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FINAL TRANSCRIPT

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SCOX - Q2 2005 The SCO Group Earnings Conference Call

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Darl McBride
The SCO Group, Inc - President & CEO

CONFERENCE CALL PARTICIPANTS

Al Patroski
- Private Investor

Bob Mims
Salt Lake Tribune - Analyst

PRESENTATION

Operator

Good day, everyone, and welcome to The SCO Group's second quarter 2005 earnings conference call. Today's call is being recorded. At this time for opening remarks and introductions, I will turn the call over to Mr Blake Stowell, Public Relations Director. Mr Stowell, please go ahead.

Blake Stowell - The SCO Group, Inc

Thanks. Good day, everyone, and welcome to The SCO Group's fiscal second quarter 2005 earnings conference call. At this time everyone is in listen-only mode. Later a question and answer session will be opened. During that question and answer session the Company will only be taking questions on the Company's core UNIX business. Today's call is being recorded. Participating on the all 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 afternoon containing our results, which we will be discussing further 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 the Private Securities Litigation Reform Act of 1995. These forward-looking statements are made only as of the date of this conference call and we undertake no obligation to update or revise the forward-looking information, whether as a result of new information, future developments, or otherwise.

Our performance is subject to significant risks and uncertainties known and 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 or achievements to be materially different from any projections or future results implied by those forward-looking statements. Accordingly, you should not place implied -- accordingly you should not place undue reliance on these forward-looking statements. For a full discussion of these and other risks and uncertainties, please see our annual report on form 10K for the fiscal year ended October 31, 2004, and other reports we have filed with the SEC, all available at www.sco.com. I will now turn the call over to Darl McBride, President and Chief Executive Officer of The SCO Group, Inc.

Darl McBride - The SCO Group, Inc - President & CEO

Okay, thanks, Blake, and thanks, everyone, for joining us on today's call. The second quarter was a productive, business as usual quarter for SCO, free of some of the media drama of recent quarters. Our core UNIX business continue to operate profitably and

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we increased revenues in that business over last quarter as a result of solid performance across all geographies. As we have said before, we believe that business will continue to generate positive operating results and will remain cash flow positive throughout the remaining quarters of fiscal 2005. Strategically, we continue to focus on commercial success in the marketplace. I'll speak more specifically on this later. But, we look forward to launching SCO OpenServer 6 later this month. At the same time, we remain committed to pursuing our legal strategy in the court room and are well positioned to see it through to its conclusion. I'll now turn this call over to Bert Young, our CFO, for an overview of the Company's financial results. Bert.

Bert Young - The SCO Group, Inc - CFO

Thanks, Darl. Good afternoon, everyone. The Company reported revenue of 9.3 million for the second quarter of fiscal year 2005, as compared to revenue of 10.1 million for the comparable quarter of the prior year. The net loss for the first quarter was 2.0 million or \$0.11 per diluted common share, compared to a net loss of 14.7 million or \$1.04 per diluted common share reported in the comparable quarter of the prior year. Revenue for the first two quarters of fiscal year 2005 was 18.1 million compared to revenue of 21.5 million for the first two quarters of fiscal year 2004. The net loss for the first two quarters was 4.9 million or \$0.28 per diluted common share compared to a net loss of 17.2 million or \$1.23 per diluted common share for the first two quarters of fiscal year 2004. Revenue for the UNIX business was 9.2 million versus 10.1 million for the prior quarter.

UNIX revenue was down year-over-year primarily as a result of continued competitive pressure for operating systems. However, as noted by Darl, revenue for the second quarter was slightly higher than revenue in the first quarter. For the second quarter of 2005, the cost of revenue for the UNIX business was 1.3 million resulting in gross margin of 7.9 million or 86%. Costs and expenses for the UNIX business were 7.4 million. Cost for sales and marketing and research and development were in line with our expectations. But our general and administrative costs were unusually high due to the additional legal and accounting costs incurred in connection with the restatement of our 2004 quarterly financial statements and quarterly reports. We expect that sales and marketing and R&D costs will continue to stay at their current levels and that G&A costs will decrease to a level that was incurred in the first quarter of fiscal year 2005.

As a management team, we're pleased the UNIX business continues to operate profitably. Revenue derived from SCOsource licensing was \$30,000 for the quarter. As we have stated in prior quarters we've cautioned that predicting this revenue stream is very challenging and will continue to be difficult to predict. As in previous quarters, we're continuing to classify legal and professional fees and other costs and expenses that directly relate to enforcement of our intellectual property rights as costs of revenue. For the second quarter fiscal year 2005 these costs were 2.9 million and were down from the prior quarter as a result of less than anticipated spending for escrow related expenses. Before turning to our cash discussion, one other positive development for the quarter occurred as SCO sold shares of Trolltech AS it had owned since 1999 in a private transaction for total proceeds of 779,100.

The Company accounted for the sale as component of other income in its second quarter and year-to-date statements of operations. Cash and cash equivalents and available for sale securities were approximately 14.2 million at April 30, 2005. In addition, approximately 4 million remains in an escrow account and is classified as a component of restricted cash as of April 30th, leaving the Company with 18.2 million in cash. As we've done in previous quarters, if you deduct the three quarterly payments of 2 million each that we have to make over the next three quarters to Boyce, Shuller(ph) and Flexner, and the remaining escrow balance of 4 million, we will have a total of 8.2 million after the litigation expenses have been subtracted. If you recall from last quarter, this number was 7.4 million. So our efforts in quarter two yielded a positive cash result. With that I will hand things back to you, Darl.

Darl McBride - The SCO Group, Inc - President & CEO

Okay, thanks, Bert. I would like to spend the remainder of the call addressing our business performance and prospects. We were pleased with the performance of our UNIX business and that business is focused on generating positive cash flow despite a very challenging business environment. Key customer wins during the quarter include Costco, Thomson Financial, McDonalds,

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Goodyear, CTC Chile, Siemen's, Dolan and Achison(ph) in the U.K., Argo's also in the U.K., People's Bank of India, Comverse and Carrefour out of France. The Company continues to receive great feedback from the product beta testers of the pre-release version of our OpenServer 6 product, Copneg(ph) and Legend.. In some cases the product has seen double performance in product benchmarks compared to the previous version of SCO OpenServer.

Upon its release SCO OpenServer 6 will support numerous applications including UnixWare and SCO OpenServer apps, Java apps and applications that run on MySQL, PostgreSQL, Tom Cat, Apache and many other popular environments. The Company will also continue to include backward compatibility for applications that have run on previous versions of SCO OpenServer. The Company will host a significant product launch event in New York City on June 22nd, which will be attended by many of SCO's software and hardware partners, key customers as well as members of the media and the analyst community. In addition to our June launch for SCO OpenServer 6, we have scheduled our annual SCO forum event August 7th through the 9th at the MGM Grand Hotel in Las Vegas. We look forward to another great gathering this year for our resellers and our software and hardware partners.

It's been less than two months since we provided the last litigation update so we don't have a lengthy report for you this time, but we have had a couple of important developments since we last reported, which I will explain briefly. First, in our last call we reported that the United States magistrate had ordered IBM to produce code and revision information that we have been seeking for some time. In response IBM filed a motion asking the magistrate to reconsider some aspects of that order. On April 19th the magistrate judge ruled on IBM's motion for re-consideration giving IBM some relief on deadlines and some other matters but strongly reaffirmed the court's prior order directing IBM to turn over the information we had requested including both public and private information regarding its development of and contributions to Linux. We look forward to reviewing this information which we believe will be very helpful in putting together the technical side of our case.

We look forward to having this information delivered to us by July 18th. On April 28th the court issued an order denying various media entities' request to intervene in the case for the purpose of unsealing certain documents filed with the court. However, the court directed the parties to take another look at their sealed filings and unseal any documents that are not properly filed under seal. As a result of that order, many important documents will be unsealed by the parties in the coming weeks. The hearing on Novell's second motion to dismiss our case was held on May 25th. The judge took the matter under advisement. But we are optimistic that the court will allow us to conduct discovery in this case. Would also like to mention that we have now concluded the initial discovery in the Auto Zone case and filed our report last Friday, May 27th, with the federal court in Nevada. Let me just summarize what the report says.

Contrary to Auto Zone's various statements to the court, SCO found through its discovery, including sworn depositions and other admissions directly from Auto Zone, many instances of coping of programs containing SCO OpenServer code. Auto Zone has represented that it has now removed all of the SCO code and proprietary information that it copied or used in its migration to Red Hat Linux. Because they claim they have now removed all of the SCO code and proprietary information, SCO is not going to move for a preliminary injunction at this time. Auto Zone does not admit that it violated SCO's rights or caused SCO damage in that migration process, which are still points of dispute between the parties. Given the stay issued by the court in the case, we reserve the right to pursue infringement and damages at some future point. It is important to remember that issues regarding the broader problems we allege are in Linux as they relate to our contractual and IP rights have been stayed by the court in Nevada. So our report does not address those issues.

As I mentioned we reserve our rights to pursue those claims once the stay is lifted. The discovery we undertook in the Auto Zone case was limited in scope to issues surrounding any SCO code or libraries or other proprietary information used or copied by Auto Zone in migrating to Linux and did not address the Linux issues that are being litigated in the IBM case in Utah. I would now like to take a second and point out something we think this report demonstrates. There have been a lot of questions as to SCO's motives behind its various court cases and suggestions in the media that we are off-base in trying to find our code in other people's systems. I think this report shows by Auto Zone's own admissions they copied our code. At any rate, we could spend a lot of time on all these points that I've mentioned today, but that's not the purpose of this call. And so we will not be discussing this in any greater detail and we will not be responding to any questions about this in the Q&A session.

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If you want additional information about the magistrate's ruling on IBM's motion for re-consideration, the court's ruling on the motion to intervene by the media or which documents have been unsealed as a result of that order, or additional information about the report we have filed in the Auto Zone case, you should obtain copies of these documents from the respective courts, read them and draw your own conclusions about their importance. Thank you for understanding that we really can't go into greater detail or discussion about these matters that will be played out in the courts. With that, I will now turn the call over to the operator to open up the phone lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, Mr. McBride. [OPERATOR INSTRUCTIONS] We'll take our first question from Al Patroski, a private investor.

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

Hello, Al.

Al Patroski -- *Private Investor*

Hi. Congratulations on the UNIX numbers. Those look pretty good.

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

We felt good about the quarterly performance. Thanks.

Al Patroski -- *Private Investor*

Last quarter you had 50 people in sales and marketing and 55 in product development. Do you have those numbers handy for this quarter.

Bert Young - *The SCO Group, Inc - CFO*

Yes, there is really no change in headcount this quarter from the previous quarter.

Al Patroski -- *Private Investor*

Okay. And on BayStar -- BayStar at this point they still can't sell those million shares of common stock they have, right?

Bert Young - *The SCO Group, Inc - CFO*

Yes. The -- probably the answer to that question is really a status on the S 1 filing. We have received information from the SEC. They've chosen not to review our S 1 filing and so we should be effective with the BayStar S 1 filing any day, really, tomorrow, the following day, we should be effective. And at that point BayStar shares will be registered in a way that they could sell them again if that's what they choose to do.

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Al Patroski - - Private Investor

Okay. In the deal last year, you agreed to take care of registration and BayStar agreed to limit its selling to 10% of the NASDAQ volume.

Bert Young - The SCO Group, Inc - CFO

No, it was 10% of the trailing five-day SCO volume.

Al Patroski - - Private Investor

Right. I meant that the trading of SCO on NASDAQ.

Bert Young - The SCO Group, Inc - CFO

Yes.

Al Patroski - - Private Investor

So is BayStar still going to stick to that volume limit even though you didn't keep registration in order?

Bert Young - The SCO Group, Inc - CFO

Yes. So that the agreement continues. There is no change in that agreement at all.

Al Patroski - - Private Investor

Okay. And there's not going to be some kind of catch-up provision so that they can sell 10% of the volume over those months that they missed.

Bert Young - The SCO Group, Inc - CFO

We've had no discussions like that with them, no.

Al Patroski - - Private Investor

Okay. So as far as you know, they're okay with just -- ?

Bert Young - The SCO Group, Inc - CFO

As far as we know, they'll adhere to the agreement that we had in place. They were adhering to it before and they will adhere to it afterwards.

Al Patroski - - Private Investor

Okay. For the last few months you have not been adhering to it, right?

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Bert Young - The SCO Group, Inc - CFO

Well, the agreement had -- our obligation was to do our best efforts at keeping registration effective.

Al Patroski -- Private Investor

I see.

Bert Young - The SCO Group, Inc - CFO

And when we missed that NASDAQ filing, then we made our best efforts to get that filing effective which is now this S 1 being effective here in a day or two.

Al Patroski -- Private Investor

I see. I see the rescision liability is now 850,000. Do you think you will be able to get that resolved this quarter?

Bert Young - The SCO Group, Inc - CFO

We will begin -- our expectation is in this quarter we expect to begin the rescision offer that we will make to our employees. I doubt at the end of quarter three that number will be eliminated completely, but we may resolve a good portion of that liability but over quarter three and quarter four we would expect that rescision liability to begin to resolve itself.

Operator

[OPERATOR INSTRUCTIONS] We'll go next to Bob Mims, Salt Lake Tribune.

Bob Mims - Salt Lake Tribune - Analyst

Hi, Darl, how are you?

Darl McBride - The SCO Group, Inc - President & CEO

Good, how are you, Robert?

Bob Mims - Salt Lake Tribune - Analyst

Good. I was hoping for -- it's probably obvious -- it's in the report but hoping you might explain it for 8 year old. You have decreased revenues and yet your net losses have been dramatically improved. I estimate around 75% improvement there. Certainly the Trolltech sale doesn't begin to account for that. Are there one or two or three areas of cost cutting, perhaps, that might account for this improvement?

Darl McBride - The SCO Group, Inc - President & CEO

Go ahead, Bert.

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Bert Young - *The SCO Group, Inc - CFO*

You're right, Bob, to mention the Trolltech, that is clearly a big amount of benefit in other income that effects our -- improves the net loss for the quarter. The other area really is the up side in revenue from the previous quarter. Just if you take costs out of our UNIX business quarter over quarter, there was a little bit of an increase in costs in our G&A area, but the additional revenue this quarter over last quarter would account for the up side in profitability out of the business. The other thing I mentioned on the call is we did have a drop in expenses, the expenses in the lawsuit, those are the expenses we categorize in the -- when we talk about the escrow account.

Bob Mims - *Salt Lake Tribune - Analyst*

Okay.

Bert Young - *The SCO Group, Inc - CFO*

Those were -- those were almost \$400,000 less this quarter than the previous quarter.

Bob Mims - *Salt Lake Tribune - Analyst*

Very good. Thank you.

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

The one other comment I would make, Bob, with respect to our overall UNIX business, we have not released into the marketplace the level of operating system upgrades that we're doing this month for nearly 6 years. So we're confident that our program going forward with SCO OpenServer 6, that has been a multi-year multi-million dollar development effort, is going to provide customers with increase in performance and response security enhancements that they haven't seen before. We've had a revenue decline for a number of years here. We're in a very intense competitive environment and we're now shipping a product here that we believe is going to provide some stability on a go forward basis.

Bob Mims - *Salt Lake Tribune - Analyst*

Some of your big UNIX customers who perhaps have been a little shy of publicity of lately, will they be coming out to support you at Yankee Stadium.

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

We've got a number of folks that are signed up for the event, and -- so, yes, there is going to be, I don't know the exact numbers right now, but I believe the clients right now there's going to be well over 100 folks there, a number of those customers that will be showing up for that event.

Bob Mims - *Salt Lake Tribune - Analyst*

Thank you.

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Darl McBride - The SCO Group, Inc - President & CEO

Thank you, Bob.

Operator

There are no questions remaining on our roster. Mr. McBride, I will turn it back over to you for any additional or closing remarks.

Darl McBride - The SCO Group, Inc - President & CEO

Okay, great. Quiet Q&A session. This is fine. So let's go ahead and wrap this up. I think if you step back and look at where we are, the -- from a summary standpoint during Q2 we kept focused on the UNIX business and moving our litigation efforts forward. The Company's UNIX business is continuing to generate solid cash flow. Legal fees are in line with expectations. We are looking forward to launching the new SCO OpenServer product in June and we made solid progress with regard to our litigation effort and are looking forward to having our cases heard. So with that, that's basically all we have for today. Thanks for joining the call and we will look toward to speaking with you again soon.

Operator

Once again, this will conclude today's presentation. Your participation is appreciated. You may disconnect at this time.

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