe this level of revenue represents stabilization of revenue in the UNIX business at or near 10 million per quarter. While current quarter revenue is down from revenue of 21.4 million from the comparable period of the prior year, this is primarily the result of a lack of SCOSource licensing revenue. SCOSource revenue was 8.3 million in the second quarter of fiscal year 2003. Year-to-date revenue for our UNIX division was 21.5 million.

We are continuing to face increasing competition from other operating system products primarily Linux, which continues to negatively impact our UNIX division's revenue. The company reported a net loss to common stockholders of 14.96 million or \$1.06 per basic and diluted share for the second quarter of fiscal year 2004. The net loss from operations for the second-quarter of fiscal year 2004 was 9.4 million, and included a charge of approximately 0.7 million for general administrative costs related to streamlining our UNIX business operations and a charge of 2.1 million related to the impairment of goodwill and intangible assets. Exclusive of these two charges, the net loss from operations would have been 6.6 million.

For the first two quarters of fiscal year 2004 the company reported a net loss to common stockholders of 17.2 million or \$1.23 per basic and diluted common share. However, our cash and available for sale security position remains strong at April 30, 2004, totaling 61.3 million. Our cash used in operations during quarter 2 totaled 3.4 million. I'll talk a little bit more about cash later on in the call.

The breakdown by geography of our UNIX products and services revenue for the second quarter was 58 percent of revenue in the Americas and 42 percent international, which includes our customers in EMEA and Asia.

Turning to operating costs and expenses at the UNIX division for the second quarter of fiscal 2004 were 9.9 million. Our operating costs related to our UNIX division continued to trend down as expected. Additionally, the company is focused on cost containment and streamlining operations in the UNIX division to the point where the UNIX business will cover its expenses and throw off cash. We will use the cash generated for our UNIX division and our working capital as appropriate reinvest in our business.

Turning to the SCOSource division, due to questions being raised in end-user's minds, arising from Novell's claims that SCO does not hold the copyrights to UNIX, which we believe is a false claim, revenue to date from our SCOSource division has been minimal. However, our SCOSource initiatives are moving forward. Our sales funnels continue to build and we've engaged in discussions with potential customers for significant licensing opportunities. As in previous quarters, we are continuing to classify legal and professional fees and other costs and expenses that relate to the enforcement of our intellectual property rights as costs of revenue. For the second-quarter 2004 these costs were 4.4 million.

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We expect that costs and expenses relating to the enforcement of our intellectual property rights will remain at approximately the current level for the next quarter as we protect our valuable UNIX intellectual property and aggressively pursue our legal claims through the court system. During quarter 2 we completed the previously announced exchange agreement of our Series A preferred convertible preferred stock for series A-1 convertible preferred stock. As a result of this exchange, we eliminated the derivative financial instrument associated with the series A shares. As part of the exchange we recorded a non-cash dividend expense in the amount of 6.3 million that represents the difference between the fair value of the new Series A-1 shares and the carrying value of the Series A shares and related derivative. The dividend increased our net loss to common shareholders for the second quarter but does not affect our cash balance.

As we announced on June first, we are pleased to have completed an agreement with BayStar Capital. The company has agreed to repurchase and retire all 40,000 Series A-1 shares owned by BayStar for 13 million in cash and the issuance of approximately 2.1 million common shares. The transaction will be completed upon the effectiveness of the shelf registration statement for the resale of the common stock by BayStar. Upon completing the repurchase all Series A-1 shares will be canceled, and the rights and preferences of the Series A-1 shares will be terminated. The net result of our preferred stock financing activities will be the Company receiving 37 million in cash and issuing approximately 2.8 million shares or an effective price of \$13 per share.

The retirement of the preferred stock is important valuable to the company. There are a number of reasons we feel this is a positive outcome for our common stockholders including the Company's equity structures simplified to only one class of outstanding stock, the significant preferences in voting rights and covenants relating to the preferred stock eliminated, accrual of quarterly dividends has been eliminated, and the accounting classification will increase stockholders' equity and strengthen our balance sheet. The stock overhang relating to the future conversion of preferred to common stock has been eliminated, and now all large shareholders will now be aligned with the company's strategy going forward.

Prior to the purchase and retirement of the preferred stock, we reviewed our cash balance and projected our cash needs for the future. We believe that our cash balance is sufficient to fund our legal activities in the foreseeable future and are

committed to maintaining that cash for the protection of our valuable intellectual property. Finally on this point we are delighted that we've come to an agreement with BayStar and upon completing the purchase, welcome them as a significant common stockholder to the Company.

Looking forward to the third quarter, we expect consolidated revenue to be in the range of 10 to \$12 million. Now before I turn things back to Darl, I want to give you my perspective on the business after my first 45 days here. While this quarter has had some write-offs and losses, which are significant, as I look at where we are right now, I think SCO is in good financial condition. My reasons for this conclusions are the following. First off, the write-offs that we've had for goodwill and intangibles are behind us.

Second, the accounting around the Series A preferred shares are now behind us. This includes eliminating the dividends and gains and losses on this derivative instrument, all this is gone now. Number three, we tightened down things in the core business. Both the UNIX business will generate cash going forward. Fourth, we are obviously going to spend cash on the lawsuits and our IP enforcement as we go forward. Approximately 3 to 5 million per quarter. We will offset some of that spending with SCOsource deals and working capital from the UNIX division.

Fifth, the company has no debt, and once the BayStar deal is closed will show solid equity in the balance sheet. And number six and finally, as far as the cash balance goes, when I got here I went back and looked at the last few quarters in the Company and looked back to a year ago when the IBM lawsuit was first filed compared to now. And there has been a huge amount of progress in the company over this past year. A year as of the quarter now we are just reporting, April 30, 2004, the Company's current cash and equivalents was 61.3 million. We take into affect the \$13 million payment the company will make to BayStar upon closing the transaction. The company's cash position will be 48.3 million.

Now this cash position of 48 million is the result of three things. There was \$5 million on the balance sheet January 31, 2003. The second thing is we've generated cash from the Company's business operations during the last five quarters of \$8 million positive cash generated out of the business, 8 million. And the net effect of the Company's capital raising efforts net of the fund-raising costs has been \$35 million.

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So when I look at that I think that the cash position we have is sufficient to fund the lawsuits for several years to come. Thanks for the time, and with that I will turn it back to Darl.

Darl McBride - The SCO Group - President & CEO

Thanks Bert, and thanks for your good work here in just the first couple months being on board. I would like to spend the remainder of the call focused on several major initiatives that are designed to drive revenue and shareholder value during the remainder of 2004 and beyond. The foundation of our business is built upon our UNIX intellectual property, products and services. During our second quarter we had UNIX product wins with notable customers, such as -- let me just run through like we typically do on our calls here by country -- in the U.S. the list included CVS Pharmacy, McDonalds, Thomson Financial, VayTech, WebMD, Lucent and Geotronics. In China we had Industry and Commercial Bank of China, Shanghai branch of China Construction Bank, and State Administration and Foreign Exchange. Germany, we had BMW. In Japan we had UNIX partner, (indiscernible) Electronics and Toshiba Corporation. In Korea we had the Korean Government, Ministry of Administration and Samsung Insurance. And as we go to the UK, Pizza Hut, Swiss Air (ph) Army and the Department of Navies. (ph) There are many other customers, but that just highlights again that we are a worldwide operation selling into 82 countries. That was just a snapshot of some of the deals that we did during the quarter. Again, those are primarily UnixWare and OpenServer wins.

Looking to the future of our UNIX division as Bert discussed, we will continue to make the necessary changes to increase operating efficiencies, design and create positive cash flow in this division for the remainder of 2004. We also reiterate our investment in and commitment to the current projected product releases and future development of our UNIX OS products. In fact, our upcoming releases will mark the largest across-the-board group significant product enhancements from SCO in the last several years. Let me highlight a few of those for you.

Starting and shipping this month, are two products. UnixWare 7.1.4 that is now currently available. It is our leading high-end UNIX operating system on the Intel platform and AMD platform. SmallFoot embedded UNIX, this is a complete embedded solutions toolkit that allows organizations to create a SmallFoot print based on UNIX inside a various embedded devices. Both are now available as of this month.

We have a new product coming out next month called SCOoffice Server 4.1. This is a reliable, full-featured Internet e-mail and collaboration solution for small and medium businesses. It seamlessly integrates with Microsoft Outlook and other industry standard e-mail readers and Web browsers. So that product is coming out next month. We use it here, it is very strong. I think our users are going to like that.

Our next product that will be coming out in August of this year is Vintela Authentication from SCO. This is the Company's offering for managing a single-user identity across a heterogeneous UNIX and Windows environment. And then finally, as we announced in our SCO Forum again last year we are coming out with a new version of OpenServer, we call this OpenServer Legend. It will ship in the first quarter of 2005, and we will get in more details of this at our forum event this year. The development effort is designed to be the first step for SCO in supporting a single UNIX development path for both OpenServer and UnixWare. It enables us to continue to support the 32-bit Intel architecture while adding support for higher and advanced computing.

The benefit to our customers is enhanced port for thousands of applications written for UNIX, Java and the ability to connect them with Web services. Legend will continue our commitment to value, security and reliability. Additional information regarding the release of our UnixWare 7.1.4 product as well as the other products I just have gone through will be provided during a separate press and analyst call scheduled for next Tuesday, June 15 at 11:00 Eastern time. I cordially invite all of you to join us on that call.

On a similar note, I would also like to extend an invitation to each of you on today's call to join us at SCO Forum which is our annual worldwide technology summit showcasing our technology and business solutions, along with our strategic business partners. And the event this year is scheduled for August 1st through the 3rd at MGM Grand in Las Vegas. Attendees at this year's SCO Forum will be the exclusive recipients of the OpenServer Legend preview kit, as well as the latest technical and sales training on (indiscernible) SCO's products and solutions, as well as giving you insights into our strategies for the coming year. To register you can attend, to register that event, just go to www.SCO.com.

In addition to our continued commitment to our UNIX products businesses, we stand firm in our resolve to protect and enforce our intellectual property. Let's take a minute and talk about our intellectual property licensing program. Last year we announced a license program for our IP. Companies

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that asked us about our IP plans and whether there was a way they could become compliant with us. There is a major reason that we implemented the program. That was the major reason. Based on some very rapid initial feedback, including at least one Fortune 500 Company we believe that the licensing program was a reasonable option for our customers. We understand that many people out there have complained about this program.

But imagine what would have happened if we would have taken the following approach. No, we are not going to offer you any solution to this problem, you will just have to wait and ride the uncertainty for an unspecified period of time and then you will hear from us. We can't promise what our license will look like then or what liabilities you might be subjected to, but we aren't going to offer you a solution now.

If we had done that people would have claimed that we weren't being fair, and so we didn't take that approach. Instead, we want to provide a sound, fair business solution that allows companies to continue to run their businesses knowing that they are not violating our IP rights. We are still working through that process so the decent pipeline of customers and believe we are presenting them with reasonable business alternatives to resolve the issue now rather than wait to see what the landscape looks like in a year or two, with whatever risks and uncertainties that that brings. We believe we can help companies move forward in a positive way now.

We acknowledge the licensing program did not take off the way it initially appeared it might. We believe that the claims in Novell, that Novell has publicly made about what they sold or didn't sell to the Santa Cruz operation in '95 have raised questions in the minds of our customers about whether they should license our IT. As a result, we are now involved in a lawsuit against Novell, alleging that they are slandering the title of the copyrights we own. Let's be clear. We did not cause this problem. We believe that the problem was caused by others who have violated our contractual and ownership rights. As you know, we are also litigating those claims.

We have an obligation to protect our intellectual property assets for the benefit of our shareholders, commencing with the IBM case and following up with Novell, AutoZone, the DaimlerChrysler cases; we have moved to protect these assets. Before I leave this subject I would like to update you on the status of a couple of legal cases.

In the IBM case we are currently awaiting rulings on our motion to amend the scheduling order and motions bifurcate which were heard on June 8. We anticipate a hearing currently scheduled for August 4 regarding our motion to dismiss and IBM's motion for partial summary judgment. In the Novell case we are currently awaiting the Judge's ruling on her motion to remand, if that motion is not granted, then we would also anticipate ruling on Novell's motion to dismiss.

On a new topic, I would like to comment on Linus Torvald's proposed developer Certificate of Origin system. It validates the concerns and problems we have expressed over the past year about the Linux development process that has been fraught with opportunities for illegal contributions of code, with minimal checks and balances. We believe it is in part because of this unchecked process that SCO has in property made its way, SCO Co (ph) has improperly made its way into Linux. Of course the new DCO system announced by Torvald cannot help answer questions about code and the impact of code already included in Linux. We will continue to educate our partners, customers and others about the basis for our positions for both IBM and others that have improperly contributed code to Linux.

When we began talking about our intellectual property concerns the original response from leaders in the open source community was an admission that there were errors in the Linux development and review process and that they had worked to remove the offending code from future versions of Linux. However, this does not take into account all of the other issues that are surrounding this. I think and to summarize as a company we have gone to great lengths to help commercial users understand the gravity and the magnitude of these improper contributions.

To summarize before we go to the final Q&A part of the call, the move in the last two quarters of fiscal 2004, The SCO Group will focus on the following major initiatives. Being cash-flow positive in operations for our UNIX business; a continued commitment to the enforcement of SCO's intellectual property rights and accelerating revenue from our SCO IP licensing initiatives. SCO Group is moving forward and we're excited about the revenue opportunities and business solutions that we are bringing to our customers.

Bert and I are now available to take your questions. Let me throw it back over to the operator.

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QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Maureen O'Gara with Client Server NEWS.

Maureen O'Gara - Client Server NEWS - Analyst

If you have a separate press release here about goings-on on the stock exchanges in Germany what exactly is happening?

Darl McBride - The SCO Group - President & CEO

I was contacted by a shareholder a couple weeks ago who was concerned he had been hearing that there were a number of small cap companies here in the States that were getting listed on these foreign exchanges, primarily in Germany in the Berlin Exchange, and it seemed like there was a lot of short trading going on around those Company's stocks that he was very concerned about, and was concerned whether we had fallen into this category as well. We did some research into that; our attorneys have looked into it, and upon investigation we found we were listed not only without our authorization on the Berlin Exchange, but also, Bert, what was the other one?

Bert Young - The SCO Group - CFO

(inaudible) Stuttgart and Frankfurt Exchange.

Darl McBride - The SCO Group - President & CEO

Right. Bert has really taken this and is driving it, and we are going to make sure that whatever is happening there that is improper, gets cleaned up.

Bert Young - The SCO Group - CFO

Maureen, we are looking into it. It is early. We have sent a letter to these folks and asked them to delist the shares because this hasn't happened with our permission. But it is early. We need to make people aware of it. We are going to investigate it, and we will aggressively pursue (multiple speakers).

Maureen O'Gara - Client Server NEWS - Analyst

Are they saying that this is something that's -- I don't understand how one gets listed, if there is no authorization.

Bert Young - The SCO Group - CFO

These are unregulated Exchanges, and apparently the company doesn't have to do anything to be filed there, which is what has happened but we think that is improper. And so we are trying to get it reversed. And it has only just been a week. We are really getting up to speed as quickly as we can on this and investigating what our options are.

Maureen O'Gara - Client Server NEWS - Analyst

Okay, so it's just -- I have never heard of such a thing, so maybe I am just being naive or something.

Darl McBride - The SCO Group - President & CEO

After I heard about it, Maureen, I went out and did a Google search and found a number of companies in like situations that had this happen to them. If you go out and just do a quick search you are going to find a lot of things going on. In fact, there is a CBS market watch column from last week Bert, where apparently the NASD and other agencies are over there investigating as we speak. We're not in contact with them directly, but we have been in contact with these exchanges. We have told them that we are demanding to be delisted off of them, and any activity that's going on over there, because this is unregulated, we want to make sure that this isn't coming to the detriment of our shareholders.

Maureen O'Gara - Client Server NEWS - Analyst

Do they trade in actual shares? Or I mean, here our foreign stock is a depository certificate or whatever they do here -- I don't know how they would do that from there.

Darl McBride - The SCO Group - President & CEO

Our legal counsel has looked into this. It is premature for us to say exactly what's going on, but they do have some speculation about what might be happening. But it's premature for us to comment now until we know for sure. But again, if you look just probably at what's being said out

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there you'll see what some of the other companies have started to conclude.

Maureen O'Gara - *Client Server NEWS - Analyst*

So did you guys get any revenues at all from the SCOsource this --?

Darl McBride - *The SCO Group - President & CEO*

We had a few deals from the SCOsource side, Maureen. Last quarter we announced a major deal with EVI. That is not part of the revenue stream that we reported in second quarter. That revenue will start to be accounted for in the quarter that we are currently in.

Maureen O'Gara - *Client Server NEWS - Analyst*

Okay, and you are saying that this is because of SCO's claims that you don't own the --.

Darl McBride - *The SCO Group - President & CEO*

Novell's claims.

Maureen O'Gara - *Client Server NEWS - Analyst*

Novell's claims, I'm sorry.

Darl McBride - *The SCO Group - President & CEO*

We have had a healthy pipeline as we have gone through the issues. A number of companies continue to work with us. There are other companies that have been impacted by not just Novell, but IBM and others that have come out with various programs to try and block that type of licensing move. Again, what we try to say is, look this customer program was put in place, this licensing program has been put in place from requests from customers. We are going to be very thoughtful; we are going to work through the issues, and those that step up and work with us now, we're going to work through those issues with them. And we're going to continue to move down that path.

Maureen O'Gara - *Client Server NEWS - Analyst*

You said -- you seemed to suggest that you are in active negotiations. I believe Bert said, used the word significant. Significant business opportunities as far as some of these things going forward. Is that an accurate representation of what is on the table here?

Bert Young - *The SCO Group - CFO*

Yes, so the pipeline is healthy. There are not just one or two opportunities there. There are many. And a good majority of them are significant in size.

Maureen O'Gara - *Client Server NEWS - Analyst*

But the other guys are just slamming the door on you, as saying we don't have to?

Darl McBride - *The SCO Group - President & CEO*

(multiple speakers) are not really slamming the door, Maureen. I think there is a sense of some are watching, some are moving, some are waiting. The heavy door slams aren't exactly the way I would describe it.

Maureen O'Gara - *Client Server NEWS - Analyst*

No, they are just saying, no?

Bert Young - *The SCO Group - CFO*

They are just hesitating.

Darl McBride - *The SCO Group - President & CEO*

Right, just pausing.

Maureen O'Gara - *Client Server NEWS - Analyst*

We will see how that -- now you forecast 10 to 12 this quarter, but that is mostly from the UNIX business, which --

Darl McBride - *The SCO Group - President & CEO*

Until there is a stream of revenue that comes out of the SCOsource side we're not going to get in the business of

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handicapping or projecting the forecast of it. You know, the pipeline that Bert is talking about it is healthy right now is not really part of that 10 to 12. Once we have more predictability, then we will start to give projections on that.

Maureen O'Gara - Client Server NEWS - Analyst

You don't anticipate to close any of those deals this quarter?

Darl McBride - The SCO Group - President & CEO

I didn't say that. I'm just saying that we'll announce them when they happen.

Darl McBride - The SCO Group - President & CEO

Last question, Maureen.

Maureen O'Gara - Client Server NEWS - Analyst

The EV 1 revenue will show up on this quarter?

Darl McBride - The SCO Group - President & CEO

Yes, they will start this quarter, and they will be booked over multiple quarters going forward.

Maureen O'Gara - Client Server NEWS - Analyst

All right, thanks.

Operator

(OPERATOR INSTRUCTIONS) Stephen Shankland with CNET.

Stephen Shankland - CNET - Analyst

I am sorry, I missed the first part of the call. It seemed like from the statement here that you guys spent 6.5 million, roughly, on the SCOSource expenses. Is that correct for the quarter?

Bert Young - The SCO Group - CFO

No, so the legal efforts were 4.4 million is what was spent.

Stephen Shankland - CNET - Analyst

Okay, and the reason that's interesting, I guess you guys had said you expected to be in the range of 2 to 3 million per quarter. Are you -- was this an anomalous quarter? (multiple speakers) more expensive?

Darl McBride - The SCO Group - President & CEO

I think we've been projecting 3 to 5 is what we've been saying pretty consistently for the last number of months.

Stephen Shankland - CNET - Analyst

Okay, thanks.

Operator

Terry Tillman with Schwab.

Terry Tillman - Schwab SoundView - Analyst

In terms of the easy one, just to clarify was there any revenue contribution on the SCOSource side in the first quarter or is that just going to start in the third quarter?

Darl McBride - The SCO Group - President & CEO

From the EV 1 side, the revenue contribution won't start until the quarter we are in right now which is Q3. The deal was closed in Q2, and the revenue will start, recognition will start the quarter we're in.

Terry Tillman - Schwab SoundView - Analyst

And in terms of I think earlier it was characterized the pipeline healthy, and for the SCOSource opportunities -- I mean do you foresee any kind of tipping point or is it just very volatile and it's hard to predict on when or if some of these will really monetize?

Darl McBride - The SCO Group - President & CEO

I think its more -- I think there could be some tipping points or breakage of the dam depending on how some legal cases work their way through in the coming weeks and months. I think that independent of that there are some companies

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that are just saying we want to move ahead and not have to deal with all of the issues. The reality is it's a very complex set of issues. You have contract issues, you have copyright issues, going from various parts of the code base. And it's going to be a while (indiscernible) realize before all these things are done. So some people are saying we're going to step up and resolve that now. We are offering some discounts reflecting the fact that there is some uncertainty with all these claims being finalized.

But on the backside of this, then there will probably be a different profile in terms of what we are going to be offering in terms of license fees. So we understand it is a complex environment, and some are going to move their way through in the short-term depending on the timing and nature of how some of these court cases evolve. You could see some things really accelerate.

Terry Tillman - Schwab SoundView - Analyst

As it stands now with the cash on the balance sheet, you could foresee being able to take these court cases at least for two full years out?

Darl McBride - The SCO Group - President & CEO

At least that. I think Bert, you are modeling on (indiscernible) going for several years given we're going to start to throw off some cash on the core business (inaudible).

Bert Young - The SCO Group - CFO

That's correct, Terry.

Terry Tillman - Schwab SoundView - Analyst

Okay. Thank you.

Operator

Larry Solomon with Capital Guardian.

Larry Solomon - Capital Guardian - Analyst

When you talk to Novell they say that you guys never got a copyright and that this contract and the amendment were very ambiguous. And they say if you go to the copyright office

you won't find that we actually issued any copyrights, even though in that document it states pretty clearly that you get the copyrights needed to complete the transaction. So can you just sort of talk about how do we get that resolved sort of once and for all? I know you guys didn't sue to have the judge interpret that because you interpreted it as you've already got it. But how do get the world to see that, because it seems like that's where the licensing of Linux really hinges is on that difference in interpretation with Novell?

Darl McBride - The SCO Group - President & CEO

I think that is a big factor that we've heard from some of the people that haven't stepped up in the short-term. We obviously feel very strongly about our claims there. In the hearing that we have this week in the court room, the judge, Judge Kimball said that he would be ruling on this case -- on the Novell case -- in a matter of days, so we are waiting on that. Now that's going to be just an issue of whether it's going to be in state court or federal court. If it's in federal, then obviously he'll also rule on the motion to dismiss, I assume. I agree with you that that is an important point there, Larry.

Larry Solomon - Capital Guardian - Analyst

So when did he say that he would rule in a matter of days?

Darl McBride - The SCO Group - President & CEO

That came out in the hearing earlier this week.

Larry Solomon - Capital Guardian - Analyst

So specifically he's just ruling on venue?

Darl McBride - The SCO Group - President & CEO

We don't know. We don't know exactly. The two motions in front of him are whether to remain the case, as well as a motion to dismiss. But we can't comment on that. I think as it relates to all of our comments with respect to the suits, let me transition off from your statement there, or question a little bit, Larry.

I want to back up just a little bit. Let's go back where we were when we filed these cases. A year ago -- obviously we're a small company. We had a set of claims here. We tried to work through issues that we had. We got backed into a corner

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where we really had really two choices, either forfeit our claims of our property rights or to put our issues before the authority of the court and let them resolve the issues for us. All the shareholders here on the phone today probably would have not been very happy with us if we had said well we're just going to forfeit our rights and go continue on our path of going out of business.

Based on the damage that was being done to our UNIX business from Linux. We stepped up. We fought for our rights, for the shareholders rights to go in and say look, we have this property, and we want the court authority to come in and rule on this for us. We have put this in front of the courts. Now that it's there we have a limited amount that we can really talk about.

I'd love to sit here and tell you, Larry, that you know on August 13th the dam is going to break, and this thing is going to go, and the licensing problem is going to take off. Shareholders would all like to hear that. The reality is we have put the vehicles in place to get our claims heard. The reality is I believe it is now a war of patience. I think that if we are all patient and let the court and the various venues take care of these issues and work them through.

We all have eyes. We can all read. You look at the Novell thing, and say gosh, how could this not be that SCO owns the copyrights? The court takes care of that. So we've put that case in front of the court. We've taken the problem of our allegations that our UNIX code has seeped into Linux. We've put that in front of the court, and so where there is this barrage of battles going on, this war of wars that continues day in and day out, we've backed off from the position of trying to have a daily commentary on what everybody's issues are. We're making our comments through our legal counsel, through the Boies, Schiller law firm in the court system.

And so we believe that, again, by being patient and working through these issues that the shareholders that are patient with us right now, we believe are going to be highly rewarded as our claims are finally heard.

Larry Solomon - *Capital Guardian - Analyst*

What about the idea that Novell says if you go to the copyright office it says that they have -- it says in the contract that they transfer copyrights but they never did? Is that something that you just need to wait for the court to compel them to actually do that?

Darl McBride - *The SCO Group - President & CEO*

Again -- exactly. We've put our claims -- we've obviously disagree totally with what Novell has said and what they have done in the public marketplace. We have our suspicions as to why they have done that. Obviously that's had some impact on our licensing program in the short-term. But the courts will be able to work through our issues. We'll have our day in court, and we believe very strongly that that will turn into a positive outcome for us. But in terms of the specifics, I don't know.

Operator

Herb Jackson with Renaissance Ventures.

Herb Jackson - *Renaissance Ventures - Analyst*

Most of my questions have been answered with the exception of the German stock exchange. When would you expect a delisting to take effect, or have they given you any indication?

Darl McBride - *The SCO Group - President & CEO*

We sent a notice letter out, what was it yesterday, day before yesterday?

Bert Young - *The SCO Group - CFO*

Day before yesterday.

Darl McBride - *The SCO Group - President & CEO*

This is new territory for us, so we don't know is the answer to that question. All we know is we're going to continue down this path and make sure that nothing is being done here that is damaging to the shareholders of this company.

Herb Jackson - *Renaissance Ventures - Analyst*

Is the short interest visible on the German exchanges?

Darl McBride - *The SCO Group - President & CEO*

The guy that I met with a couple weeks ago, that was his concern that the story he was hearing that the short interest

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that's out there on these international exchanges don't show up on the NASDAQ. But I don't know; again this is not my area of expertise. I am just -- we got this feedback, and we are following up on it, we are trying to sort out what's going on.

Herb Jackson - Renaissance Ventures - Analyst

Is there any color that you could add to ISV or reseller relationship development? In terms of if there was a trigger on the Novell issue, and you had the opportunity to through resellers --.

Darl McBride - The SCO Group - President & CEO

We're looking at it. We've had some demand from resellers to take this, we have had demand from customers and resellers to say is there a program here that we can layer in. We're being very surefooted on these issues. We are working through, we are listening, if we're going to do anything around that aspect which resellers will probably be addressing that during our reseller conference in August.

Herb Jackson - Renaissance Ventures - Analyst

Okay, good stuff.

Operator

Paula Rooney with CRN.

Paula Rooney - CRN - Analyst

What would you say to those who continue to doubt SCO's ability to financially fight IBM in court? And then secondly, if you could give a quick comment on the possibility that Sun may open source Solaris or is looking at that? Do you have any concerns about that?

Darl McBride - The SCO Group - President & CEO

Okay, so on the ability to finance this, Bert, do you want to take that on?

Paula Rooney - CRN - Analyst

Can we get you to answer that? I didn't hear what Bert said during the call but I wanted to get your color on it.

Darl McBride - The SCO Group - President & CEO

The real simple answer is we're going to have enough cash to get to our destination. We're on a journey right now. We have a variety of legal vehicles in place to get us to our destination. We have the vehicles in place. We have the best litigator and litigation team in the world in place. I might add, we not only have David Boies, but one of the top guys in his firm, Robert Silver, that is now heavily engaged on top of the team with Mark Heise, that has been engaged for a year. We have got the fire power on the legal side. We've got the cash necessary and very strong claims to get to where we need to go. So we feel good on all three points.

With respect to the Sun side of things, Sun has the broadest rights of any of SCO's UNIX licensees and has been a good licensee in good standing with us for many years. There are no details that Sun's plan to open source Solaris that are clear at this time, and so we really don't have anything to comment on. We are confident that Sun will continue to be a good licensee. I think when we hear the word Open Source all our minds rush to a certain concept of what that means. I think in -- if you look at UNIX in total, even if you look at where SCO is coming from, we have made UNIX very open over the years. This thing is available in every major university and research institution.

There is a lot of ways of opening your code up. Microsoft's got a thing called Shared Source, so there's a lot of open avenues or aspects that people can do out there. I don't know exactly what Sun is talking about, but from the fact we've had a good relationship with them and discussions over the years and months we have worked with them, we feel confident that they will continue to be a good licensee of ours as we go forward.

Paula Rooney - CRN - Analyst

They won't open it up under the GPL?

Darl McBride - The SCO Group - President & CEO

Again until they talk about what they're doing specifically I can't really comment on it. I am very comfortable and confident that Sun is going to do things that are going to enhance property rights, not destroy them.

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Paula Rooney - CRN - Analyst

Thank you.

Operator

Robert McMillan with IDG.

Robert McMillan - IDG - Analyst

Just a question about SCOsource revenue for Q2. Can you tell me what that was?

Bert Young - The SCO Group - CFO

It was not -- it was just a couple small licensing deals; people that signed up for our SCOsource agreement.

Robert McMillan - IDG - Analyst

So you're not saying what the -- was it zero?

Bert Young - The SCO Group - CFO

Not, it is \$11,000.

Robert McMillan - IDG - Analyst

\$11,000, okay. Can you explain the impairment of goodwill charge that you have? What in English what does that mean?

Bert Young - The SCO Group - CFO

So we had an acquisition we completed a little over a year ago. And expected a certain level of revenue as the result of that. That revenue has not happened to date, and as we do our quarterly review of the balance sheet items and do our impairment analysis, the asset that had been booked for this, for this acquisition, we felt like we needed to impair it, so we have written that off.

Robert McMillan - IDG - Analyst

Which acquisition was that?

Bert Young - The SCO Group - CFO

Volta's.

Operator

Dion Cornett with Decatur Jones.

Dion Cornett - Decatur Jones - Analyst

First of all, let me say congratulations on the A-1 exchange agreement. As we wrote about in our last couple of newsletters that was certainly a good deal for the common shareholders.

Darl McBride - The SCO Group - President & CEO

Thanks.

Dion Cornett - Decatur Jones - Analyst

A couple quickies here on the income statement. Your core license revenue was down about 24 percent year-over-year. This is about twice the rate we've seen in other companies that are suffering from their use business being cannibalized by Linux and to some extent Windows. Is there anything specific that you would attribute that to?

Darl McBride - The SCO Group - President & CEO

I think one of the challenges we have, when I joined the Company, Dion, the Company had three operating systems. And the two that we are currently operating under didn't have a lot on the development plan, didn't have a lot of fire power in terms of upcoming releases. That was corrected this week, and then we will have another one coming out with Legend in six months. And so as you know, software companies live and breathe on new releases. And so we have a new one now, another one in six months. So I think the anomaly here related to the other guys is that we went through a dark period where there just wasn't a lot going on with the UNIX development for a significant period of time.

Dion Cornett - Decatur Jones - Analyst

Fair enough. And the revenues from EV 1, I had originally estimated a quarter of \$1 million for the April quarter, and obviously you guys were far short of that. Based on comments

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you made last quarter about it being recognized in Q2, Q3, can you sort of explain why that shift in accounting there? And my impression is that they paid back in March when the deal was originally signed.

Darl McBride - *The SCO Group - President & CEO*

No, they didn't pay. We signed the deal back then. The payments were to show up in future periods. The first of those future periods is this quarter.

Dion Cornett - *Decatur Jones - Analyst*

Just what's the magnitude going to be? Is a quarter of a million still right for the July quarter?

Bert Young - *The SCO Group - CFO*

That would be a little high.

Darl McBride - *The SCO Group - President & CEO*

From them that would be high. It is going to be spread out over multiple quarters, but it will be in the six figures.

Dion Cornett - *Decatur Jones - Analyst*

And Bert, just one quickie here, what would share count have been had you reported a profit, ballpark?

Bert Young - *The SCO Group - CFO*

60.5 million shares.

Dion Cornett - *Decatur Jones - Analyst*

Thank you very much.

Operator

Larry Greenmeier from Information Week Magazine.

Larry Greenmeier - *Information Week Magazine - Analyst*

I just wanted to go over just quickly the product announcements that you had run off earlier in the call. You

mentioned something about an August -- you had called it Vintela, did I get that right?

Darl McBride - *The SCO Group - President & CEO*

Yes, correct.

Larry Greenmeier - *Information Week Magazine - Analyst*

V i n t e l a, and that is for managing single user ID?

Darl McBride - *The SCO Group - President & CEO*

Correct.

Larry Greenmeier - *Information Week Magazine - Analyst*

This month it was UnixWare 7.1.4?

Darl McBride - *The SCO Group - President & CEO*

Yes, that's correct.

Larry Greenmeier - *Information Week Magazine - Analyst*

You mentioned that this idea of UNIX development is where the company is heading. Can you tell us anymore about the relationships between Intel and AMD and how you are working with them to improve these UNIX, on I guess on x86 products?

Darl McBride - *The SCO Group - President & CEO*

Yes. We continue to work with those guys. We are moving the development forward for UNIX on Intel. The Legend product we think is going to be very interesting. There is going to be a lot of very nice features that come out on that. And we are really on the front end of developing some broader-based industry support as we move down that path.

Larry Greenmeier - *Information Week Magazine - Analyst*

Thanks.

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Operator

Steven Vaughan-Nichols from eWeek.com.

Steven Vaughan-Nichols - eWeek.com - Sr Editor

I was curious about your attempts to realize more profit out of the UNIX division. Does that mean that we are going to see more cuts, more employee cuts in that division in the upcoming quarter?

Darl McBride - The SCO Group - President & CEO

We've tightened down and streamlined some things in the past there; as with any business we're going to continue to look for efficiencies. One of the things that Bert has brought to the table here is trying to figure out how to get your products to market more efficiently and effectively; how do you get more efficiencies with your development teams, as well as with the fact that we have this large reseller channel. So we are not commenting on future issues other than to say we're going to be as streamlined as possible. And if there are additional judgments we will make those, but we are going to take a prudent business approach to the business.

Steven Vaughan-Nichols - eWeek.com - Sr Editor

Thank you very much.

Operator

Peter Williams, independent trader.

Peter Williams - VNU Business Publications - Independent trader

Good afternoon, gentlemen. This is a question for Mr. McBride. You said that you are in the process of explaining to potential SCOSource customers the gravity and magnitude of improper code contributions to Linux and that as a result they should go and buy a license to effectively ensure themselves against any future claims you may make. Now I understand gravity and magnitudes to mean there to be serious, large, significant contributions and lots of them, yet you have not been able to show any in the IBM lawsuit. How do you reconcile the two statements?

Darl McBride - The SCO Group - President & CEO

I'm glad you brought that up Peter, because this is really a point of concern quite honestly frustration in large part with how things are being positioned in this IBM case versus the reality. I think it is important to not confuse IBM's positioning with the reality of what's going on in this case. If you look at the -- first of all, I'm not going to get into all of the details of what's going on in the court. But what I would tell you is that there is a dramatic difference between what IBM postures and what they say in their documents that are publicly available and what we have provided to them under protective order. In other words, they are kind of getting the best of both worlds right now, they are going around saying "boy, SCO is not showing the code" whereas if you get to the realities, if you look behind the filings, if you look at under the protective order and look what's there, SCO has been very diligent in providing substantial amounts of information back to IBM.

The fact that the judge, the Magistrate came out and said SCO has acted in good faith, I mean the Magistrate can see what we're filing, so there's a reason she is making that comment, I believe. And that is that we are producing volumes of information back to the court and back to IBM. Unfortunately, all of us in on the call here and all of us as end-users and those in the Linux community and everywhere else are not able to see all of that. So I want to make sure that we understand the game is going on. There's another issue going on here around the posturing about saying SCO is just trying to drag this case out. They are trying to drag this on whereas IBM wants to rush in and get it done.

Well, that is the positioning that IBM wants to rush the case, but if you look at their actions they're the ones really trying to slow the case down. From the time we filed the case, going forward nine months, we did not -- we had zero versions of the source code in dispute that everybody already agrees we were going to see. And it took them nine months, took them March of this year before they ever produced one version of AIX or DYNIX code to us when we had -- I think its AIX in that case -- when we got the versions of code that came in we have been diligently going through that, and we have responded back into the court over the last couple of months.

So the reality is there is a long delay that was put in place by IBM. They still haven't supplied all of the versions that we've requested. IBM has filed 14 counterclaims unrelated to our question, our claim that Linux is tainted in their problems

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there with IBM's contributions into Linux. They filed 14 counterclaims totally unrelated to our case. So I think it.

Peter Williams - VNU Business Publications - Independent trader

That's something I don't understand, which is that Linux is Open Source, and the Source is openly available. So can you not just go to a Source repository and pull up a file and say here, you guys stole that from our intellectual property. This is where it is. You can point at it because you don't need to wait for IBM to provide it, do you?

Darl McBride - The SCO Group - President & CEO

Well, it's a little bit -- there's one more step you have to do there. The first is the thing you got to do is you got to be able to take the code -- you take the contracts that we have with IBM, you take the code that is in question, and that is protected between us and IBM. And you get that settled. Again, they still have not provided all the versions that we've asked for. But with the versions that we have we been able to go back in and we've put claims on the table. Again, you are not seeing those, but they are on the table. And there will be more as we go through the case here.

Then the next step is to compare the code that is in question that is in violation against our rights, against what is publicly available there. So you are right, at one level this is not a difficult game here to play. It is not a difficult scenario to figure out. But it is difficult if that middle interim piece isn't there. So I would ask IBM a question, why are you not putting us the code?

Peter Williams - VNU Business Publications - Independent trader

Well, would it not help your SCOsource licensing program if you could go to your potential customers and say look, here's what we've put in front of IBM, make up your mind yourself. (multiple speakers)

Darl McBride - The SCO Group - President & CEO

It would help tremendously. And if we didn't have these things under protected seal of the court, we would be doing that. And so I guess one of the things that I want to make sure all of you take away from this call today is that there is a major goal. There's a Grand Canyon site goal between what IBM is saying publicly and the real facts of this case. And what we

are supplying that are under protective order. Mark my words. There will be a day that will come when you will all see many, many documents that will directly contradict IBM's current public posturing.

Peter Williams - VNU Business Publications - Independent trader

Okay. Thank you for the answer.

Operator

Although we have further questions, unfortunately you have run out of time. So we appreciate your interest and feel free to contact Human Relations Department if you have any further questions. Then I will turn it back over to Darl for closing comments.

Darl McBride - The SCO Group - President & CEO

Well, I think I just made my closing comment. I believe very strongly in our case. I believe very strongly in our claims. I would like to make one final comment regarding the wrapup on the BayStar case, as Bert said, we welcome them on board as long-term shareholders. There was some concerns that BayStar had expressed that with management out talking about this case too much in the press, the answer to that was a resounding, yes. I totally agree with Larry on that. And part of the -- I think what we got drawn into was the fact that IBM has a lot of agents that are out there day in and day out that attack us. And we felt like from a defense standpoint to protect our shareholders who are on the call today, we were the only guys in town to fight back. And for a number of weeks and months we did that.

Well, the reality as we said earlier, we're going to fight this came out through the court rooms. And it is a game of patience, and it is frustrating for all of us when you see a claim out there saying somebody else owns our copyrights and there is somebody else saying this or that. If we can all be patient here over the coming months, quarters, years however long it takes -- I don't know -- but I believe we're going to have a very firm outcome.

In the meantime, the voice (ph) team is really stepping up with the key generals that are running the case now, as it relates to the litigation. They are firmly driving that. Management here is focused on the licensing, the innovation of the core UNIX products and seeing the core business

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completing the innovative products that it's working on. So we're going to continue down the path that we've laid out. We feel good about the direction we are going. We appreciate all of you as shareholders, and we look forward to continuing the battle. Thanks for joining us today.

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