SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2002

OR

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

For the transition period from ____________ to ______________

0-16096
(Commission File Number)

Borland Software Corporation

(Exact Name of Registrant as Specified in its Charter)

Delaware	**94-2895440**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

100 ENTERPRISE WAY
SCOTTS VALLEY, CALIFORNIA
95066-3249
(Address of Principal Executive Offices) (Zip Code)

Registrant’s Telephone Number, Including Area Code: **(831) 431-1000**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. **YES** ☒ **NO** ☐

The number of shares of common stock issued and outstanding as of April 30, 2002, the most recent practicable date prior to the filing of this report, was 70,483,561.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

BORLAND SOFTWARE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value and share amounts)

	March 31, 2002 (unaudited)	December 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 237,979	$ 280,467
Short-term investments	58,218	13,903
Accounts receivable, net	41,040	38,405
Other current assets	14,150	14,348
Total current assets	351,387	347,123
Property and equipment, net	18,502	18,994
Other non-current assets	11,631	9,706
	$ 381,520	$ 375,823
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 44,786	$ 47,080
Income taxes payable	7,188	8,915
Deferred revenues	25,247	23,859
Other current liabilities	9,512	8,715
Total current liabilities	86,733	88,569
Long-term liabilities	10,471	10,469
	97,204	99,038
Stockholders' equity:		
Preferred stock: $.01 par value; 1,000,000 shares authorized; 115 shares issued and outstanding	—	—
Common stock: $.01 par value; 200,000,000 shares authorized; 70,426,225 and 68,028,526 shares issued and outstanding	704	680
Additional paid-in capital	492,156	488,744
Accumulated deficit	(182,415)	(187,012)
Deferred compensation	(1,005)	(1,123)
Cumulative comprehensive income	3,067	3,687
Less common stock in treasury, at cost – 4,835,900 shares	(28,191)	(28,191)
	284,316	276,785
Total liabilities and stockholders' equity	$ 381,520	$ 375,823

See Notes to the Condensed Consolidated Financial Statements.

BORLAND SOFTWARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts, unaudited)

	Three Months Ended March 31,	
	2002	**2001**
Licenses and other revenues	$ 47,668	$ 42,407
Service revenues	9,409	9,289
Net revenues	57,077	51,696
Cost of licenses and other revenues	3,520	2,981
Cost of service revenues	5,035	5,031
Cost of revenues	8,555	8,012
Gross profit	48,522	43,684
Research and development	11,949	11,058
Sales, general and administrative	31,033	28,346
Amortization of intangibles and merger-related expenses	1,522	412
Total operating expenses	44,504	39,816
Operating income	4,018	3,868
Interest income, net and other	1,730	3,448
Income before income taxes	5,748	7,316
Income tax provision	1,151	1,463
Net income	$ 4,597	$ 5,853
Net income per share:		
Basic	$ 0.07	$ 0.09
Diluted	$ 0.06	$ 0.08
Weighted average number of common shares outstanding:		
Basic	70,188	61,863
Diluted	76,040	71,890

See Notes to the Condensed Consolidated Financial Statements.

BORLAND SOFTWARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands, unaudited)

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
Net income	$ 4,597	$ 5,853
Other comprehensive income (loss):		
Foreign currency translation adjustments	(387)	(879)
Fair market value adjustment for available for sale securities	(233)	24
Comprehensive income	$ 3,977	$ 4,998

See Notes to the Condensed Consolidated Financial Statements.

BORLAND SOFTWARE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, unaudited)

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 4,597	$ 5,853
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,642	2,053
Loss on sale of property and equipment	—	8
CHANGES IN ASSETS AND LIABILITIES:		
Accounts receivable	(2,913)	(637)
Other assets	479	147
Accounts payable and accrued expenses	(2,233)	(4,075)
Income taxes payable	(2,230)	487
Other	2,554	(787)
Cash provided by operating activities	1,896	3,049
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(836)	(1,989)
Acquisition of Redline Software, Inc. (VMGEAR)	(2,193)	—
Purchases of short-term investments	(55,426)	(11,436)
Sales and maturities of short-term investments	11,111	41,667
Cash provided by (used in) investing activities	(47,344)	28,242
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net	3,431	1,502
Repayment of capital lease obligations and other debt activity	—	(48)
Cash provided by financing activities	3,431	1,454
Effect of exchange rate changes on cash	(471)	(965)
Net change in cash and cash equivalents	(42,488)	31,780
Cash and cash equivalents at beginning of period	280,467	216,634
Cash and cash equivalents at end of period	$ 237,979	$ 248,414

See Notes to the Condensed Consolidated Financial Statements.

BORLAND SOFTWARE CORPORATION

Notes to Condensed Consolidated Financial Statements (unaudited)

NOTE 1—BASIS OF PRESENTATION

The accompanying Borland Software Corporation ("Borland") condensed consolidated financial statements at March 31, 2002 and December 31, 2001 and for the three months ended March 31, 2002 and 2001 are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all financial information and disclosures required by generally accepted accounting principles for complete financial statements and certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly Borland's financial position at March 31, 2002 and December 31, 2001, and its results of operations and cash flows for the three months ended March 31, 2002 and 2001. The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The results of operations for interim periods are not necessarily indicative of the results to be expected for any subsequent quarter or for the full year. The condensed consolidated financial statements and notes should be read in conjunction with our audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2001 as filed with the Securities and Exchange Commission (the "SEC") on March 29, 2002.

NOTE 2—NET INCOME PER SHARE

We compute net income per share in accordance with Statement of Financial Accounting Standards "Earnings per Share" ("FAS No. 128"). Under the provisions of SFAS No. 128, basic net income per share is computed by dividing the net income available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and potentially diluted shares outstanding during the period. Potentially diluted shares, which consist of incremental shares issuable upon exercise of stock options and warrants and upon conversion of the issued and outstanding shares of Series C Convertible Preferred Stock, are included in diluted net income per share to the extent such shares are dilutive.

The following table sets forth the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended March 31, 2002	2001
Numerator:		
Net income before accretion charges	$ 4,597	$ 5,853
Accretion charges to preferred stock	—	219
Income available to common stockholders for basic earnings per share	$ 4,597	$ 5,634
Denominator:		
Denominator for basic income per share - weighted average shares	70,188	61,863
Effect of dilutive securities	5,852	10,027
Denominator for dilutive income per share	76,040	71,890
Net income per share – basic	$ 0.07	$ 0.09
Net income per share – diluted	$ 0.06	$ 0.08

The diluted earnings per share calculation for the three months ended March 31, 2002 and 2001 excludes approximately 3.0 million and 2.1 million options, respectively, because their effect would have been antidilutive.

NOTE 3—RESTRUCTURING

The following table summarizes our restructuring activity for the three months ended March 31, 2002 (in thousands):

	Severance and Benefits	Facilities	Other	Total
Accrual at December 31, 2001	$ 329	$ 279	$ 293	$ 901
Additions	4	468	—	472
Cash payments	(229)	(90)	(13)	(332)
Accrual at March 31, 2002	$ 104	$ 657	$ 280	$ 1,041

During the three months ended March 31, 2002, we recorded a provision of approximately $0.5 million associated to leases in the United States and United Kingdom that are currently not in use. We have recorded a restructure reserve associated to certain leases in the United Kingdom in the amount of $2.4 million as of March 31, 2002 and December 31, 2001. This amount represents the excess of our contractual obligation over the minimum income under the current sublease arrangement. Due to the timing of the contractual payments, this amount has been included in other long-term liabilities. Subsequent to March 31, 2002, there have not been any significant changes to our estimate of the total costs of prior restructuring activities.

NOTE 4—ACQUISITION OF REDLINE SOFTWARE, INC. (VMGEAR)

On January 18, 2002, we completed our acquisition of Redline Software, Inc. ("Redline"), a privately held software firm located in San Jose, California. Redline develops and markets performance assurance and testing solutions for Java developers. The transaction was accounted for as a purchase. Total fixed consideration of $2.0 million was paid upon the close of the transaction and acquisition-related costs were $0.2 million. The contingent consideration includes retention payments of $6.0 million to be earned through the continued employment of certain individuals and additional earnout payments contingent upon future revenues derived from the sale of Redline products and the retention of certain employees of Redline. Contingent consideration , if any, will be earned and paid over a three-year period. We recorded goodwill for the excess of the purchase price over the net assets acquired of $1.6 million and $0.6 million for acquired technology which will be amortized over the estimated useful life of 18 months. In accordance with the provision of Statement of Accounting Statements No. 142, "Goodwill and Other Intangibles," we did not amortize the excess of the purchase price over net assets acquired during the three months ended March 31, 2002. The contingent consideration will be expensed when it is deemed probable that such payments will be made.

NOTE 5—RECENT ACCOUNTING PRONOUNCEMENTS

In November 2001, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue 01-09, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products" ("EITF 01-09"), which is a codification of EITF 00-14, 00-22 and 00-25. This issue presumes that consideration from a vendor to a customer or reseller of the vendor's products to be a reduction of the selling prices of the vendor's products, unless the consideration relates to a separate identifiable benefit and the benefit's fair value can be established. During the three months ended March 31, 2002, we adopted the provisions of EITF 01-09. The adoption of this pronouncement did not have a material impact to our financial position or results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after March 15, 2001. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. The adoption of this pronouncement did not have a material impact to our financial position or results of operations for the quarter ended March 31, 2002.

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

The statements made throughout this Quarterly Report on Form 10-Q that are not historical facts are forward-looking statements and, accordingly, involve estimates, projections, goals, forecasts, assumptions and uncertainties that could cause actual results or outcomes to differ materially from those expressed or implied in the forward-looking statements.

These forward-looking statements may relate to, but are not limited to, future capital expenditures, acquisitions, future revenues, earnings, margins, costs, demand for our products, market and technological trends in the software industry, interest rates and inflation and various economic and business trends. You can generally identify forward-looking statements by the use of words such as "expect," "estimate," "project," "budget," "forecast," "anticipate," "intend," "plan," "may," "will," "could," "should," "believes," "predicts," "potential," "continue" and similar expressions or the negative or other variations thereof. These forward-looking statements involve substantial risks and uncertainties. Examples of such risks and uncertainties are described under "Factors That May Affect Future Results and Market Price of Stock" and elsewhere in this report, as well as in our other filings with the Securities and Exchange Commission or in materials incorporated by reference. You should be aware that the occurrence of any of these risks and uncertainties may cause our actual results to differ materially from those anticipated in our forward-looking statements, which could have a material and adverse effect on our business, results of operations and financial condition. New factors may emerge from time to time, and it is not possible for us to predict new factors, nor can we assess the potential effect of any new factors on us.

These forward-looking statements are found at various places throughout this Form 10-Q. We caution you not to place undue reliance on these forward-looking statements, which unless otherwise indicated, speak only as of the date they were made. We do not undertake any obligation to update or release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this Form 10-Q.

We were incorporated in California in 1983 and reincorporated in Delaware in 1989. We maintain our executive offices at 100 Enterprise Way, Scotts Valley, California 95066-3249, and our main telephone number at that location is 831-431-1000. We also maintain a Web site on the Internet at www.borland.com and a community site at http://community.borland.com.

All Borland brand and product names are trademarks or registered trademarks of Borland Software Corporation, in the United States and other countries. This Form 10-Q also contains additional trade names, trademarks and service marks of other companies. We do not intend our use or display of other parties' trademarks, trade names or service marks to imply a relationship with, or endorsement or sponsorship of, us by these other parties.

Overview

As a leading global provider of technology for the rapid and effective development, deployment, integration and management of software applications, we enable enterprises to realize the profitability-enhancing potential of innovation. By delivering comprehensive best-in-class technology solutions dedicated to interoperability, we allow enterprises of all sizes to move into Web-based computing while leveraging their legacy systems. From Fortune 1000 companies to the millions of individual developers known as the "Borland Nation," we provide our customers the freedom to develop applications, deploy them on most major platforms, and integrate and manage them across the enterprise. Our solutions, including those for the high potential growth areas of Java, Linux, Web Services and wireless technologies, are designed to enable organizations to increase productivity and deliver higher performance projects faster and on budget, while lowering total cost of ownership.

Our loyal customers are enterprises of many sizes, including individual developers which comprise the Borland Nation, small independent software and services firms, as well as prominent companies worldwide, including leading companies in high technology, telecommunications and financial services. Many of our customers use Borland technology so that they themselves can create and ship software and system products conforming to high performance specifications. Our principal technology partners include leading technology companies such as Apple, Ericsson, Hitachi, IBM, Intel, Macromedia, Microsoft, Nokia, Rational, Red Hat, Siemens, Sun Microsystems and Sybase.

The key strengths and benefits of our products and services include:

- *Comprehensive Solution.* With products and services for the various dimensions of the software application lifecycle—development, deployment, integration and management—we give customers the ability to implement applications critical to their businesses rapidly and effectively, as well as access to one vendor to resolve issues across underlying technologies.
- *Best-in-Class and Performance Leadership.* When a Borland product is installed, we believe it provides for a user experience that is as good or better than anything available in the marketplace. Our products have won numerous awards and maintain a large and dedicated following of users.
- *Freedom of Choice.* Borland products eliminate "lock-in," which is prevalent with solutions from major system vendors. Borland products do not promote one software platform over another; they simply enable all major technology platforms for productive implementation. One key reason our products eliminate "lock-in" is that we provide interoperability between competing technologies.
- *Standards-Based.* We aggressively adopt standards whenever possible. As a result, Borland products are standards-based when standards exist or are emerging. Standards promote interoperability and mass adoption of technologies.
- *Simplicity and Control.* Borland products simplify the process of developing and deploying applications, improving efficiency and productivity and speeding time to market.
- *Low Cost of Ownership.* Borland products lower cost of ownership because they promote productivity and reduce computing infrastructure investment wherever possible. We also accomplish this with small foot-print, highly optimized products.

Our goal is to extend our leadership position to become the dominant provider of technology solutions for the rapid and effective implementation of software applications, particularly in areas such as Java and J2EE, .NET, Web Services, Linux and wireless and mobile computing. Key elements of our strategy to achieve this goal include:

- Widening our lead in Java products;
- Promoting platform independence and interoperability, including through Web Services;
- Leveraging our strategic alliances and technology partnerships, including in growing areas such as wireless and mobile application development;
- Targeting large enterprises with our comprehensive application lifecycle management solutions;
- Focusing on the needs of our installed base, e.g., the "Borland Nation;"
- Capitalizing on the strength of the "Borland" brand, with new product and service offerings and through international expansion; and
- Undertaking selective strategic acquisitions, including those that extend the breadth of our application lifecycle management solutions.

To achieve this goal, we now offer leading products and services for addressing various dimensions of the software implementation process—development, deployment, integration and management. Innovation, quality, performance, ease of use and interoperability are the hallmarks of our products. Our products provide key pieces necessary for enterprises to implement applications critical to their business rapidly and effectively. For the development phase, we offer our JBuilder, Delphi, Kylix and C++Builder integrated development environments ("IDEs"), as well as our hosted TeamSource DSP service. Our deployment and integration products include our Borland Enterprise Server line of application servers, including Borland Enterprise Server, AppServer Edition for high end EJB deployments, VisiBroker Edition to facilitate legacy integration and our recently introduced Web Edition for JavaServer Pages (JSP)/Servlet-based application deployments. Our deployment products also include JDataStore, an embedded database for web and mobile applications, and InterBase, our high-performance embedded SQL database. To manage applications, we offer Borland AppCenter, a visual distributed application management solution.

We also provide expert training, consulting and support services through our dedicated professional services organization. In addition, we provide service and support for software developers worldwide through an online developer community and an e-commerce site, http://community.borland.com, which offers a range of technical information, value-added services and third-party products.

Our focused efforts in sales and marketing include a sales model that combines strong indirect and direct sales efforts. We also pay particular attention to our research and development activities.

For a more in-depth discussion of our business, including a discussion of our critical accounting policies and estimates, please read our Annual Report on Form 10-K as filed with the SEC on March 29, 2002.

Results of Operations for the Three Months Ended March 31, 2001 and 2002

Revenues

Our revenues are derived from software licenses and sales of its related services, which include assistance in implementation and integration, and post-contract customer support, training and consulting services. Net revenues were $57.1 million and $51.7 million for the three months ended March 31, 2002 and 2001, respectively. The growth in net revenues was principally attributable to the increase in net revenues from our Java and RAD businesses. The Java and RAD businesses grew 40% and 19%, respectively, during the three months ended March 31, 2002 when compared with the three months ended March 31, 2001. The growth in our Java and RAD businesses was offset by a decline in our Enterprise business. Our Enterprise business declined 25% during the three months ended March 31, 2002 when compared with the three months ended March 31, 2001.

Licenses and Other Revenues

Licenses and other revenues represent amounts earned from granting customers licenses to use our software products. Licenses and other revenues totaled $47.7 million for the three months ended March 31, 2002, compared to $42.4 million from the same quarter a year ago. License and other revenues were 84% and 82% of total net revenues for the three months ended March 31, 2002 and 2001, respectively. Licenses and other revenues from our Java, RAD, and Enterprise businesses represented, 45%, 31%, and 24%, respectively, of total license and other revenues for the three months ended March 31, 2002. This is compared to 36%, 30%, and 34%, respectively, for the three months ended March 31, 2001. Licenses and other revenues during the three months ended March 31, 2002 were favorably affected by the continued strong demand for our Java products. Licenses and other revenue from our Java business, which includes JBuilder, Borland Enterprise Studio for Java and Optimizeit product lines, grew 40% over the same quarter a year ago. Licenses and other revenues from our RAD business, which includes the Borland Delphi, C++Builder and Kylix product lines, increased 19% from the same quarter in 2001. Licenses and other revenues from our Enterprise business, including VisiBroker, Borland AppServer and Borland AppCenter product lines, decreased by 25% over the same quarter a year ago.

License and other revenues from our Java business were favorably affected by the continued success of JBuilder 6.0 released during the three months ended December 31, 2001 and by the initial release of our Optimizeit product during the three months ended March 31, 2002. License and other revenues from our RAD business were favorably affected by the release of C++ Builder 6.0 during the three months ended March 31, 2002. The revenue growth in this product is reflective of the upgrade purchases by our customers upon the new version release. Consistent with historical trends, we expect that the upgrade activity will decrease in the quarters subsequent to the general release. Licenses and other revenues from our Enterprise business were negatively impacted by lower demand from our Original Equipment Manufacturers, or OEM, customers. We believe that this behavior is due to concerns about the current economic climate, particularly in the United States. Continued concerns around the United States and world economy could impact the buying patterns of our OEM customers and impact our Enterprise business.

Service Revenues

Service revenues represent amounts earned from customer support, training and consulting services related to our software products. Service revenues increased to $9.4 million for the three months ended March 31, 2002, compared to $9.3 million for the three months ended March 31, 2001. Service revenues were 16% and 18% of total net revenues for the three months ended March 31, 2002 and 2001, respectively. Technical support revenues represented 68% and 59% of the total service revenues for the three months ended March 31, 2002 and 2001, respectively, while consulting and training revenues represented 32% and 41% of the total service revenues for the same periods, respectively. The growth of our technical support revenues is due to the increase in number of enterprise-level support contracts and we expect this trend to continue should we have success licensing software to a larger number of enterprise customers. Consulting and training revenues have been negatively impacted by the lower demand for such services. We believe such behavior is due to customers concerns about the current economic climate and their efforts to manage controllable costs. Continued concerns around the United States and world economy could impact the demand for such services.

International Net Revenues

International net revenues represented 62% of our total net revenues for the three months ended March 31, 2002 compared to 56% for the three months ended March 31, 2001. The increase in the percentage of non-U.S. net revenues for the three months ended March 31, 2002, as compared to the three months ended March 31, 2001 was principally due to the growing adoption of the Java language in Europe and the Asia/Pacific region and the decline in our Enterprise business in the U.S. due to the downturn in the U.S. economy. We expect non-U.S. revenues to continue to be a significant percentage of total net revenues in future periods.

Fluctuations in foreign currency exchange rates did not have a material impact on our total net revenues or operating results for the three months ended March 31, 2002. However, our non-U.S. revenues would be adversely affected if the U.S. dollar were to strengthen against major foreign currencies including Japanese Yen, United Kingdom Pound Sterling and the Euro.

The following table presents our total revenues by region:

	Three Months Ended March 31, 2002	2001
Americas	$ 25,800	$ 25,741
Europe, Middle East and Africa ("EMEA")	20,059	18,205
Asia Pacific	11,218	7,751
Net revenues	$ 57,077	$ 51,696

Amounts reported for our Americas region represent revenues generated from our operations located in the United States, Canada and Brazil. Amounts reported for our EMEA region represent revenues generated from our operations located in the Netherlands, Germany, France, United Kingdom, Sweden, Italy, Russia and Spain. Amounts reported for our Asia Pacific region represent revenues generated from our operations located in Singapore, Japan, South Korea, Hong Kong, Taiwan, Australia, New Zealand, China and India.

Cost of Revenues

Cost of Licenses and Other Revenues

Cost of licenses and other revenues consist primarily of production costs, product packaging, and royalties paid to third-party vendors. Cost of licenses and other revenues were $3.5 million and $3.0 million for the three months ended March 31, 2002 and 2001, respectively. The increase in cost of licenses and other revenues for the three months ended March 31, 2002 when compared with the three months ended March 31, 2001 was due to an increase in royalty costs payable to third-party vendors. The level of royalty costs in future quarters will be dependent upon our success in licensing our products that include third party technology.

Cost of Service Revenues

Cost of service revenues consists primarily of salaries and benefits, third-party contractor costs, and related expenses incurred in providing customer support, consulting and training. Cost of service revenues was $5.0 million for the three months ended March 31, 2002 and 2001. Cost of technical support revenues represented 30% and 25% of the total cost of service revenues for the three months ended March 31, 2002 and 2001, respectively, while cost of consulting and training revenues represented 70% and 75% of the cost of service revenues for the same periods, respectively. The increase in cost of technical support revenues for the three months ended March 31, 2002 when compared the three months ended March 31, 2001 is due to additional headcount and other resources deployed to manage the higher support activity. The lower cost of consulting and training during the three months ended March 31, 2002 when compared with the same quarter a year ago was due to a reduction in headcount and other resources due to fewer consulting and training engagements.

Gross Margins

Gross margins were 85% for the three months ended March 31, 2002 and 2001, respectively. Gross margins on license and other revenues were 93% for the three months ended March 31, 2002 and 2001, respectively. Gross margins from service revenues were 46% for the three months ended March 31, 2002 and 2001, respectively. While we would expect our total gross margins to remain consistent with these levels, the future gross margins will be a function of our future net revenues, the level of third-party royalty-bearing technology sold with our product offerings, our ability to control our manufacturing costs and our utilization of our professional services group.

Operating Expenses

Research and Development

Research and development (“R&D”) expenses consist primarily of salaries and other personnel-related expenses, facilities costs and fees and expenses of third-party consultants. R&D expenses were 21% of revenues for each of the three months ended March 31, 2002 and 2001. R&D expenses for the three months ended March 31, 2002 increased to $11.9 million from $11.1 million for the three months ended March 31, 2001. The increase in R&D expenses for the three months ended March 31, 2002 when compared with the three months ended March 31, 2001 was due to additional employee related expenses. While we expect total dollars spent on R&D to increase in 2002 when compared with 2001, we expect our R&D expenses to remain relatively consistent as a percentage of net revenues.

Sales, General and Administrative

Sales, general and administrative (“SG&A”) expenses consist primarily of salaries, benefits, sales commissions, the cost of product marketing programs, and facility and information system costs. SG&A expenses increased by 9% this quarter compared to the same quarter of last year but decreased as a percentage of total revenues to 54% from 55% for the three months ended March 31, 2002 and 2001, respectively. The increase in total dollars was principally due to increased employee costs due to increased headcount in our direct sales force and strategic marketing organizations. We expect the future expansion of our sales and marketing organizations to be dependent on our ability to generate future meaningful revenue growth. To the extent net revenues from our direct sales channel increase, we expect our SG&A expenses to increase as a result of variable compensation from our sale incentive plans related to levels of direct sales.

Restructuring Charges

The following table summarizes our restructuring activity for the three months ended March 31, 2002 (in thousands):

	Severance and Benefits	Facilities	Other	Total
Accrual at December 31, 2001	$ 329	$ 279	$ 293	$ 901
Additions	4	468	—	472
Cash payments	(229)	(90)	(13)	(332)
Accrual at March 31, 2002	$ 104	$ 657	$ 280	$ 1,041

During the three months ended March 31, 2002, we recorded a provision of approximately $0.5 million associated to leases in the United States and United Kingdom that are currently not in use. We have recorded a restructure reserve associated to certain leases in the United Kingdom in the amount of $2.4 million as of March 31, 2002 and December 31, 2001. This amount represents the excess of our contractual obligation over the minimum income under the current sublease arrangement. Due to the timing of the contractual payments, this amount has been included in other long-term liabilities. Subsequent to March 31, 2002, there have not been any significant changes to our estimate of the total costs of prior restructuring activities.

Interest Income, Net and Other

Interest income, net and other decreased from $3.4 million during the three months ended March 31, 2001 to $1.7 million during the three months ended March 31, 2002. The decline in interest income, net and other for the three months ended March 31, 2002 when compared with the three months ended March 31, 2001 principally reflects the decrease in interest income of $2.0 million, despite higher cash balances, due to a decline in prevailing interest rates. Changes in interest rates will continue to impact our interest income performance in future periods.

Income Taxes

For the three months ended March 31, 2002 and 2001, we generated pretax profits of $5.7 million and $7.3 million, respectively. Our effective tax rate was 20% for these same periods. We have significant net operating loss and tax credit carryforwards in the U.S. and a number of non-U.S. jurisdictions in which we conduct business. These loss and credit carryforwards are used to offset our tax liability as allowed by law. In addition, we incur withholding taxes in a number of non-U.S. jurisdictions that are imposed regardless of the profitability of Borland in that jurisdiction. Similar to the 2001 calendar year, we anticipate our tax provision for 2002 to be comprised principally of non-U.S. income taxes and non-U.S. withholding taxes. Our effective tax rate,which is dependent on the amount and location of our taxable profits, ability to utilize our net operating loss and credit carryforwards in certain jursdictions, and the amount of our non-U.S. withholding taxes which are imposed regardless of our profitability, is currently expected to be 20% for 2002.

Liquidity and Capital Resources

As of March 31, 2002, cash, cash equivalents and short-term investments totaled $296.2 million; an increase of $1.8 million from $294.4 million at December 31, 2001. Working capital increased from $258.6 million at December 31, 2001 to $264.7 million at March 31, 2002.

Cash provided by operating activities for the three months ended March 31, 2002 was $1.9 million, consisting of $4.6 million in net income and $1.6 million in depreciation and amortization offset by an increase in non-cash working capital of $4.3 million. Cash provided by operating activities during the three months ended March 31, 2001 was $3.1 million, consisting of $5.9 million in net income and $2.1 million in depreciation and amortization offset by an increase in non-cash working capital of $4.9 million.

Cash used in investing activities for the three months ended March 31, 2002 included $2.2 million used for the acquisition of Redline discussed in Note 4 above and $0.8 million in cash used for the purchase of property and equipment. Cash used in investing activities for the three months ended March 31, 2001 included $2.0 million for the purchase of property and equipment.

Cash provided by financing activity was $3.4 million and $1.5 million for the three months ended March 31, 2002 and 2001, respectively, and principally consisted of proceeds from the issuance of common stock to employees under our Employee Stock Option and Stock Purchase Plans.

Currency fluctuations did not have a significant impact on our cash position during the three months ended March 31, 2002. Although we partially hedge our foreign currency exchange rate risk, strengthening of the U.S. dollar against the Euro, United Kingdom Pound Sterling, Australian and Singapore dollars and Japanese Yen would harm our business. We cannot predict currency exchange rate fluctuations and there can be no assurance that foreign currency exchange rates will not have a material adverse impact on our future cash flows and operating results. See further discussion of foreign currency risk in Item 3, "Quantitative and Qualitative Disclosures About Market Risk."

For the remainder of 2002, we expect that operating expenses will decrease slightly as a percentage of revenue when compared with 2001. We anticipate that operating expenses and planned capital expenditures will continue to constitute a material use of our cash resources. We expect our capital expenditures in 2002 to be greater than fiscal year 2001. In addition, we may utilize cash resources to fund acquisitions or investments in other businesses, technologies or products lines. We believe that our available cash and cash equivalents, together with our anticipated future cash provided by operating activities, will be sufficient to meet our working capital and operating expense requirements for at least the next twelve months. At some point in the future we may seek additional funds to support our working capital and operating expense requirements or for other purposes and may seek to raise the additional funds through public or private debt or equity financings. If we seek additional financing, there is no assurance that this additional financing will be available, or if available, will be on reasonable terms and not dilutive to our stockholders.

FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF STOCK

We operate in a rapidly changing environment that involves many risks, some of which are beyond our control. The following is a discussion that highlights some of these risks. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations or results. If any of these risks actually occur, our business operations or results could be harmed.

Our success is dependent on the broad adoption of certain programming languages and standards, particularly Java.

Many of our most popular products are focused on Java, and we continue to invest heavily in Java and Java standards, including enterprise-focused standards such as Java 2 Platform, Enterprise Edition, or J2EE, and Enterprise JavaBeans, or EJB, to enhance the performance and functionality of these products. Java, however, is a relatively new language and was developed primarily for the Internet and corporate Intranet applications. While we believe that Java is making significant inroads with respect to its adoption for enterprise applications, it is still too early to determine whether Java will achieve widespread acceptance as a programming language and platform for enterprise applications. For example, EJB and J2EE implementations have not yet been widely adopted and in particular are only sparingly and partially used in enterprise class processing environments, and our deployment and management products are principally focused on these standards. Additionally, several of the distinguishing features of JBuilder, our integrated development environment, or IDE, for Java, are geared for J2EE and EJB development. If Java, including EJB and J2EE, does not become widely adopted, our business could be adversely impacted.

In addition, our infrastructure products, including Borland Enterprise Server, are based on Common Object Request Broker Architecture, or CORBA, in addition to EJB and J2EE. CORBA is a standard from the Object Management Group (OMG) for communicating between distributed objects (objects are self-contained software modules). CORBA provides a way to execute programs (objects) written in different programming languages running on different platforms no matter where they reside in the network. While we believe that CORBA has achieved widespread acceptance as a software-based communications interface through which objects are located and accessed, critics contend that it is a highly complex technology requiring significant investments to implement it, as well as in training and support. If CORBA is displaced or its popularity diminished, our business would be impacted.

If we are unable to maintain our license to Java technology, we may not be able to license our Java products to third parties, which will harm our business.

Our Java products require proprietary technology made available by Sun Microsystems in order to operate. Pursuant to license agreements with Sun Microsystems, we license the Java 2 Platform, Standard Edition specification, the Java 2 Platform, Enterprise Edition specification and the Java 2 Platform, Micro Edition specification. The principal agreement provides for a five-year term and will terminate on December 28, 2005. While we would expect to renew this agreement, Sun is not obligated to do so. Upon expiration of this license, we will continue to have the right to distribute our software products containing the version of Java technology incorporated at the time of expiration. However, if the agreement is terminated by Sun due to material breach of the terms of the license or upon an action for infringement of intellectual property rights relating to the Java technology by us against Sun Microsystems or any of its other licensees, we are required to return or destroy all copies of the Java technology, including derivative works. If Sun Microsystems fails to renew the license agreement or otherwise stops making this proprietary technology available on commercially reasonable terms, and we are unable to develop or otherwise identify effective alternatives to licensing this technology, our business will be harmed. Alternatively, if Sun Microsystems makes significant changes to the Java language or its proprietary technology, or fails to correct defects and limitations in these products, our ability to continue improving and shipping our products could be impaired.

We are relatively new to the software application infrastructure market, and may not be able to successfully compete in that market.

The software application infrastructure market is relatively new and evolving. While we believe we maintain strong relationships with the information technology, or IT, organizations in large enterprises through our developer network, we do not have extensive experience in this market. For example, we entered this market for the first time as the result of our acquisition of Visigenic in 1997 and are now marketing comprehensive implementation solutions to enterprises including development and infrastructure products. There can be no assurance that the software application infrastructure market will grow or that we will be able to compete successfully in it. To compete successfully in the software application infrastructure market we will need to:

- successfully select the operating platforms, database management systems and server software which ultimately achieve market acceptance;
- successfully and efficiently invest significant resources in direct sales, marketing and product development;
- compete with several very large and well-established companies with significant “mindshare,” as well as a number of smaller successful companies, that are already competing in these markets;
- develop stronger relationships with systems integrators and other strategic partners with access to enterprise accounts and “C”-level decision-makers on software application infrastructure products; and
- coordinate the activities of our various product organizations to provide fully integrated products, including synchronizing release cycles.

We have a relatively new direct sales force and our limited experience in managing them may impair our ability to expand sales and generate increased revenue, particularly with regard to our application infrastructure products.

We have been rapidly expanding our direct sales force and plan to hire additional sales personnel. Because a significant percentage of our sales force are relatively new to our company, there is a limited history on which to evaluate their performance. There can be no assurance that our expanded sales force will succeed in increasing or sustaining our revenue or improving our competitive position or that our newly-hired employees will achieve desired levels of productivity. In addition, while we have experienced sales management personnel, our company has limited experience in managing a large, geographically-dispersed sales force. For example, we may experience difficulty in integrating the new members of our sales team into our operations. Our failure to successfully manage our sales force may impair our ability to increase sales and grow our revenue.

If our efforts to motivate and train our sales and technical personnel are unsuccessful or are not cost-effective, our operating results would be harmed.

We need to extensively train and motivate our sales personnel and invest additional resources in our sales efforts as well as educate our authorized resellers. Our software products and services require a sophisticated sales effort, including efforts targeted at the senior management and information technology departments of our prospective customers. In addition, we believe our products, including both our development and application infrastructure products, compare well against our competition's products on the basis of our products' technical and performance benefits, increasing our particular need to have well trained, technically savvy sales personnel in order to communicate these advantages to prospective customers. We have made significant investments in training our direct sales force and implemented new sales compensation programs for 2002 in an effort to improve and motivate our sales force and increase sales. There can be no assurance, however, that these programs will be successful in achieving this result in the long term, and such changes and additional investments could significantly increase our sales-related expenses and impact operating results.

Our increasing focus on enterprise customers may increase fluctuations in our financial results.

As we increasingly seek to license software products directly to our customers, particularly large enterprises, we have experienced sales cycles that are substantially more lengthy and uncertain than those associated with our traditional business of licensing software through indirect and retail channels. We expect that a significant percentage of our future revenue will be from enterprises, including large global organizations. These transactions typically contain multiple elements, including licenses for development and deployment products, technical support, maintenance, consulting and training services. As a result, these customers generally commit significant time and resources to evaluating our software, and they require us to expend substantial time, effort and money in establishing the enterprise relationship and in educating them about our software products and solutions, which can sometimes result in lower operating margins. Also, sales to these types of customers generally require an extensive sales effort throughout the customer's organization and often require final approval by the customer's Chief Information Officer or other senior or "C"-level employee. In particular, while our strategy includes leveraging the loyalty of our developer network to sell our software application infrastructure products within their enterprises, we believe that purchase decisions on software application infrastructure technology often involve more senior level employees than sales of development products. All of these factors substantially extend the sales cycle and increase the uncertainty of whether a sale will be made in any particular quarter, or at all. We have experienced and expect to continue to experience delays and uncertainty in the sales cycle as well as increased up-front expenses in connection with enterprise sales. The timing of the execution of enterprise volume licenses, or their nonrenewal or reregistration by large customers, could cause our results of operations to vary significantly from quarter to quarter and could have a material adverse impact on our results of operations.

Our international operations and sales could be harmed by factors outside our control.

A substantial portion of our revenue is from international sales. International sales accounted for approximately 62% of our revenues in the three months ended March 31, 2002. Given our focus on international markets and the market potential for our products in such markets, we anticipate increased international sales going forward. However, there are inherent risks in doing business internationally, including:

- the difficulty of staffing and managing an organization spread over various countries and continents;
- potentially reduced or less certain protection for intellectual property rights than is available under the laws of the United States;

- seasonal reductions in business activity during the summer months in Europe and other parts of the world;
- longer payment cycles in some countries and greater difficulty in collecting accounts receivable;
- fluctuations in foreign currency exchange rates;
- restrictions on the expatriation of currency from a particular country;
- export restrictions, tariffs, duties and other trade barriers;
- changes in regulatory requirements;
- compliance with various conflicting laws and regulations;
- overlap of different tax structures; and
- political or economic instability in certain parts of the world.

One or more of these risk factors could have a material adverse effect on our future international operations and sales and, consequently, on our business, operating results and financial condition. In addition, our subsidiaries generally operate in local currencies, and their results are translated monthly into U.S. dollars. If the value of the U.S. dollar increases significantly relative to foreign currencies, there could be a material adverse effect on our business, operating results and financial condition.

Our business may suffer if international trade is hindered, disrupted, or economically disadvantaged.

Political and economic conditions abroad may adversely affect international sales of our products. Protectionist trade legislation in either the United States or foreign countries, such as a change in the current tariff structures, export or import compliance laws, or other trade policies, could adversely affect our ability to sell our software products and services in foreign markets. Changes in policies by the U.S. or foreign governments resulting in, among other things, higher taxation, currency conversion limitations, restrictions on the transfer of funds or the expropriation of private enterprises also could have a material adverse effect on us. Any actions by countries in which we conduct business to reverse policies that encourage foreign investment or foreign trade also could adversely affect our operating results.

The success of our Linux-based products is dependent upon increased future adoption of Linux.

We are investing time and resources in developing products, such as Kylix, for the Linux operating system. Linux is a relatively new operating system that runs on a variety of hardware platforms. Linux has yet to be adopted on a widespread basis, though major hardware vendors like IBM and Sun Microsystems are supporting it. If Linux is not adopted, or is adopted more slowly than we anticipate, our investments in Linux compatible products may not generate their anticipated return.

The success of our Web Services enabled products is dependent upon the adoption of Web Services.

We have recently enhanced our existing products with Web Services capabilities, including providing for the development of Web Services-enabled components and the integration of Web Services-enabled components. We believe that the popularity of using and making available Web Services for software development could be substantial. However, the Web Services-based development market is young and only now emerging, and we cannot predict whether this market will develop as we anticipate. If the market does not develop as we anticipate, our growth may not be as strong as we expect. In particular, we are anticipating a significant market opportunity to bridge the Microsoft .NET and Java platforms through Web Services. If the Web Services market does not develop as we anticipate or if one of these platforms achieves significantly greater market acceptance than the other, the opportunity to bridge the two platforms through Web Services may not be as significant as we expect and we will not be able to benefit from this opportunity through our development and deployment products. Alternatively, if we are unable to enhance our products to remain current with technological advances in the respective platforms, we will not be in a position to capitalize on this cross-platform Web Services opportunity.

We may not be able to successfully compete against current and potential competitors.

Our markets are intensely competitive. Rapid change, new and emerging technologies and fierce competition characterize these markets. The pace of change has accelerated due to the emergence of the Internet, and related programming platforms and languages, including Sun Microsystem's Java and Microsoft's .NET and C#, as well as new operating systems such as Linux.

With respect to our JBuilder product, we compete primarily with the Java IDEs offered by IBM, Sun Microsystems and WebGain. With respect to our integrated Java performance assurance tools such as Optimizeit, we compete with Rational Software and Sitraka. With respect to our Delphi and C++Builder products, we compete primarily with Microsoft. With respect to our TeamSource DSP service, our potential competitors may include Merant, Microsoft, Oracle and Rational Software. With respect to our Borland Enterprise Server, AppServer Edition, we compete primarily with BEA and IBM. With respect to our Borland Enterprise Server, VisiBroker Edition and our VisiBroker middleware product, we compete primarily with Iona. With respect to Borland Enterprise Server, Web Edition, we compete primarily with Microsoft. At this time we have no significant competitors to our Borland AppCenter and Kylix products. In the markets for our development products, we also compete with platform vendors such as Microsoft, Sun Microsystems, Hewlett-Packard, IBM, Red Hat and Apple Computer.

We differentiate our products from our competitors' products based on scalability, functionality, interoperability, cost of ownership, performance and reliability as well as their effectiveness in addressing our customers' needs. There can be no assurance that we will be able to successfully differentiate our products from those of our competitors in the future or be able to continue to enhance our product lines to meet the needs of our customers. In addition, many of our competitors have substantially greater financial, management, marketing and technical resources than we have. Many of our competitors have well established relationships with our current and potential customers, extensive knowledge of the market and extensive product development, sales and marketing resources. These competitors may be more successful than us at developing and marketing products in our markets.

Because there are relatively low barriers to entry in a number of our markets, we also can expect additional new competition from other established and emerging companies. Increased competition in our markets, including from companies with substantial resources, could result in price reductions, fewer customer orders, reduced gross margins and loss of market share. Any one of these results could adversely affect our business. For example, given the growth and adoption of Java, we are already observing increased attention on the market for Java development technologies, and expect additional new entrants. Certain vendors, for example, which have heretofore not focused significant resources on the Java development market, have altered their product strategies to incorporate Java development offerings. Similarly, the market for development technologies to enable Web Services is receiving increased attention as well. Because we are dependent on the market for Java development for a substantial portion of our revenue, going forward, increased competition in this market could damage our competitive position and significantly affect our operating results.

Bundling arrangements or product give-aways by our competitors, including freely available development technologies, may diminish demand for our products or pressure us to reduce our prices.

Certain of our competitors, such as those that are primarily hardware vendors or platform providers, generate a substantially greater proportion of their sales in markets in which we do not directly compete. In addition, we believe a number of such competitors view sales of products such as development technologies as important for enhancing the functionality of their core products, as well as the demand for such products. As a result, certain such companies may offer products that compete with our offerings bundled with their other products, such as application servers, work stations, personal computers, operating systems and databases. In such event, the effective price for products that compete with our products may be heavily discounted or offered at no charge. Such competitive pressures could require us to reduce the price of our products and related services and adversely affect our operating results. Similarly, certain industry alliances and arrangements exist or may be formed in the future under which companies in markets in which we do not compete ally with companies in our markets to bundle products in order to help increase respective market shares. Such arrangements may result in lower effective prices for products that compete with our offerings than our own prices, putting pressure on us and diminishing our competitive position.

In addition to bundled offerings and bundling arrangements, certain competitors make available or have begun making available for no charge to their customers products that compete with our products, including our development technologies such as JBuilder. While we believe that products made available at minimal or no cost are not able to compete with our offerings on the basis of quality, performance, reliability and cost of ownership, among other things, freely available competitive technologies are a risk to our business. At a minimum, technologies offered at no charge increase pricing pressure and threaten to impact our results. IBM's open source Eclipse initiative, for example, is an example of a model under which products that are competitive with our offerings may eventually become available at minimal or no cost. IBM Eclipse is attempting to create an open source toolkit in which customers can access and create development technologies at no charge. If this type of model is widely adopted, our business will be harmed.

If we are unable to meet rapid changes in technology and introduce competitive products, our existing products could become technologically obsolete.

The market for our products is highly competitive and is characterized by continuous technological advancement, evolving industry standards and changing customer requirements. While we believe that to date we have successfully developed products that incorporate the latest technologies and standards, we cannot be certain that we will successfully design and market new products and upgrades of our current products that are competitive and work with existing and new computer platforms and operating environments.

Additionally, we face a number of competitive risks in the software market, including, but not limited to, the following:

- we may introduce products later than we expect or later than competitors' introductions;
- competitors may introduce competing products at lower prices or potentially at no cost;
- our products may not meet customers' expectations regarding features and performance;
- competitors' products based on new technologies or new industry standards may quickly render our existing products obsolete;
- the free availability of certain core new technologies may lower barriers to entry and minimize our competitive advantages on the basis of price and performance; and
- in order to match actions by competitors, we may need to provide product upgrades at lower prices which may result in lower margins and decreased operating results.

We may not successfully address these risks. If we do not successfully address these risks, our business and operating results could be seriously harmed.

Our strategic relationships and partnerships may not achieve their objectives, and the failure to do so could impede our growth.

We currently maintain a number of important strategic alliances and technology partnerships with industry leaders such as Microsoft, Sun Microsystems and Nokia. Our current technology partners give us, among other things, early access to emerging technologies, additional resources to market our products, as well as an entry point to meet potential customers. Our relationships with systems integrators and resellers also provide additional expertise to our customers and bolster our service capabilities, among other things. In the future, we anticipate exploring additional strategic alliances, technology partnerships and other arrangements designed to further all of these goals. Our current or prospective strategic alliances and technology partnerships may not achieve their intended objectives however, and parties to our strategic alliances and technology partnerships may not perform as contemplated. Additionally, our partners may choose to terminate their arrangements with us in situations where no binding contractual arrangements exist. Under our relationships with Nokia and SAP, for instance, these companies are currently recommending JBuilder as their preferred IDE for Java development to their customers and/or vendors of ancillary products. These arrangements are not binding however, and either company may choose not to recommend JBuilder at some future date or to recommend a competitor's products. The failure to develop or maintain our strategic alliances and technology partnerships, or our partners' inability to perform or decision not to perform or to opt out of their arrangements with us, may impede our ability to introduce new products or enter new markets. As a result, our operating results could be materially affected.

If the wireless and mobile application market does not develop as anticipated or if our products for the wireless or mobile market are not widely accepted, our growth may be negatively impacted.

We have recently introduced new Java-based products targeted for development applications for mobile and wireless devices, including our JBuilder MobileSet. We have also entered into strategic relationships or technology partnerships with wireless device manufacturers, including Nokia, in order to enhance our position in this market. If the market for mobile and wireless applications does not develop as we anticipate or as quickly as we anticipate, the demand for our wireless products will be adversely impacted. The failure of the wireless market to develop as we expect, or our failure to penetrate this market, will impede our anticipated sales growth and could result in substantially reduced earnings from those we anticipate.

The growth in the market for mobile and wireless applications will depend on a number of factors, any of which may impact our ability to derive substantial revenue from this market in the future. These factors include:

- rate of adoption of mobile devices by enterprises and consumers, including personal digital assistants, handheld computers, smart phones, pagers and other mobile devices;
- rate of adoption of wireless applications and services available on such devices by enterprises and consumers;
- aggressive and successful marketing of wireless applications and services by a limited number of communication service providers, including pricing;
- the rate of build out of and upgrades to existing wireless networks, including: availability of rights to cell and switch sites as well as zoning variances and other approvals for network construction; completion of cell site design, frequency planning and network optimization; completion of fixed network implementation; expansion of customer care, network management and billing systems; and vendor equipment availability;
- availability of additional spectrum capacity to enable service providers to expand existing wireless data services and develop third generation services; and
- health issues, including as they relate to radio frequency emissions or the use of devices while driving automobiles, and potential state law restrictions and/or litigation in conjunction therewith.

In addition to the development and growth of the market itself, our ability to generate significant revenue in the wireless application implementation market will depend on our ability to adapt to the rapid technological shifts in this market to keep our products viable and competitive. Technological factors that may impact our ability to generate substantial revenue in the wireless market include:

- failure of Java to gain in popularity as a programming platform for wireless and mobile application development;
- emergence of a dominant programming language or platform or operating system for mobile and wireless devices and our corresponding ability to develop technologies that facilitate software development and deployment for such technologies;
- failure of a dominant platform or operating system to emerge and our corresponding ability to develop technologies that facilitate software development and deployment across the range of such technologies or a significant subset thereof;
- increasing proliferation of mobile or wireless devices with varying technical specifications and form factors, and our corresponding ability to develop products capable of facilitating development and deployment to the range of devices with varying such requirements;
- evolving standards and other technological changes; and
- pace of overall technological change in the mobile and wireless markets.

If the wireless and mobile market does not develop as we anticipate or if we are unable to respond to technological shifts in the market, our anticipated sales and operating results could be adversely impacted. In addition, even if the wireless market does develop and we have competitive products, our failure to market and sell these products to our customers will impact our anticipated sales and operating results.

Because competition for qualified personnel is intense, we may not be able to recruit or retain qualified personnel, which could negatively impact the development and license of our products.

We believe that our ability to successfully grow and manage our business and to develop new products will depend, in large part, on our ability to recruit and retain qualified employees, particularly highly skilled software engineers and management personnel. Over the last few years, we have increased compensation, bonuses, stock options and other fringe benefits in order to attract and retain key personnel. In the past, some of our competitors have utilized their greater resources to provide substantial signing bonuses and other inducements to lure key personnel away from us. As a result, we may be required to further increase compensation and benefits. We are not certain that these efforts will succeed in retaining our key employees, and our failure to attract and retain key personnel could significantly harm our business. Even if we succeed in attracting and retaining key personnel, these increased compensation costs may not be offset through either improved productivity or higher revenue.

Furthermore, we do not maintain key person insurance on any of our employees or management team members, including Dale L. Fuller, our President and Chief Executive Officer. If we lose one or more of the members of our management team, including Mr. Fuller or other key employees, we will not receive insurance or other proceeds to help offset the loss to us of unique skills and talents or the potentially high cost of replacement personnel, and our business and operating results could be seriously harmed.

If our products do not operate with the wide variety of hardware, software and operating platforms, environments and programming languages used by our customers, our revenues would be harmed.

Our customers use a wide variety of constantly changing hardware, software and operating platforms. We invest and will continue to invest a significant amount to develop products for new or emerging software and hardware platforms in the server, desktop, personal digital assistant, mobile, wireless and other environments that may develop from time to time. However, there is a risk that a new hardware or software platform that we do not provide products for could rapidly grow in popularity. In particular, we believe that this risk is substantial with regard to particular proprietary platforms and languages for which we may not be given preferential access or access at all. As a result, we may not be in position to develop products for such platforms or may be late in doing so. If we fail to introduce new products that address the needs of emerging market segments, or if our new products do not achieve market acceptance, including because they are late in development, our future growth and profitability could suffer. In addition, we may incur significant expenditures to develop products for emerging platforms that do not ultimately become large or profitable market segments.

For example, Microsoft has recently introduced a new operating environment for Web-based applications called Microsoft .NET. While we are releasing development products that support the .NET environment, our business would be harmed if we are unable to develop an effective development product for the .NET environment that addresses the needs of our customers, or if our competitors, particularly Microsoft, do so more effectively than we do. Similarly, if certain emerging programming languages, such as Microsoft's C#, gain significantly in popularity and we do not offer a development technology to facilitate development in such languages, our competitiveness could be diminished and our results adversely impacted. An alternative to Java, C# is an object-oriented programming language that was recently introduced by Microsoft and is based on C++. We believe that C# is gaining in market acceptance. We do not, however, currently offer a development product for the C# programming language. In addition, it is possible that certain platforms may emerge for which Java implementations are not possible or feasible on a cost-effective basis. Because we are focused on Java products, we could lose customers if this happens.

Our research and development efforts may be costly and may not produce successful new products and product upgrades.

Our future success will depend upon our ability to enhance our current products and develop and introduce new products on a timely basis, particularly if new technology or new industry standards render any existing products obsolete. We believe that we will need to incur significant research and development expenditures to remain competitive, particularly since many of our competitors have substantially greater resources. The products that we are currently developing or may develop in the future may not be technologically successful or may not be accepted in our market. In addition, the length of our product development cycle may be greater than we expect. If the resulting products are not introduced in a timely manner, or do not compete effectively with products of our competitors, our business will be harmed.

Delays in the introduction of new products may cause us to lose customers to our competitors or harm our reputation.

From time to time, we announce when we expect to introduce a new product. We also attempt to maintain a consistent release schedule for upgrades of existing products. In the past, some of our products have shipped later, sometimes substantially later, than when we originally expected. The loss of key employees may increase the risk of these delays. Some of our products are based on technology licensed from third parties. We have limited control over when and whether these technologies are upgraded. The failure to receive adequate notice of, the delay in release of, or the inadequacy of enhancements to technology licensed from third parties could have a material adverse effect on our ability to develop and enhance our products. Due to these uncertainties inherent in software development, it is likely that these risks will materialize from time to time in the future. We could lose customers as a result of substantial delays in the shipment of new products or product upgrades.

We depend on technologies licensed to us by third parties, particularly that of Sun Microsystems and Microsoft, and the loss or inability to maintain these licenses could prevent or delay sales or shipments of certain of our products.

We are dependent on licenses from third-party suppliers for some elements of our products such as various file libraries. In particular, we are dependent on technology licenses from Sun Microsystems with respect to our Java products and we are dependent on licenses from Microsoft with respect to our, Delphi and C++Builder products. If any of these licenses were terminated or were not renewed, or if these third parties failed to develop new technology products or failed to notify us in a timely manner of any new or updated technology, we might not be able to ship such products. We would then have to seek an alternative to the third party's technology and, in some cases, it is possible that an alternative may not exist. This could result in delays in releasing and/or shipping our products, increased costs or reduced functionality of our products and could have a material and adverse effect on our business, operating results and financial condition.

Open source technologies both lower barriers to entry in our markets and have the potential to harm our ability to sell our products and services on profitable terms.

The free availability of technology, such as Linux, may allow competitors to enter our markets more easily and at lower cost. For example, our ability to enhance our development technologies is based on access to technologies we obtain through costly licenses with Sun Microsystems and Microsoft, among others, providing a potential barrier to entry in our markets. If key technologies are made freely available, the advantages we derive from our industry relationships and financial position could be diminished. In turn, our competitive position, our revenues and growth could be negatively impacted.

In addition, some of our competitors are offering to license software for free or effectively offering competing software for free as part of a bundled solution to gain competitive advantage. If broadly and successfully adopted, this type of competition, particularly open and free access to development technologies, could materially adversely affect our ability to sell additional licenses and maintenance and support renewals on profitable terms.

The relative immaturity of Java could negatively impact our growth and operating results.

Because Java is, in part, a relatively new programming language and still evolving in functionality, we believe that the demand for development technologies, particularly for upgrades that facilitate the tailoring of applications to the latest Java standards, is currently strong. However, should Java and Java standards stop evolving, the need for new, upgraded development technologies may weaken and our ability to sell upgrades of our Java development technologies may be impacted. Since our operating results are dependent, in part, on selling upgrades to our existing customer base, our operating results would be adversely affected. In addition, in the event that Java matures to the point where vendors are able to have success selling broadly applicable packaged Java software without fear of obsolescence, the need for extensive in-house Java development could be curtailed. If in-house development is curtailed, the need for our development technologies will be impacted and our operating results would be adversely affected.

Our historical financial information relating to a number of our development technologies is based on sales of development applications for legacy languages and traditional hardware platforms, and as such may not be indicative of our future performance in developing and marketing software for emerging languages and emerging hardware platforms.

Our historical financial information relating to a number of our development technologies is based on sales of software designed to develop applications for legacy platforms (e.g., Windows and C++) as well as traditional computer hardware platforms (e.g., mainframes, work stations, applications servers, desktop personal computers, notebook computers, etc.). While we continue to enhance the functionality of these products and expect sales of these technologies to continue to generate a significant percentage of our revenue, we expect to derive an increasing percentage of our revenue from sales of our development technologies for emerging platforms such as Java and .NET, as well as emerging hardware platforms such as wireless and mobile computing devices and personal digital assistants, or PDA, devices. Relative to our traditional business, we do not have a lengthy operating history in these markets upon which to evaluate our prospects, which may make it difficult to predict our actual results in future periods. Accordingly, actual results of our future operations may differ materially from our anticipated results.

The customers for our application infrastructure products are, and we expect our customers will continue to be, highly concentrated in a small number of vertical markets, so a continued downturn in these markets would significantly harm our revenues.

A large portion of our revenue with respect to our application infrastructure products is derived from customers in a small number of vertical markets such as the technology, telecommunications and financial markets. While we believe that customers in these markets are attracted to the performance advantages of our products, continuation or deepening of the current downturn in any of these markets could have a significant impact on our revenues with respect to our application infrastructure products. Our infrastructure business was adversely affected in 2001 and in the first quarter of 2002 by the downturn in these markets. Our failure to broaden our base of customers outside these vertical markets would reduce our future revenues with respect to our application infrastructure products if an extended downturn occurs in our targeted vertical markets.

If we cannot increase market awareness of our products and services our business could be harmed.

We continue to expand our marketing operations to increase market awareness of our products and services, market our products and services to a greater number of customers and generate increased revenue. Our products and services increasingly require strong marketing efforts to address the various departments of an enterprise, as well as the developer community at large, and our inability to effectively market our products could impede our ability to compete effectively.

The number of factors that affect our revenues makes our future results for a particular period difficult to predict and therefore we may not meet expectations for a particular period.

We believe that our revenues have the potential to vary significantly from time to time. These fluctuations could cause our stock price to fluctuate significantly. We believe that these variations may result from many factors including:

- timing, and any delay in the introduction, of upgrades to existing products or new products;
- the mix of channels through which we sell our products;
- the relative mix of demand for our various products and services;
- the size and timing of significant orders and their fulfillment;
- the number, timing and significance of product upgrades and new product announcements by us and our competitors;

- changes in pricing policies by us or our competitors;
- customer order deferrals in anticipation of upgrades or new products offered by us or our competitors;
- product release cycles for our products and those of our competitors;
- product defects that may be discovered from time to time and other product quality problems;
- general domestic and international economic and political conditions; and
- information technology budgets and overall capital expenditure budgets of our customers and prospective customers.

A significant portion of our customers place orders toward the end of a given quarter. Revenue may also fluctuate based on our customers' fiscal year budgeting cycles. Therefore, revenues may be difficult to predict, and any revenue shortfall for a quarterly period may not be known until late in the quarter. Additionally, our costs are based on projected revenues and are relatively fixed in the short term. Therefore, if our revenue levels fall below projections, net income may be significantly reduced, and, accordingly, we may experience a loss. As a result, we believe that quarterly revenues and operating results will continue to be difficult to forecast and period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of trends or our future performance.

We depend on a small number of distributors like Ingram Micro for a significant portion of our revenue; if we lose one or any of our major distributors our revenue could suffer.

Ingram Micro, one of our major distributors, accounted for approximately 10% of our total revenue for the quarter ended March 31, 2002, 13% of our total revenue during the year ended December 31, 2001 and 12% of total revenue during the year ended December 31, 2000. We expect that Ingram Micro will continue to be a significant customer and a small number of distributors will continue to account for a significant portion of our revenue for the foreseeable future. Our inability to increase the number of our distributors or the loss of any one major distributor like Ingram Micro could limit our ability to maintain or increase our market share, or could cause our revenue to drop quickly and unexpectedly.

Because we rely on independent software vendors, value-added resellers, system integrators and other channel partners to compliment our direct sales, if we cease doing business with one or more of these parties, our revenue could suffer.

We rely on independent software vendors, value-added resellers, systems integrators and other channel partners to compliment our direct sales. A part of our strategy is also to bundle our software in the products offered by value-added resellers, or VARs, or independent software vendors, or ISVs. The pricing, terms and conditions of our agreements with these partners are individually negotiated and vary among partners. These agreements are non-exclusive. Many of our agreements do not require our customers to make a minimum number of purchases. We have virtually no control over the shipping dates or volumes of systems shipped by our customers. Although we believe our relationships with our channel partners have been successful to date, we cannot guarantee that these relationships will continue to be successful or to grow or that the channel partners will continue to purchase our products in the future. If we do not continue to get referrals from third parties or if we are unable to secure license agreements with these parties on profitable terms, our business may suffer.

We are dependent upon certain retail distribution channels.

A significant portion of our sales is made through retail distribution channels, which is subject to events that cause unpredictability in customer demand. Our retail distributors also carry the products of our competitors. Some of our retail distributors have limited shelf space and limited capital to invest in inventory. Their decision to purchase our products is based on a combination of demand for our products, our pricing, the terms and special promotions we offer and other factors that we do not control and cannot predict. Our agreements with retail distributors are generally nonexclusive and may be terminated by them or us without cause. Accordingly, there can be no assurance that our distributors will continue to carry our products.

Failure to expand or grow our professional services offerings and enlist others to provide services for our products could harm our business and results of operations.

We believe that growth in our product sales and license revenue will depend on our ability to provide our customers with comprehensive professional services and to enlist other parties to provide similar services, including independent software vendors, systems integrators, distributors and other channel partners. These professional services include maintenance, architectural consulting, training, education and project management. If we fail to attract, train and retain skilled personnel to deliver professional services, our business and operating results could be seriously harmed. We plan to increase the number of our professional services personnel to meet these needs. However, competition for qualified professional services personnel is intense, and we may be unable to attract, train and retain the number of highly qualified professional services personnel that we need.

As part of our growth strategy, we have also embarked on an effort to utilize our professional services more aggressively, including using them as a means to market our products or to obtain feedback which we can then incorporate into our product plans. A decline in the price of or demand for our professional services offerings may harm our business and operating results and negatively impact our growth strategy.

Consolidation in our industry may impede our ability to compete effectively.

Consolidation continues to occur among companies that compete in our markets as firms seek to offer more extensive suites of software products and broader arrays of software solutions and take advantage of efficiencies and economies of scale. Additionally, a number of major hardware companies have sought to expand their software and services offerings through acquisitions. Changes resulting from this consolidation may negatively impact our competitive condition, particularly as certain products, when offered as part of a bundled suite, are offered for free or are given away to sell more hardware components. In addition, as we seek to expand our product lines, skills and capacity through acquisitions, a trend toward consolidation may result in our encountering increased competition for attractive targets, and having to pay higher prices for those targets.

We may not be able to successfully complete business combinations or integrate combined businesses into our existing business.

As a part of our business strategy, we may make acquisitions of businesses, products or technologies in the future. However, there may not be suitable businesses, products or technologies available for acquisition on terms acceptable to us. There may be substantial costs associated with acquisitions including the potential dilution to our earnings per share, the incurrence or assumption of debt, the assumption of contingent liabilities, the amortization of expenses related to intangible assets and the legal and other fees associated with the negotiation and consummation of the acquisition. Acquisitions entail numerous risks, including the difficulty in the integration of operations, technologies, products and personnel, as well as difficulties and uncertainties in our ability to maintain key business relationships that the business entities have established. Acquisitions also divert the attention of management from other business concerns. We may make acquisitions in new markets where we have limited or no prior experience. Further, there is no guarantee that any acquisition we complete will result in earnings accretion, cost efficiencies or synergies. We may expend resources to acquire products and technologies that we are not ultimately able to commercialize. Furthermore, acquired businesses may bring with them unanticipated or undisclosed liabilities and risks. Any one of these risks, if realized, could negatively affect our business, financial condition and operating results.

If our encryption technology does not satisfy our potential customers' needs for the confidential transfer of information, sales of certain of our application infrastructure products could suffer.

We use and will continue to use encryption technology licensed by third parties in some of our products, such as in Borland Enterprise Server, VisiBroker Edition, to provide security for the exchange of our customers' confidential information. Encryption technologies have been breached in the past. There can be no assurance that there will not be a compromise or breach of our security technology. If such a breach were to occur, it could have a material adverse effect on our reputation and sales of our application infrastructure products.

If the license of our products that contain encryption technology is delayed by export regulations, revenues from licensing our application infrastructure products in foreign markets could be harmed.

There are numerous regulations regarding the export of encryption technology from the United States. In the past, some of our sales have been delayed while we have awaited regulatory clearance to export our encryption technology, especially to countries outside the European Union. Similar delays in the future would negatively impact our revenues.

Our products may contain unknown defects that could result in a loss of revenues, decreased market acceptance, injury to our reputation and product liability claims.

Software products occasionally contain errors or defects, especially when they are first introduced or when new versions are released. We have not experienced any substantial problems to date from potential defects and errors, but we cannot assure you that our products are or in the future will be completely free of defects and errors. Errors in our software may be caused by defects in third-party software incorporated into our software. If so, we may be unable to fix these defects without the cooperation of these software providers. Because these defects may not be as significant to our software providers as they are to us, we may not receive the full and timely cooperation that we may require. In addition, we may not have the contractual right to access the source code of third-party software and, even if we access the source code, we may be unable to detect and fix the defect. The discovery of a defect or error in a new version or product may result in the following consequences, among others:

- delayed shipping of the product;
- immediate loss of revenue;
- delay in market acceptance;
- diversion of development resources;
- damage to our reputation; and
- increased service and warranty costs.

These consequences could materially and adversely affect our business, operating results and financial condition.

Our products also interoperate with many components of complicated computer system implementations, such as mainframes, application servers, personal computers, application software, databases, operating systems and data transformation software. Failure of any one of these components could cause all or large portions of computer systems to fail. In such circumstances, it may be difficult to determine which software or hardware component failed, and it is likely that customers would bring a lawsuit against several companies, including us. Regardless of its merits, responding to any claim can be time consuming and costly and divert the efforts of our technical and management personnel. In addition, we may not have insurance coverage for these types of claims or our insurance coverage for these types of claims may not be adequate.

Many of our license agreements contain provisions designed to limit our liability for potential product liability claims. It is possible, however, that these provisions may not protect us because of existing or future federal, state, local or foreign laws or ordinances or judicial decisions. A successful product liability claim for large damages brought against us could have a material adverse effect on our business, operating results and financial condition.

Intentional efforts to harm or disrupt the functioning of our software or web site could harm our reputation and result in significant unexpected costs.

Our products or services may be the target of intentional disruptions, such as software viruses specifically designed to impede the performance of our products. Similarly, experienced computer programmers or hackers may attempt to penetrate our network security or the security of our web site and misappropriate proprietary information or cause interruptions to the delivery of our services or products. Our activities could be substantially disrupted, and our reputation and future sales could be harmed if these efforts were successful.

If we fail to effectively manage our growth, our infrastructure, management and resources could be strained, our ability to effectively manage our business could be diminished and our operating results could suffer.

Our future success is dependent on growing our company. The failure to manage our growth effectively could strain our resources, which would impede our ability to increase revenues. During the past two years, we have increased the number of product releases we make each year and have introduced a number of new products and services. We plan to continue to expand further the number and diversity of our software solutions and their use in the future. Our ability to manage our planned growth effectively will require us to:

- successfully hire, train, retain and motivate additional employees;
- enhance our operational, financial and management systems; and
- expand our research and development capacity.

As we expand and diversify our product and customer base, we may be required to increase our selling, general and administrative expenses. We also may be required to increase staffing and other expenditures in order to meet the anticipated demands of our customers. Our customers, however, do not commit to license our software for more than a short time in advance. Any increase in expenses in anticipation of future orders that do not materialize would adversely affect our profitability. If we cannot manage our growth effectively, our business and results of operations could be negatively impacted.

The price of our common stock could fluctuate significantly.

Like the publicly-traded securities of other high technology companies, the market price of our common stock has experienced significant fluctuations and may continue to fluctuate significantly. During the period from March 31, 2001 to March 31, 2002, the price of our common stock has ranged from a low of $6.25 on April 3, 2001 to a high of $18.40 on January 11, 2002. On May 10, 2002, the most recent practicable date prior to the filing of this Form 10-Q, the closing price of a share of our common stock on The Nasdaq Stock Market was $9.78. From time to time, the market price of our common stock may be significantly affected by a number of factors, including, but not limited to, the following:

- announcements of new products or product upgrades by us or our competitors;
- technological innovation by us or our competitors;
- quarterly variations in our results of operations or those of our competitors;
- changes in the prices of our products or those of our competitors;
- changes in actual or projected revenue and revenue growth rates for us as a whole or for specific geographic areas, business units, products or product categories;
- changes in the price-to-earnings, price-to-sales and other multiples used to value companies in the software industry;
- changes in revenue, earnings or other estimates by research analysts who cover our stock;
- actual or anticipated changes in information technology spending;
- a decision by a respected research analyst to initiate or drop coverage on our stock or upgrade or downgrade our stock;
- speculation by the press, product analysts or research analysts about us and our products, revenues and/or earnings including the growth rate of each;
- the relatively low trading volume in our stock;

- stock sales from time to time by our executive officers and members of our board of directors;
- actual or anticipated changes in interest rates; and
- general market conditions or market conditions specific to the software industry.

The stock prices for many companies in the technology sector have experienced wide fluctuations which, at times, have been unrelated to the operating performance of such companies.

Sales of our common stock by significant stockholders may cause the price of our common stock to decrease.

Several outside investors in Borland own significant portions of our common stock, or preferred stock that is convertible into common stock, though, to our knowledge, based on Schedule 13G filings made with the SEC, none individually own in excess of 8% of our common stock, even on an as converted basis, as of May 10, 2002, the most recent practicable date prior to the filing of this Form 10-Q. If these stockholders were to sell significant amounts of their Borland stock, then the market price of our stock could be negatively impacted. Moreover, because of current levels of liquidity in our stock, the effect of such sales, or of significant portions of our stock being offered or made available for sale, could result in particularly strong downward pressure on our stock. Investors should be aware that they could experience significant short-term volatility in our stock if such stockholders decide to sell a substantial amount of their Borland stock at one time.

The conversion of our Series C Preferred Stock ("Series C Stock") may have a dilutive effect.

Each share of our Series C Stock is convertible, at the option of the holder, into fully paid and non-assessable shares of Borland common stock based upon a fixed conversion ratio. In the event of a reorganization, reclassification or other change (other than a stock dividend, stock split or reverse stock split), each share of Series C Stock would be convertible, at the option of the holder, into the kind and amount of shares of stock and other securities and property receivable upon such events. Upon transfer by the holder to an unaffiliated third party, each share of Series C Stock would automatically convert into fully-paid and non-assessable shares of our common stock based upon a fixed conversion ratio. In the event of a merger, consolidation, tender offer, agreement to sell, or sale of all or substantially all of our assets, each share of Series C Stock would automatically convert into the right to receive the same consideration as if the Series C Stock had been converted into common stock immediately prior to such events. In the event of liquidation, dissolution or winding up of Borland, the holders of shares of Series C Stock would receive the same consideration as if the Series C Stock had been converted into common stock immediately prior to such event. The conversion ratio is subject to certain adjustments in the event of a stock split and other capital reorganizations. As of May 10, the 115 shares of Series C Stock not previously submitted for conversion were convertible into 1,236,595 shares of our common stock.

We may become subject to costly and time-consuming class action litigation following significant changes in our stock price.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such companies. Were such litigation to be commenced against us, we would incur substantial costs and there would be diversion of our management's attention and resources, which could materially adversely affect our business, results of operations and financial condition.

If we are unable to protect our intellectual property, we may lose a valuable asset.

As a software company, our intellectual property rights are among our most valuable assets. We rely on a combination of patent, copyright, trademark, trade secret laws, confidentiality agreements and other contractual arrangements, domain name registrations and other methods to protect our intellectual property rights, but these measures may provide only limited protection. The protective steps we have taken may be inadequate to deter misappropriations of our intellectual property rights. In addition, it may be possible for an unauthorized third party to reverse-engineer or decompile our software products. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights, particularly in certain international markets. Litigation may be necessary to protect our intellectual property rights, and such litigation can be time consuming and expensive. We have 98 issued U.S. patents, 10 issued foreign patents and additional pending applications for U.S. and foreign patents. It is possible that some or all of our patents may be challenged, invalidated or circumvented. It is also possible that our pending patent applications may never result in issued patents, and if they do result in issued patents, those patents may be invalidated. In addition, effective protection of intellectual property rights is unavailable or limited in some foreign countries, making the possibility of misappropriation of our intellectual property more likely. Current laws in the United States that prohibit copying give us only limited practical protection from software "pirates," and the laws of many other countries provide very little protection. Policing unauthorized use of our products is difficult, expensive and time consuming and we expect that software piracy will be a persistent problem for our software products. In addition, the unique technology of the Internet may tend to increase, and provide new methods for, illegal copying. Accordingly, we cannot be certain that we will be able to protect our intellectual property rights against unauthorized third-party copying or use. This could materially and adversely affect our competitive position.

We may incur substantial expenses and divert management resources in prosecuting others for their unauthorized use of our intellectual property rights.

In the future, we may need to file lawsuits to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of the proprietary rights of others. This litigation, whether successful or unsuccessful, could result in substantial costs and diversion of resources, which could have a material adverse effect on our business, financial condition and results of operations. In addition, should any of our competitors file patent applications or obtain patents that claim inventions also claimed by us, we may choose to participate in an interference proceeding to determine the right to a patent for these inventions because if we fail to enforce and protect our intellectual property rights, our business could be harmed. Even if the outcome is favorable, this proceeding could result in substantial cost to us and disrupt our business.

Third party claims of intellectual property infringement may subject us to costly litigation or settlement terms or limited sales of our products.

From time to time, we have received notices claiming that we have infringed a third party's patent or other intellectual property right. We expect that software products in general will increasingly be subject to these claims as the number of products and competitors increase, the functionality of products overlap and as the patenting of software functionality becomes more widespread. Further, the receipt of a notice alleging infringement may require in some situations that a costly opinion of counsel be obtained to prevent an allegation of intentional infringement. Regardless of its merits, responding to any claim can be time consuming and costly and divert the efforts of our technical and management personnel from productive tasks. In the event of a successful claim against us, we may be required to pay significant monetary damages, including treble damages if we are held to have willfully infringed, discontinue use and sale of the infringing products, expend significant resources to develop non-infringing technology and/or enter into royalty and licensing agreements that might not be offered or available on acceptable terms. If a successful claim were made against us and we failed to commercially develop or license a substitute technology, our business could be materially harmed. In addition, we may not have insurance coverage for these types of claims or our insurance coverage for these types of claims may not be adequate.

Increasing regulation of the Internet, imposition of sales and other taxes on products sold or distributed over the Internet and privacy concerns relating to the Internet could harm our business.

We intend to expand our business through, among other channels, electronic commerce on the Internet. The electronic commerce market on the Internet is relatively new and rapidly evolving. While this is an evolving area of the law in the United States and overseas, currently there are relatively few laws or regulations that directly apply to commerce on the Internet. Changes in laws or regulations governing the Internet and electronic commerce, including, without limitation, those governing an individual's privacy rights, pricing, content, encryption, security, acceptable payment methods and quality of products or services could have a material adverse effect on our business, operating results and financial condition. Taxation of Internet commerce, or other charges imposed by government agencies or by private organizations may also be imposed. Laws and regulations applying to the solicitation, collection and processing of personal or consumer information could also be enacted. Any of these regulations could result in a decline in the use or popularity of the Internet as a medium for commerce, which could have an adverse effect on our future sales and revenue growth.

Our future sales and any future profits will be substantially dependent upon the continued widespread acceptance and use of the Internet by consumers and businesses as an effective medium for exchanging information and conducting business. To be successful, consumers and businesses that historically have used traditional means of commerce to transact business must continue to accept and utilize the Internet as a medium for conducting business and exchanging information. Consumers and businesses may eventually reject the Internet as a viable commercial medium for a number of reasons, including potentially inadequate network infrastructure, slow development of enabling technologies such as broadband or other technologies that enable rapid download of purchased products, insufficient commercial support and privacy and security concerns. In addition, delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity could cause the Internet to lose its viability as a commercial medium.

Our charter documents and Delaware law could discourage an acquisition of our company, even if an acquisition might be viewed as beneficial to our stockholders.

Our stockholder rights plan, and certain provisions in each of our Restated Certificate of Incorporation, Amended and Restated Bylaws and the Delaware General Corporation Law may discourage, delay or prevent an actual or potential change in control of our company even if that change in control would be beneficial to and in the best interests of our stockholders. This could limit our stockholders' ability to approve a transaction that they may deem to be in their best interests. In addition, our Board of Directors has the authority, without stockholder approval, to fix the rights and preferences of, and issue shares of one or more series of preferred stock.

In October 2001, we adopted a new stockholder rights plan, which replaced an existing plan that expired in December 2001, to protect our stockholders in the event of a proposed takeover that has not been recommended or approved by our Board of Directors. Under our current stockholder rights plan, each share of our outstanding common stock has attached to it one preferred share purchase right. Each preferred share purchase right entitles the holder, other than the acquiring person or entity, under certain circumstances, to purchase shares of our common stock at a 50% discount from its then-current market price.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risks relating to our operations result primarily from changes in interest rates and foreign currency exchange rates, as well as credit risk concentrations. To address the foreign currency exchange rate risk we enter into various hedging transactions as described below. We do not use financial instruments for trading purposes.

Foreign Currency Risk

We transact business in various foreign countries and have established a foreign currency hedging program utilizing foreign currency forward exchange contracts to hedge intercompany balances and other monetary assets denominated in foreign currencies. The goal of the hedging program is to offset the earnings impact of foreign denominated balances. We do not use foreign currency forward exchange contracts for trading purposes. At month-end, foreign denominated balances and the forward exchange contracts are marked-to-market and unrealized gains and losses are included in current period net income.

During the three months ending March 31, 2002, we have recorded net foreign exchange losses of $0.3 million. The foreign exchange losses were generated primarily due to the strength of the dollar relative to the Euro and the Japanese Yen. It is uncertain that these currency trends will continue. If these currency trends continue, we will continue to experience foreign exchange losses on our intercompany receivables to the extent that we have not hedged the exposure with foreign currency forward exchange contracts. Such foreign exchange losses could have a material adverse effect on our operating results and cash flows.

During the quarter ended March 31, 2002, we recorded a foreign currency gain of approximately $0.4 million as part of other comprehensive income due to foreign currency movements on our long-term intercompany balances. As of March 31, 2002, we had $9.1 million and $2.8 million in long-term intercompany balances that will be settled in Australian dollars and Singapore dollars, respectively.

The table below provides information about our derivative financial instruments, comprised of foreign currency forward exchange contracts. The information is provided in U.S. dollar equivalent amounts, as presented in our financial statements. For foreign currency forward exchange contracts, the table presents the notional amounts (at the contract exchange rates), the weighted average contractual foreign currency exchange rates and the net fair value as of March 31, 2002. All instruments mature within twelve months (dollar amounts in thousands).

	Notional Amount	Average Contract Rate	March 31, 2002 Net Fair Value
Foreign currency forward exchange contracts:			
Euro	5,484	0.8666	(31)
Australian Dollar	1,558	0.5283	(16)
New Zealand Dollar	647	0.4313	(15)
Singapore Dollar	1,357	0.5427	—
Korean Won	1,897	0.00074	(33)
Hong Kong Dollar	2,499	0.1281	(1)
Great Britain Pound	1,113	1.4230	(2)
New Taiwan Dollar	860	0.0282	(12)
Others	806		(10)
Total	16,221		(120)

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place our cash equivalents and short-term investments in a variety of financial instruments such as commercial paper. By corporate policy, we limit the amount of our credit exposure to $5.0 million to any one commercial issuer.

We mitigate default risk by investing in securities rated as least A2/P2 as published by Standard and Poors and Moodys and by constantly positioning our portfolio to respond appropriately to a significant reduction in the credit rating of any investment issuer. Our portfolio includes only marketable securities with active secondary and resale markets to ensure portfolio liquidity.

The table below presents principal (or notional) amounts and related weighted average interest rates by year of maturity for our investment portfolio (dollar amounts in thousands).

	2002	2003	2004	2005	2006	Thereafter	Total
Cash equivalents							
Fixed rate	$ 237,979	—	—	—	—	—	$ 237,979
Average interest rate	2.12%	—	—	—	—	—	2.12%
Short-term investments							
Fixed rate	$ 58,218	—	—	—	—	—	$ 58,218
Average interest rate	2.97%	—	—	—	—	—	2.97%

Credit Risks

Our financial instruments that are exposed to concentrations of credit risk consist primarily of cash equivalents and trade receivables. Our cash equivalents are in high quality securities placed with major banks and financial institutions. Concentrations of credit risk with respect to receivables are limited due to the large number of customers and their dispersion across geographic areas. We perform periodic credit evaluations of our customers' financial condition and generally do not require collateral. As of March 31, 2002, no single group or customer represents greater than 10% of total accounts receivable.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

Although litigation is subject to inherent uncertainties, we do not believe that the ultimate outcome of any of our legal proceedings will have a material adverse effect on our financial position or overall trends in results of operations. However, if an unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period. We believe that, given our current liquidity and cash and investment balances, even were we to receive an adverse judgment with respect to litigation that we are currently a party to, such a judgment would not have a material impact on cash and investments or liquidity.

Item 5. Other Information

Agreements with Sun Microsystems, Inc.

Filed with this Form 10-Q, pursuant to (b)(10) of Item 601 of Regulation S-K, are certain agreements between ourselves and Sun Microsystems, Inc. ("Sun") relating to Borland's license from Sun of Sun's Java technology.

Agreements with Microsoft Corporation

Filed with this Form 10-Q, pursuant to (b)(10) of Item 601 of Regulation S-K, are certain agreements between ourselves and Microsoft Corporation ("Microsoft") relating to Borland's license from Microsoft of certain Microsoft technology.

Item 6. Exhibits and Reports on Form 8-K

A. Exhibits

The following exhibits are filed as part of, or incorporated by reference into, this Quarterly Report.

Exhibit No.	Description of Exhibit
4.1	Specimen Stock Certificate of Borland Software Corporation. *
10.1	Addendum Number 1 to Software License Agreement between Sun Microsystems, Inc. and Borland Software Corporation, dated as of December 12, 2001. *
10.2	Addendum Number 1 to Trademark License between Sun Microsystems, Inc. and Borland Software Corporation, dated as of December 12, 2001. *
10.3	Addendum Number 2 to Master Support Agreement between Sun Microsystems, Inc. and Borland Software Corporation, dated as of December 12, 2001. *
10.4	Addendum Number 3 to Master Support Agreement between Sun Microsystems, Inc. and Borland Software Corporation, dated as of December 21, 2001. *+
10.5	Wireless Toolkit Supplement to the Sun Community Source Licenses between Sun Microsystems, Inc. and Borland Software Corporation, dated as of December 21, 2001. *+
10.6	Open Tools License Agreement between Microsoft Corporation and Borland Software Corporation, dated as of March 2, 1999. *+
10.7	Amendment Number 1 to Open Tools License Agreement between Microsoft Corporation and Borland Software Corporation, dated as of June 2, 1999. *

Exhibit No.	Description of Exhibit
10.8	License and Distribution Agreement (Microsoft Internet Explorer and Components – Windows 95 and Windows NT Version) between Microsoft Corporation and Borland Software Corporation, dated as of May 7, 1997. *

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* Filed herewith.

\+ Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.

A copy of any exhibit will be furnished (at a reasonable cost) to any stockholder of Borland upon receipt of a written request. Such request should be sent to Borland Software Corporation, 100 Enterprise Way, Scotts Valley, California 95066-3249, Attention: Investor Relations.

B. Reports on Form 8-K

During the quarter ended March 31, 2002, Borland filed the following Current Reports on Form 8-K with the Securities and Exchange Commission:

Form 8-K filed on March 15, 2002 announcing the entry of Doug Barre, Keith E. Gottfried, and Edward Shelton into stock trading plans in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934.

Form 8-K filed on January 22, 2002 announcing that Borland had acquired all of the outstanding capital stock of Redline Software, Inc., a Delaware corporation known to its customers as VMGEAR, pursuant to a Stock Purchase Agreement.

SIGNATURES

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

BORLAND SOFTWARE CORPORATION
(Registrant)

Date: May 10, 2002

/ s / FREDERICK A. BALL

Frederick A. Ball
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Duly Authorized Officer)