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FINAL TRANSCRIPT

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SCOX - Q3 2005 The SCO Group Earnings Conference Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the SCO Group's third-quarter 2005 earnings conference call. Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to Mr. Blake Stowell, Public Relations Director. Mr. Stowell, please go ahead.

Blake Stowell - The SCO Group - Public Relations Director

Thanks. Good day, everyone, and welcome to the SCO Group's fiscal third quarter 2005 earnings conference call. At this time, everyone is in listen-only mode. Later in the call, we will have a question-and-answer session. 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 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 afternoon containing our results, which we will be discussing further in this call.

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 these forward-looking statements. 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 10-K for the fiscal year ended October 31, 2004 and other reports we have filed with the SEC, all available at www.SCO.com.

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

Darl McBride - The SCO Group - President, CEO

Thanks, Blake, and thanks to everyone for joining us on today's call. The third quarter was a productive quarter for SCO, with some very positive developments in our business, including the successful launch of SCO OpenServer 6 at Yankee Stadium. Our core UNIX business continued to operate profitably and, while revenue for UNIX products and services fell versus last year, revenues have sequentially increased for the past two quarters. As we have said before, we believe that the UNIX business will continue to generate positive operating results and will remain cash flow positive throughout the fourth quarter of fiscal 2005.

Strategically, we continue to focus on commercial success in the marketplace. I will speak more specifically on this later, but our launch of OpenServer 6 illustrates our strategy to continue to innovate our UNIX operating systems to offer our customers the most reliable and secure applications platform. At the same time, we remain committed to pursuing our legal strategy in the courtroom and are well-positioned to see it through to its conclusion.

I'd now like to turn the call over to Bert Young, our CFO, for an overview of the Company's financial results.

Bert Young - The SCO Group - CFO

Thanks, Darl. The Company reported revenue this quarter of 9.4 million for the third quarter of fiscal year 2005, as compared to revenue of 11.2 million for the comparable quarter of the prior year. The decrease in revenue was primarily attributable to continued competitive pressures on the Company's UNIX products and a decrease in SCOsource licensing revenues. The net loss applicable to common stockholders for the third quarter was 2.4 million or \$0.13 per diluted common share, compared to a net income available to common stockholders of 7.5 million or \$0.38 per diluted common share reported in the comparable quarter of the prior year.

Included in the net income available to common stockholders for the third quarter of fiscal year 2004 was a one-time contribution of capital of 14.9 million recorded as a preferred stock dividend. Exclusive of this dividend, the net loss for the third quarter of fiscal year 2004 would have been \$7.4 million loss.

Revenue for the first three quarters of fiscal year 2005 was 27.5 million, compared to revenue of 32.7 million for the first three quarters of fiscal year 2004. The net loss attributable to common stockholders for the first three quarters of fiscal year 2005 was a loss of 7.3 million or \$0.41 per diluted common share, compared to 9.7 million or \$0.67 per diluted common share for the first three quarters of fiscal year 2004.

Revenue for the UNIX business for the third quarter was 9.3 million versus 10.5 million for Q3 last year. UNIX revenue was down year over year, primarily as the result of competitive pressure for operating systems. However, as noted by Darl, revenue for the third quarter was slightly higher than revenue in the second quarter.

For the third quarter of 2005, the cost of revenue for the UNIX business was 1.4 million, resulting in gross margin of 7.9 million or 85%. Costs and expenses for the UNIX business were 6.9 million, which continues to trend down year over year. Costs for sales and marketing, research/development, general/administrative were in line with our expectations, and we expect them to remain at current levels for the fourth quarter.

As a management team, we are pleased that the UNIX business continues to operate profitably. Revenue derived from SCOsource licensing was \$32,000 for the quarter. As we have stated in prior quarters, we have cautioned that predicting this revenue stream is very challenging and will continue to be difficult to predict.

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As in previous quarters, we're continuing to classify our legal and professional fees and other costs and expenses that relate directly to the enforcement of our intellectual property rights as cost of revenue. For the third quarter of fiscal year 2005, these costs were 3.1 million, which was in line with our expectations and includes the 2 million payment paid to Boies, Schiller & Flexner, which was the fourth of the total six payments we will make to our lawyers.

Cash and cash equivalents and available-for-sale securities were 12.6 million at July 31, 2005. In addition, approximately 3.6 million remains in an escrow account and is classified as a component of restricted cash, leaving the Company with 16.2 million in cash. As we have done in previous quarters, I would like to characterize the 16.2 million of cash. First, we have two quarterly payments remaining of \$2 million each or 4 million that we will make to Boies over this quarter and next; and secondly, we have the remaining escrow balance of 3.6 million reserved for litigation expenses, leaving a total of 8.6 million after the litigation expenses have been subtracted. If you will recall, this number was 8.2 million at the end of quarter two and 7.4 million at the end of quarter one. So our efforts in the third quarter continued to build upon our positive cash results year to date.

With that, I will hand things back to you, Darl.

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

Thanks, Bert. I would like to spend the remainder of the call addressing our business performance and opportunities. We were pleased with the performance of our UNIX business, and that business is focused on generating positive cash flow despite a very competitive business environment. A sampling of our customer wins during Q3 included Siemens; McDonald's; Goodyear; Lucent; Unisys; Thomson Financial; WebMD; OCA Argentina (ph); Ministry of Defense in the UK; Marconi; Argos; NEPA, which is Nigeria's electric power provider; Dena Bank in India; the Indian Government Telecommunications Agency; and converse.

The Company has received outstanding feedback from our partners, customers, resellers, engineers and many others who have upgraded to our newly-released SCO OpenServer 6 product. OpenServer 6 provides full support for up to 32 processors, 64 gigabytes of memory, terabyte file sizes and full support for multi-core processing capabilities. Our product has received praise in the marketplace for its security, including the technology risk management firm mi2g, which has named OpenServer one of the most secure operating systems in the world. In addition, OpenServer 6 is backward-compatible, which allows our customers the ability to seamlessly upgrade from their existing OpenServer product without losing compatibility with their other applications.

Our annual SCO Forum Event in Las Vegas from August 7th through the 9th was a great success, and it illustrates our mission as a Company to bring the highest-quality UNIX technology to our customers. Sometimes, our true purpose as a software innovator gets buried under the negative media coverage relating to our legal efforts. However, we believe that our loyal shareholders and customers know us as the owner of intellectual property rights and core developer of the UNIX operating system and as their dedicated partner in bringing the most reliable and cost-effective software to the marketplace.

As part of SCO Forum, we were excited to make a couple of major executive announcements. First of all, Sandy Gupta, a veteran of SCO's technology team, was promoted to Chief Technology Officer and will continue to lead SCO's technology efforts going forward. Additionally, Tim Negris was named Senior Vice President of Marketing, and is responsible for all product and corporate marketing activities for SCO. Tim has over 25 years in the software industry working for companies such as Oracle and IBM, where he led the marketing efforts of IBM's multi-billion-dollar software business unit.

As you may have seen on Friday, we announced the signing of an agreement with MySQL AB to jointly deliver a certified commercial version of the popular MySQL database for SCO OpenServer 6. As part of the agreement, we will work together on a range of marketing sales, training, business development and support programs that will benefit customers throughout the Americas, Europe and Asia. In addition, SCO will include a trial subscription to the MySQL Network enterprise database service with each new copy of SCO OpenServer and offer full MySQL Network subscriptions through its reseller channel. We believe the SCO/MySQL partnership will bring great benefits to the customers and channel partners of both companies, in creating a fully-supported, high-performance, low-cost, easy-to-manage applications platform that can scale out across the distributed

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and network customer systems environments common to both companies. We will make sure the operating system and the database undergo extensive compatibility and certification testing, to ensure a good developer and end-user experience. And finally, MySQL Network will also be available directly from SCO resellers throughout the world, offering customers a single point of contact.

This is a strong partnership that will benefit both companies' stakeholders. This relationship is indicative of the different opportunities we are pursuing to broaden the usability of OpenServer 6 and to extend our reach into the marketplace and grow our UNIX business.

In addition to our partnerships, we are also developing new platforms and services. To that end, we are very proud to announce that we will be attending the upcoming DEMO Conference from September 19th through the 21st to publicly introduce and showcase innovative technology that the Company has been working on for more than a year. The DEMO Conference focuses on emerging market trends with an emphasis on innovation in the hottest segments, including mobile, consumer and enterprise. DEMO was attended by a select group of decision-makers from emerging companies, respected veterans, sought-after BCs, top analysts and influential journalists. Technologies that have previously seen their debut at DEMO include Tivo, the PalmPilot and Java.

We can't go into too much detail today, but suffice it to say we think this is going to be an important launch for a unique product and platform that will carry our UNIX heritage of speed, safety, security and innovation into the next generation of communications. Early trials of the technology have yielded extremely positive feedback and resulted in signed customer deals. To coincide with the launch at DEMO, I will be in New York hosting a launch event for key members of the press, our partners, customers, investors and industry analysts. As you can tell, we are really excited about this, so look for our announcement in a little under two weeks.

On the litigation front, we don't have a lengthy report for you at this time, but we do want you to know about a couple of key developments as we remain on track to protect our rights in the courts. With regards to the IBM case, on July 1st of this year, the judge presiding over the case issued a revised scheduling order establishing, among other things, discovery and motion deadlines over the next 18 months, as well as a five-week jury trial to commence on February 26th of 2007. We are pleased that a date has been officially set. And, as we have said from the beginning, we look forward to the opportunity to present our case in court.

In addition, on July 1st, the court issued an order granting our motion to depose IBM Chairman and CEO Sam Palmisano, and ordered IBM to produce Mr. Palmisano for a four-hour deposition in New York. The court found that Mr. Palmisano could have unique personal knowledge related to the claims in the case. We will likely set that deposition for sometime in the later part of this year or early part of next year.

Finally, we are continuing to take discovery with IBM and working through issues as part of that effort, and look forward to gaining all of the discovery from them, as ordered by the court in this case.

With regards to the Novell litigation on July 29th, Novell submitted an answer and counterclaim asserting various defenses and claims which, again, were not totally unexpected, given Novell's curious behavior over the last couple of years. We believe we have very good defenses to all of their claims and look forward to commencing discovery in that case. We will file our response to Novell's answer and counterclaims in mid-September. We continue to believe, as do people directly involved in the 1995 transaction, that the Santa Cruz operation purchased the entire UNIX business, including copyrights, from Novell.

To summarize the status of our legal cases, we remain confident of our claims and our legal team, and look forward to a successful conclusion to the litigation so we can focus on our business initiatives.

Finally, before we go to Q&A, I would like to take a moment to acknowledge the tragedy of Hurricane Katrina in the Gulf Coast. Given what has happened down there, it makes things like earnings calls seem fairly trivial. We at SCO want to try to do our part

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to help. We have done a zip-code-by-zip-code analysis and placed and received calls from our partners and customers to determine who has been affected and how we can help them. We are doing everything we can to help them get back online by donating and replacing SCO software. We are hopeful that this will help rebuild the infrastructure and restore the day-to-day operations as quickly as possible.

At this time, we're assisting one of our largest customers, CVS Pharmacies, who runs more than 5,000 pharmacy locations. CVS is deploying 30 mobile pharmacy units throughout the affected Gulf Coast areas to assist thousands of individuals in obtaining the prescriptions and medical supplies they need. SCO has donated our UnixWare software to help CVS run these mobile pharmacy units, the first of which was set up outside the Astrodome in Houston, Texas five days ago. UnixWare is also helping CVS's Baton Rouge stores operate around the clock to handle the extra needs of displaced individuals. We wish everyone affected by this tragedy a speedy recovery.

With that, I will now turn to call over to the operator to open up the phone lines for questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Steven Vaughan-Nichols, Ziff-Davis Internet.

Steven Vaughan-Nichols - Ziff-Davis Internet - Analyst

My question today is about OpenServer 6. I know I liked it, and certainly the last time I talked to your resellers, they liked it. What sort of results, though, have you seen at this very early-stage of its rollout, as far as actual commercial success? Or basically, how is it doing so far, in terms of the market?

Darl McBride - The SCO Group - President, CEO

We had it available for a few weeks of this quarter, and we did see some initial traction. I think the majority of the resellers saw this for the first time at the SCO Forum event, which started in Q4. The feedback there was very positive. I roamed around and chatted with some of the resellers. In fact, we had an upgrade class focused on going to OpenServer 6, and it was practically unanimous, in terms of people in that class saying they were interested in upgrading.

In terms of how long that will take, what the tractions will be, it's a little bit early to tell. We're very encouraged about the support we have gotten from industry partners, the support we have received from hardware and software. The MySQL announcement is a great indicator of companies that have very broad footprints that are coming out to support this -- HP, CA, et cetera. There's been a number of great partnerships there. I believe that -- I guess the other proof point there, there was one customer that I talked to who had basically gone through, looked at it, said this thing is awesome, went in and basically tore out a 250-server implementation of Red Hat and put in OpenServer to replace it.

So we're encouraged that some of the early signs are there. What we don't know is probably what you're actually asking for, which is how fast the uptake, how quickly will it come? What I can tell you is in the absence of OpenServer 6, it would be a much different situation right now. We wouldn't see people putting in OpenServer to take out Red Hat. We wouldn't see -- even though the incremental sales right now is creeping up, we are very encouraged that we're heading in the right direction.

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Operator

Al Petrosky (ph), Private Investor.

Al Petrosky - Private Investor - Analyst

I just had a quick question for Bert, and then a question for Darl. On the operating loss of 2,242, do you have the two segment numbers for that, the UNIX and SCOsource?

Bert Young - The SCO Group - CFO

Well, we normally don't do the segment reporting on the call. It will come out in the Q. But we did lay out -- in my comments, we mentioned what the UNIX one is. You can probably back into the other. But UNIX revenue was 9.3 million, gross margin 2.9 and operating was 6.9. So you can see what the UNIX business threw off, then, and the loss, obviously, in the legal side.

Al Petrosky - Private Investor - Analyst

And then, I wanted to ask about this Cymphonix product that you are partnering on now. Do you know about how many of those have been shipped to your resellers at this point?

Darl McBride - The SCO Group - President, CEO

I don't know the exact number on that. There's definitely been some interest in it. I know another success story at SCO Forum is that a number of resellers that went to the session there that saw it were very interested in the product. It's a performance bandwidth management tool, sits on the edge of the network. And the interest level there seemed to be good, but I don't have the exact numbers on that. We did definitely have some sales of that in Q3, but again, the majority of the resellers didn't see it until the beginning of Q4.

Al Petrosky - Private Investor - Analyst

And did those devices each have Linux on them? Is that right?

Darl McBride - The SCO Group - President, CEO

The agreement with them was basically to put together -- put Cymphonix running on OpenServer 6, and the work is going on right now. So they are basically going through a port to have that running out there as we speak. So that's situation of that.

Al Petrosky - Private Investor - Analyst

And when somebody buys one of these devices, they get a box that plugs into their network?

Darl McBride - The SCO Group - President, CEO

Yes.

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AI Petrosky - Private Investor - Analyst

And they get some software that runs on their desktop to monitor it?

Darl McBride - The SCO Group - President, CEO

Sure.

AI Petrosky - Private Investor - Analyst

And so, are you talking about porting the desktop software to OpenServer, or the devices are going to become Linux 3, as well?

Darl McBride - The SCO Group - President, CEO

We're talking about the device itself. The appliance itself will actually be powered by OpenServer. You are bringing up a good question. The way it's working in the short-term, AI, until we get this device ported over to OpenServer, is there is an IP agreement that's part of the deal that goes into the customer environment. So until we have the OpenServer port done, we basically deal with the Linux issue with an IP agreement that's separate from the actual product sale.

AI Petrosky - Private Investor - Analyst

In the SCOSource information on your website, you had said that Linux has this unholy combination of SCO IP and Linux and GPL code, which makes it illegal for anyone to distribute. And that's why you have only offered licenses to end users who already have copies. So how is it that you have -- you've said that you can't offer a license that would allow people to make new copies of Linux, even in-house. So how have you been partnering with somebody who has been shipping out Linux on devices?

Darl McBride - The SCO Group - President, CEO

I'm trying to figure out exactly where that's coming from. We have basically said, from our SCOSource licensing perspective, we have put a plan in place where, when we are working with a partner of this nature, we have an IP agreement where this basically is the customer or partner that's out there moving these boxes, the covers that we do, they need to have the protection on the IP side.

Operator

Robert Silver (ph), Private Investor.

Robert Silver - Private Investor - Analyst

My question to you relates to the OpenServer 6. You've only had it on the market for six weeks. What are your expectancies as forward-looking for the next quarter, as an estimate as to what the gross sales would be with the OpenServer and related software?

Darl McBride - The SCO Group - President, CEO

It's a little bit premature right now to predict what the sales are going to be. Again, when we look forward, we don't typically give guidance on these kind of numbers. What we have said from a guidance perspective, and we'll reiterate it, is we expect to

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continue to be profitable with our UNIX business operations. What I can absolutely guarantee you is that if we didn't have an OpenServer 6 right now, that would be a hard statement to make. So we see some customers that are continuing on various versions of 5, others that are in test mode, others that are in the process of upgrading to 6. I'd love to be able to give some guidance on this, in terms of what the uptake on that is going to be.

Robert Silver - *Private Investor - Analyst*

As a follow-up, how many units were sold in the quarter?

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

We don't have those broken out.

Bert Young - *The SCO Group - CFO*

Well, we don't give that kind of information out.

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

We don't break those out; it's just part of our regular communications.

Robert Silver - *Private Investor - Analyst*

As a final question, but for your legal fees, would you have been profitable for the quarter?

Bert Young - *The SCO Group - CFO*

Well, certainly.

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

Yes, absolutely.

Bert Young - *The SCO Group - CFO*

Yes. You know, we lost \$2.3 million. That includes a payment of \$2 million for the law firms.

Robert Silver - *Private Investor - Analyst*

All right, so that's very encouraging. When you make your final two payments, then you are going to be free from attorney fees until the trial?

Bert Young - *The SCO Group - CFO*

That's going to be a big chunk of expenses that are not going to be here.

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

We're going to have continue to have some money that's tied to our escrow payments that go to paying for experts and the document production and whatnot. So there's still some addition beyond the 2 million, but there's no doubt that having those 2 million quarterly payments drop off will be a big boost to our quarterly numbers.

Operator

(OPERATOR INSTRUCTIONS). Maureen O'Gara, Client Server News.

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

You said you signed deals for this new widgetry that you're going to be showing at DEMO?

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

Yes.

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

Did that bring in revenues?

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

The deals that were signed were in Q4. The way this played out is at the beginning of this fiscal year, we had a very strong initiative to get new innovations going on just around OpenServer 6. We did deliver on OpenServer 6, and obviously the reviews are in on that. But we had this new initiative that we have been talking about for a little bit now, around this wireless mobile environment out there and how you have a platform interoperate with handset devices. We initially rolled this out to some partners under a preview session in June. Some of those partners got very enthused about it. They got on board, and it's really starting to take off with this. So again, we haven't gotten to an announcement date yet, but what I can tell you is virtually everybody that sees this loves it. It has very broad-based application opportunities beyond our current base. It absolutely will provide a lot of value to our current base, and it will allow us to go in some new growth directions, as well. So we are pretty bullish, and I think as we get to the 21st, we will roll this out, and everybody will get to see what we're talking about.

But the fact that we have been working on this for over a year and then sometime before that with one of the acquisitions that we did -- we have been able to put together a product that has a lot of the SCO historical legacy trademark values, if you will, the security, reliability and the speed of next-generation communications. And we think the world in the next generation is going to be communicating a whole lot more through the air than through the wires.

Operator

Al Petrosky, Private Investor.



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Al Petrosky - Private Investor - Analyst

I had another financial question for Bert. On the S-1 you filed in July, you said that the stock rescission offer would cost \$700,000 if everybody accepted. I see now you have got the liability jumped up to 1.1 million. What's going on with that?

Bert Young - The SCO Group - CFO

Well, so, what that number is measuring, Al, is if we had to give everybody back their money based on the stock sales that they have made -- and this is primarily our employee stock purchase plan -- that that would be the total number. And the number went up because we did an ESPP purchase in May. So that's why the number went up. But the amount of cash that we think will actually go out, based on people accepting our rescission offer, will be quite a bit less than that; it will be a fraction of that.

So on the financials, we show a total liability obligation if we had to give everyone their money back. If you have read the S-1, we will make an offer to those employees, and some may take us up on it, and some may not. If someone bought shares at \$1 a share and they are now worth 4 in the market, I don't know why they would take our offer to buy back at a buck. See what I mean?

Al Petrosky - Private Investor - Analyst

And then, do you think that you will be paying out the cash during Q4 or Q1?

Bert Young - The SCO Group - CFO

That's a tough call. It will be four or one. We have heard from the SEC; we're in discussions with them to finalize the S-1. Once it's finalized, then we will make the offer, which will be a 30-day offer. Our hope is to get that finished this quarter, quarter four, that we're in. If we just don't go fast enough with the SEC, it may fall over into quarter one. But I'm sure by the time we report quarter four, we will probably be able to give a read on what acceptance there was and what cash impact there will be. That will be an event we will differently want to get the news out to everyone on.

Operator

And that's all the time we have for questions. I will turn the conference back over to Mr. McBride for any additional or closing remarks.

Darl McBride - The SCO Group - President, CEO

So, in summary, during Q3 we remained focused on innovating in the marketplace with our UNIX business, with the launch of OpenServer 6, and allowed our legal teams to continue protecting our intellectual property by moving our litigation efforts forward. The company's UNIX business is continuing to generate solid cash flow. Legal fees are in line with expectations, and we have been solid progress with regard to our litigation efforts, and are looking forward to having our cases heard.

That's all we have for today. Thanks again for joining the call, and we will look forward to speaking with you soon.

Operator

That does conclude today's SCO Group's third quarter 2005 earnings conference call. You may disconnect at this time. We do appreciate your participation.

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