SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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SCANSOFT INC
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UNITED STATES
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 PERIOD ENDED JUNE 30, 2001

OR

TRANSITION REPORT PURSUANT SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 0-27038

SCANSOFT, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	94-3156479
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(IRS EMPLOYER IDENTIFICATION NUMBER)

9 CENTENNIAL DRIVE
PEABODY, MA 01960
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)

(978) 977-2000
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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 [X]   No [ ]

50,901,574 shares of the registrant's Common Stock, $0.001 par value, were outstanding as of July 31, 2001

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SCANSOFT, INC.

FORM 10-Q
SIX MONTHS ENDED JUNE 30, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SCANSOFT, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)
UNAUDITED

<TABLE>
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<S>	JUNE 30, 2001 <C>	DECEMBER 31, 2000 <C>
ASSETS		
Current Assets:		
Cash and cash equivalents........	$ 7,907	$ 2,571
Short-term investments........	62	62
Accounts receivable, less allowances of $5,496 and $7,375........	7,446	8,314
Inventory........	456	806
Prepaid expenses and other current assets........	1,572	1,610
Total current assets........	17,443	13,363
Goodwill and other intangible assets, net........	78,384	92,051
Property and equipment, net........	2,075	2,954
Other assets........	984	1,112
TOTAL ASSETS........	$ 98,886	109,480
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Short term bank borrowings........	$ --	$ 3,400
Accounts payable........	5,976	7,945
Accrued sales and marketing expenses........	1,388	1,880
Other accrued expenses........	5,315	5,538
Deferred revenue........	2,271	1,084
Total current liabilities........	14,950	19,847
Deferred revenue........	3,036	2,172
Stockholders' equity:		
Series B convertible preferred stock, $0.001 par value; 40,000,000 shares authorized; 3,562,238 issued and outstanding; liquidation preference $4,631........	4,631	4,631
Common stock, $0.001 par value; 140,000,000 shares authorized; 50,901,574 and 46,072,748 shares issued and outstanding, respectively........	51	46
Additional paid-in capital........	224,234	219,259
Accumulated other comprehensive loss........	(338)	(93)
Accumulated deficit........	(147,678)	(136,382)

Total stockholders' equity	80,900	87,461
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 98,886	$ 109,480

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
UNAUDITED

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	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2001	2000	2001	2000
<S>	<C>	<C>	<C>	<C>
Net revenue	$ 15,078	$ 13,975	$ 27,879	$ 21,390
Costs and expenses:				
Cost of revenue	2,828	4,084	5,718	6,525
Research and development	3,238	4,820	6,434	8,054
Selling, general and administrative	6,327	8,772	12,914	14,209
Amortization of goodwill and other intangible assets	6,833	7,098	13,667	9,012
Restructuring and other charges	--	4,956	--	4,956
Acquired in-process research and development	--	--	--	18,291
Total costs and expenses	19,226	29,730	38,733	61,047
Loss from operations	(4,148)	(15,755)	(10,854)	(39,657)
Other expense, net	(5)	(35)	(139)	--
Loss before income taxes	(4,153)	(15,790)	(10,993)	(39,657)
Provision for income taxes	242	238	303	308
Net loss	$ (4,395)	$(16,028)	$(11,296)	$(39,965)
Net loss per share: basic and diluted	$ (0.09)	$ (0.35)	$ (0.24)	$ (1.05)
Weighted average common shares: basic and diluted	48,939	45,918	47,520	38,219

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
UNAUDITED

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	SIX MONTHS ENDED JUNE 30, 2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(11,296)	$(39,965)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	975	559
Accounts receivable allowances	(1,879)	53
Amortization of goodwill and other intangible assets	13,667	9,012
Provision for impairment of intangible assets	--	3,490
Gain on sale of property and equipment	(95)	--
Write off of acquired in-process research and development	--	18,291
Changes in assets and liabilities, net of effects from acquisitions:		
Accounts receivable	2,747	4,181
Inventory	350	149
Prepaid expenses and other assets	166	(281)
Deferred revenue	2,051	626
Accounts payable and accrued expenses	(2,684)	(1,169)
Net cash provided by (used in) operating activities	4,002	(5,054)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	344	--
Cash of business acquired, net of cash paid	--	1,419
Capital expenditures for property and equipment	(345)	(165)
Net cash (used in) provided by investing activities	(1)	1,254
CASH FLOWS FROM FINANCING ACTIVITIES:		
(Payments of) proceeds from short term bank borrowings	(3,400)	4,750
Payment of notes payable	--	(1,600)
Proceeds from the issuance of common stock, net of issuance costs	4,980	615
Net cash provided by financing activities	1,580	3,765
Effects of exchange rate changes on cash and cash equivalents	(245)	(19)
Net increase (decrease) in cash and cash equivalents	5,336	(54)
Cash and cash equivalents at beginning of period	2,571	5,162
Cash and cash equivalents at end of period	$ 7,907	$ 5,108

</TABLE>

The accompanying notes are an integral part of these consolidated financial statements.

SCANSOFT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

BASIS OF PRESENTATION:

The accompanying unaudited consolidated financial statements of ScanSoft, Inc. (the "Company" or "ScanSoft") have been prepared in accordance with generally accepted accounting principles. In the opinion of management, these interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position, results of operations, and cash flows at June 30, 2001, and for the three and six months ended June 30, 2001 and 2000. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information normally included in footnotes prepared in accordance with generally accepted accounting principles has been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000 filed with the Securities and Exchange Commission on April 2, 2001.

The results for the three and six months ended June 30, 2001, are not necessarily indicative of the results that may be expected for the year ending December 31, 2001, or any future period.

On March 13, 2000, the Company merged with Caere Corporation ("Caere"), a California-based digital imaging software company. The acquisition was accounted for under the purchase method of accounting and, accordingly, the results of operations of Caere and the fair market value of acquired assets and assumed liabilities have been included in the Company's financial statements as of the acquisition date.

The preparation of 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 on the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant estimates included in the financial statements are accounts receivable and sales allowances, inventory valuation, and the recoverability of intangible assets including goodwill. Actual results could differ from those estimates.

RECLASSIFICATIONS

Certain prior year financial statement amounts have been reclassified to conform with the current year presentation.

BALANCE SHEET COMPONENTS:

The following table summarizes key balance sheet components (in thousands):

	JUNE 30, 2001	DECEMBER 31, 2000
Inventory:		
Raw materials	$ 273	$ 324
Finished goods	183	482
	$ 456	$ 806
Other current liabilities:		
Accrued compensation	$1,554	$ 1,188
Accrued restructuring	800	1,428
Accrued royalties	737	650
Accrued professional fees	295	638
Accrued taxes and other	1,929	1,634
	$5,315	$ 5,538

CAERE ACQUISITION:

On March 13, 2000, the Company acquired all of the outstanding capital stock of Caere Corporation, a California-based company that designed, developed and marketed a range of optical character recognition software tools, for consideration totaling $168.4 million.

In connection with the acquisition, $18.3 million was charged to operations upon consummation of the acquisition, which represented acquired in-process research and development on development projects that had not yet reached technological feasibility and had no alternative future use.

This acquisition has been accounted for under the purchase method of accounting. Accordingly, the results of operations of Caere and the fair market value of acquired assets and assumed liabilities have been included in the financial statements of the Company as of the date of acquisition.

PRO FORMA RESULTS (UNAUDITED)

The following table reflects the unaudited pro forma results of operations of the Company assuming that the acquisition of Caere had occurred on January 1, 2000 (in thousands, except per share data):

	SIX MONTHS ENDED June 30, 2000
Revenue..	$ 27,437
Net loss...	(38,610)
Net loss per share.................................	(0.84)

These unaudited pro forma results of operations do not include the write-off of acquired in-process research and development as this amount is non-recurring in nature. The unaudited pro forma results of operations are not necessarily indicative of the actual results that would have occurred had the transaction actually taken place at the beginning of the periods. The three months ended June 30, 2001 and 2000 and the six months ended June 30, 2001 include the results of Caere for the entire periods; accordingly, the pro forma results do not differ from the Company's reported results for those periods.

RESTRUCTURING AND OTHER CHARGES:

In connection with the acquisition of Caere in the first quarter of 2000, the Company identified 46 employees of Caere whose positions were eliminated upon consummation of the acquisition. These positions included 22 in research and development, 14 in general and administrative functions, and 10 in sales and marketing. Additionally, the Caere president and CEO position was eliminated. As a result, the Company established as part of the purchase price allocation, a restructuring reserve of $487,000 for severance payments to employees, and a restructuring reserve of $1,065,000 for severance to the Caere former president and CEO, the payments of which will continue through March 2005.

In June 2000, the Company implemented a restructuring plan to strategically refocus the Company and bring operating expenses in line with net revenues. As a result, the Company eliminated 65 employee positions including 29 in research and development, 13 in general and administrative functions and 23 in support and marketing. The Company recorded in the second quarter of 2000 a restructuring charge in the amount of $1,069,000 for severance payments to these employees, and a restructuring charge of $397,000 for certain termination fees to be incurred as a result of exiting the Los Gatos facility. Additionally, the Company wrote-off $3,490,000 of net intangible assets acquired as part of the Caere acquisition including the acquired work force of $1,074,000 and the favorable building lease of $2,416,000, which were impaired as a result of the restructuring action.

The following table sets forth the 2001 restructuring reserve activity (in thousands):

RESTRUCTURING AND OTHER CHARGES RESERVE	EMPLOYEE RELATED	LEASE EXIT COSTS	TOTAL
Balance at December 31, 2000.................	$1,428	$ 50	$1,478
Cash payments................................	(628)	(50)	(678)
Balance at June 30, 2001.....................	$ 800	$ --	$ 800

The remaining severance balance of $800,000 will be paid through March 2005 as it primarily relates to severance for the former Caere President and CEO.

NET LOSS PER SHARE:

Diluted net loss per share excludes the weighted-average effect of options and warrants to purchase common stock as well as the conversion of Series B preferred stock, of 4,341,409 shares and 4,226,626 shares for the three and six months ended June, 30, 2001, respectively, and 5,955,958 shares and 6,740,202 shares for the three and six months ended June 30, 2000. These potential common shares were excluded from the calculation of diluted net loss per share as their inclusion would have been anti-dilutive for all periods presented.

COMPREHENSIVE LOSS

Total comprehensive loss, net of taxes, was approximately $4,458,000 and $11,541,000 for the three and six months ended June 30, 2001, respectively, and was approximately $16,053,000 and $40,054,000 for the three and six months ended June 30, 2000, respectively. Total comprehensive losses consisted of net losses and foreign currency translation adjustments for the respective periods.

BANK LINE OF CREDIT:

On March 14, 2000, the Company entered into a one year Credit Agreement (the "Agreement") with its primary financial institution for a $10,000,000 revolving loan (the "Credit Facility"). Borrowings under the Credit Facility bear interest at the prime rate plus one percent (9.0% at March 31, 2001). The maximum aggregate amount of borrowings outstanding at any one time was limited to the lesser of (a) $10,000,000 or (b) the Borrowing Base. The Borrowing Base was equal to fifty percent (50%) of eligible accounts receivables. As of June 12, 2000, the Agreement was amended to modify the total commitment by the bank from $10,000,000 to $5,000,000 and the Borrowing Base requirement was removed. The Agreement was subsequently amended on October 18, 2000 and December 28, 2000 at which point the maturity date was extended from March 12, 2001 until September 30, 2001.

On May 10, 2001, the Company prepaid in full its remaining obligation on the Credit Facility, which included principle and interest amounting to $2,080,000. The Credit Facility was terminated and cancelled upon the prepayment.

CONTINGENCIES

As a normal incidence of the nature of the Company's business, various claims, charges and litigation have been asserted or commenced against the Company arising from or related to employee relations. Management does not believe these claims will have a material effect on the financial position or results of operations of the Company.

EQUITY INVESTMENT

On May 8, 2001, the State of Wisconsin Investment Board (SWIB) purchased an additional 4.76 million shares of ScanSoft common stock for $5.0 million. As of June 30, 2001, SWIB owned 8.63 million shares, or approximately 16.9 percent of ScanSoft's outstanding common stock.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives. SFAS 142 also provides specific guidance for testing goodwill for impairment. SFAS 142 is effective for the Company's fiscal quarters beginning on January 1, 2002; early adoption is not permitted. The Company is currently assessing the impact of adopting SFAS 142 on its financial position and results of operations.

In June 2001, the Emerging Issues Task Force of the Financial Accounting Standards Board issued EITF Issue No. 00-25 ("EITF 00-25"), "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." EITF 00-25 addresses whether consideration from a vendor to a reseller of the vendor's products is an adjustment to the selling prices of the vendor's products and, therefore, should be deducted from revenue when recognized in the vendor's results of operations, or, a cost incurred by the vendor for assets or services received from the reseller and, therefore, should be included as a cost of expense when recognized in the vendor's results of operations. EITF 00-25 is effective for the Company's fiscal quarters beginning on January 1, 2002; early adoption is encouraged. Upon adoption of EITF 00-25, financial statements for prior periods presented for comparative purposes should be reclassified to comply with EITF 00-25. The Company is currently assessing the impact of adopting EITF 00-25 on its financial position and results of operations.

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

FORWARD LOOKING STATEMENTS

Certain statements made in this report as well as oral statements made by the Company from time to time, which are prefaced with words such as, "expects", "anticipates", "believes", "projects", "intends", "plans", and similar words and other statements of similar sense, are forward looking statements. These statements are based on the Company's current expectations and estimates as to prospective events and circumstances, which may or may not be in the Company's control and as to which there can be no firm assurance given.

These forward looking statements, like any other forward looking statement, involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties are outlined later in this document and should not be construed as exhaustive. The Company disclaims any obligation to subsequently revise forward looking statements or to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Further discussions of risk factors are also available in the Company's registration statements filed with the Securities and Exchange Commission. The Company wishes to caution readers not to place undue reliance upon such forward-looking statements, which speak only as of the date made.

OVERVIEW

ScanSoft, Inc. provides scanning and paper-to-digital solutions for individuals and workgroups. Our products are sold primarily through retail distributors, direct e-commerce and OEM partners on a worldwide basis. On March 13, 2000, we merged with Caere Corporation, a California-based digital imaging software company. As a result, Caere became a wholly owned subsidiary of ScanSoft, continuing under the name Caere Corporation. As more fully discussed within, the Company undertook several restructuring actions during the first and second quarters of 2000 to align the two companies.

Our success in the future will depend on our ability to maintain and improve software gross margins and to increase sales of our software products. This will depend in part on our ability and the ability of our distributors, resellers and OEM partners to convince end-users to adopt paper and image input systems for the desktop and to educate end-users about the benefits of our products. Since the Caere acquisition in the first quarter of 2000, we have experienced quarterly operating losses. There can be no assurance that we will be able to reach quarterly profitability or attain annual profitability in the near future. As of June 30, 2001, we had an accumulated deficit of $147.7 million.

RESULTS OF OPERATIONS

The following table presents, as a percentage of total revenue, certain selected financial data for the three and six months ended June 30, 2001 and June 30, 2000:

<TABLE>
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	THREE MONTHS ENDED JUNE 30, 2001	THREE MONTHS ENDED JUNE 30, 2000	SIX MONTHS ENDED JUNE 30, 2001	SIX MONTHS ENDED JUNE 30, 2000
<S>	<C>	<C>	<C>	<C>
Net revenue:	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of revenue	18.8%	29.2%	20.5%	30.5%
Research and development	21.5%	34.5%	23.1%	37.7%
Selling, general and administrative	42.0%	62.8%	46.3%	66.4%
Amortization of goodwill and other intangible Assets	45.3%	50.8%	49.0%	42.1%
Restructuring and other charges	0.0%	35.5%	0.0%	23.2%
Acquired in-process research and development	0.0%	0.0%	0.0%	85.5%
Total costs and expenses	127.6%	212.8%	(138.9)%	285.4%
Loss from operations	(27.6)%	(112.8)%	(38.9)%	(185.4)%
Other expense, net	(0.0)%	(0.3)%	(0.5)%	(0.0)%
Loss before income taxes	(27.6)%	(113.1)%	(39.4)%	(185.4)%
Provision for income taxes	(1.6)%	(1.7)%	(1.1)%	(1.4)%
Net loss	(29.2)%	(114.8)%	(40.5)%	(186.8)%

</TABLE>

REVENUE

Net revenue of $15.1 million for the three months ended June 30, 2001 increased by $1.1 million or 8% from the comparable period in 2000. The primary increase in revenue was due to the release of our OmniPage Pro 11 (OmniPage 11) product in June 2001. The release of this product produced incremental revenue of approximately $1.9 million for the quarter offset by a decrease in retail revenue related to slower demand in North America. The revenue growth came primarily from the success of the OmniPage 11 upgrade program marketed directly to end-users completed in June 2001. The future success of similar programs cannot be predicted and other product releases may not be as successful.

Revenue for the six months ended June 30, 2001 increased $6.5 million or 30% from the comparable period of 2000. The increase in revenue came primarily from our OCR product family, which increased by approximately $3.1 million from the prior comparable period. The increase was attributed to a full six months of Caere revenue being included in the current period and the release of OmniPage 11 as noted above. The increase also included incremental revenue of $1.7 million from our paper management family of software, which reflects a full six months of revenue from our PaperPort 7.0 product that was released in May 2000.

The revenue split for the three months ended June 30, 2001, was 84% North America and 16% European versus 83% and 17%, respectively, for the comparable period ending June 30, 2000. The revenue split for the six months ended June 30, 2001, was 81% North America and 19% European versus 85% and 15%, respectively for the comparable period ending June 30, 2000. The slight increase in North America for the three months ended June 30, 2001 was associated with the release of the English version of OmniPage 11. The international versions of OmniPage 11 are anticipated to be released during the third quarter of 2001. The increase in European revenue for the comparable six months was attributed to the Caere acquisition completed on March 13, 2000, which included four European offices.

The breakdown of net revenue for the three months ended June 30, 2001 was 42% retail, 26% direct, 28% OEM, and 4% Corporate, this compared to 57% retail, 22% direct, 19% OEM, and 2% Corporate, for the same period in 2000. The breakdown of net revenue for the six months ended June 30, 2001 was 47% retail, 19% direct, 29% OEM, and 5% Corporate, compared to 47% retail, 23% direct, 29% OEM and 1% Corporate, for the same period in 2000. The increase in direct revenue over the comparable quarter is related to the OmniPage 11 release during June 2001. The increase in OEM revenue in the three months ended June 30, 2001 over the comparable quarter results from increased OEM business with Xerox, HP, Umax and Vividata, respectively. The increase in corporate revenue for the three and six months ended June 30, 2001 compared to the same periods in 2000, is a result of additional sales resources being committed to corporate multi-user license opportunities. We anticipate the revenue mix for the remaining quarters of 2001 to be roughly consistent with the first six months ended June 30, 2001.

COST OF REVENUE

Cost of revenue consists primarily of material costs, third party royalties, fulfillment, and salaries for product support personnel. Cost of revenue for the three months ended June 30, 2001 was $2.8 million or 18.8% of revenue, compared to $4.1 million or 29.2% of revenue in the comparable period of 2000. Cost of revenue for the six months ended June 30, 2001 was $5.7 million or 20.5% of revenue, compared to $6.5 million or 30.5% for the same period in 2000. The decrease in dollars and as a percentage of revenue for both the three and six months ended June 30, 2001 are directly attributed to the consolidation of our manufacturing fulfillment activities and cost savings initiatives we introduced in the second quarter of 2000. We anticipate cost of revenue as a percentage of revenue to remain consistent with the six months ended June 30, 2001 for the remaining quarters of 2001.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist primarily of salary and benefit costs of engineers. Research and development costs were $3.2 million or 21.5% of revenue in the three months ended June 30, 2001, compared to $4.8 million or 34.5% of revenue for the same three months in 2000. Research and development costs for the six months ended June 30, 2001 were $6.4 million or 23.1% of revenue, compared to $8.1 million or 37.7% for the same period in 2000. The decrease in terms of whole dollars for both the three and six month periods is related to cost reduction efforts undertaken during the first and second quarters of 2000. The decrease in research and development as a percentage of revenue for both the three and six month periods is directly related to increased revenues for both periods. We anticipate research and development expenses as a percentage of revenue to remain consistent with the six months ended June 30, 2001 for the remaining quarters of 2001.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling expenses include salaries, commissions, advertising, direct mail, public relations, trade shows, travel and other related sales and marketing expenses. General and administrative expenses include personnel costs for administration, finance, human resources, information systems, and general management in addition to legal and accounting expenses and other professional services.

Selling, general and administrative expenses in the three months ended June 30, 2001 were $6.3 million or 42.0% of revenue, as compared to $8.8 million or 62.8% of revenue for the same period in 2000. Selling, general and administrative expenses for the six months ended June 30, 2001 were $12.9 million or 46.3% of revenue, as compared to $14.2 million or 66.4% for the six months ended June 30, 2000. The decrease in terms of whole dollars for both the three and six month periods is related to cost reduction efforts undertaken during the first and second quarters of 2000. The decrease in selling, general and administrative expenses as a percentage of revenue for both the three and six month periods is directly related to increased revenues for both periods. We anticipate selling general and administrative expenses for the remainder of 2001 to decrease as a percentage of revenue, as compared with the first six months of 2001, as expenses are projected to grow more slowly than revenue.

OTHER COSTS AND EXPENSES

RESTRUCTURING AND OTHER CHARGES:

In connection with the acquisition of Caere in the first quarter of 2000, the Company identified 46 employees of Caere whose positions were eliminated upon consummation of the acquisition. These positions included 22 in research and development, 14 in general and administrative functions, and 10 in sales and marketing. Additionally, the Caere president and CEO position was eliminated. As a result, the Company established as part of the purchase price allocation, a restructuring reserve of $487,000 for severance payments to employees, and a restructuring reserve of $1,065,000 for severance to the Caere former president and CEO, the payments of which will continue through March 2005.

In June 2000, the Company implemented a restructuring plan to strategically refocus the Company and bring operating expenses in line with net revenues. As a result, the Company eliminated 65 employee positions including 29 in research and development, 13 in general and administrative functions and 23 in support and marketing. The Company recorded a restructuring charge in the amount of $1,069,000 for severance payments to these employees and a restructuring charge of $397,000 for certain termination fees to be incurred as a result of exiting the Los Gatos facility. Additionally, the Company wrote-off $3,490,000 of net intangible assets acquired as part of the Caere acquisition including the acquired work force of $1,074,000 and the favorable building lease of $2,416,000, which were impaired as a result of the restructuring action.

For the six months ended June 30, 2001, the Company paid $628,000 in severance payments related to these restructuring actions. The remaining severance balance of $800,000 will be paid through March 2005 as it primarily relates to severance for the former Caere President and CEO.

AMORTIZATION OF GOODWILL AND OTHER INTANGIBLE ASSETS AND IN-PROCESS RESEARCH AND DEVELOPEMENT

Amortization of intangible assets for the three months ended June 30, 2001 was $6.8 million compared to $7.1 million for the same period in 2000. Amortization of intangible assets for the six months ended June 30, 2001 was $13.7 million compared to $9.0 million for the same period in 2000. The decrease in amortization expense of $0.3 million for the three months ended June 30, 2001 was attributed to the write-off of intangible assets of $3.5 million, which were impaired as a result of the June 2000 restructuring. The increase in amortization of intangible assets of $4.7 million for the six months ended June 30, 2001 compared to the same period in 2000, resulted from six months of amortization for the Caere acquisition being taken in 2001 versus approximately four months in 2000. For the six months ended June 30, 2000, amortization was only included from March 13, 2000, the date of the Caere acquisition. The useful lives of the intangible assets used for amortization range from three to seven years. The Company also recorded a write-off of acquired in-process research and development of $18.3 million during the first quarter of 2000.

OTHER INCOME (EXPENSE), NET

Other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term investments offset by interest incurred for borrowings under credit facilities and short-term notes and currency exchange gains and losses.

Other expense, net was $5,000 for the three months ended June 30, 2001, compared to other expense, net of $35,000 for the same period in 2000. The decrease was attributable to less interest expense on bank borrowings fully repaid on May 10, 2001. Other expense, net for the six months ended June 30, 2001 was $139,000, compared to zero for the same period in 2000. The increase in other expense was directly related to realized currency exchange losses of $199,000 and interest expense of $158,000. This was offset by interest income of $80,000, a $95,000 gain realized on the disposition of assets and other income of $43,000. For the six months ended June 30, 2000 the Company experienced foreign currency exchange gains, which were offset by higher interest expense of $222,000 on higher bank borrowings resulting in net zero other income.

TAXATION

Tax provisions of $242,000 and $303,000 for the three and six months ended June 30, 2001 respectively, and $238,000 and $308,000 for the three and six months ended June 30, 2000, respectively, represent taxes in profitable foreign and state jurisdictions in which the Company does business and for which no net operating loss carryforwards were available.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2001, we had cash, cash equivalents and short-term investments of $8.0 million and net working capital of $2.5 million, as compared to $2.6 million in cash and short-term investments and a net working capital deficit of $6.5 million at December 31, 2000.

We generated $4.0 million of cash from our operating activities for the first half 2001, as compared to cash used for operations of $5.1 million for the same period in 2000. The cash generated from operations in 2001 came primarily from the results of operations, collection of amounts due for long-term contracts included in deferred revenue and decreased accounts receivables at the end of the quarter, offset by lower accounts payable and accrued expense balances.

Cash flows from investing activities during the first half of 2001 were breakeven as compared to $1.3 million cash provided, for

the same period in 2000. The breakeven cash flow consisted of proceeds of $0.3 million from the sale of property and equipment offset by $0.3 million of property and equipment acquired during the six months ended June 30, 2001. The comparable period for 2000 included proceeds of $1.4 million of cash acquired in connection with the Caere acquisition.

Cash provided by financing activities for the six months ended June 30, 2001 was $1.6 million as compared to $3.8 million provided from financing activities in 2000. The Company received net proceeds of $4.9 million from the State of Wisconsin Investment Board in exchange for 4.76 million shares of common stock. Additionally, the Company paid the full outstanding balance of $3.4 million on its bank line of credit, which terminated during the three months ended June 30, 2001. This payment represented the remaining balance on the bank line, which was cancelled concurrently with the payment. Cash provided by financing activities for the six months ended June 30, 2000 of $3.8 million was comprised primarily of proceeds of $4.8 million from our line of credit offset by the payment of $1.6 million of notes payable.

Our principal sources of liquidity as of June 30, 2001 consisted of approximately $8.0 million of cash, cash equivalents and short-term investments. As of June 30, 2001, we had fully repaid and cancelled our bank line of credit.

In connection with the Caere acquisition, we entered into a non-competition and consulting agreement with the former Caere President and CEO. Under the terms of the agreement, we agreed to pay the former Caere President and CEO on the second anniversary of the merger, March 13, 2002, in cash, the difference between $13.50 and the closing price per share of ScanSoft common stock at that time, multiplied by the number of beneficial shares owned by the former executive.

Although we generated $4.0 million of cash from operations for the six months ended June 30, 2001, there can be no assurance that we will be able to continue to generate cash from operations or secure additional equity financing if required. We have sustained recurring losses and have an accumulated deficit at June 30, 2001. We believe that the actions taken in fiscal 2000, including restructuring actions and other cost reduction initiatives, have reduced operating expenses to levels which, in combination with expected future revenues, will result in continued positive cash flow. Therefore, we believe that cash flows from future operations in addition to cash on hand will be sufficient to meet the our obligations as they become due for the foreseeable future. We also believe that, should revenue not achieve the expected levels for the remainder of 2001, we have the ability, and are committed, to reduce expenses further in order to continue to meet our obligations. We are continuing to pursue various actions in 2001, including potential equity financing and strategic alliances that may also provide additional liquidity. However, there can be no certainty that the we will meet our planned operations, will be able to reduce expenses quickly enough, or will be successful in obtaining additional equity financing or strategic alliances on terms favorable to us such that the we will be able to meet our obligations as they become due in the foreseeable future.

FOREIGN OPERATIONS:

As a result of the Caere acquisition, in March 2000, the Company significantly increased its presence in Europe. The Company conducts certain business transactions in the euro, and will change its functional currencies for the affected countries to the euro by the end of the three-year transition period. The conversion to the euro has not and is not expected to have a significant operational impact or a material financial impact on the results of operations, financial position, or the liquidity of the Company's European businesses. Changes in the value of the euro or other foreign currencies relative to the value of the U.S. dollar could adversely affect future revenues and operating results. Currently, the Company does not hedge any of its foreign-currency denominated transactions.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS:

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets." SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets, including how goodwill and other intangible assets should be accounted for after they have been initially recognized. SFAS 142 provides that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment; intangible assets with finite useful lives will continue to be amortized over their useful lives. SFAS 142 also provides specific guidance for testing goodwill for impairment. SFAS 142 is effective for the Company's fiscal quarters beginning on January 1, 2002; early adoption is not permitted. The Company is currently assessing the impact of adopting SFAS 142 on its financial position and results of operations.

In June 2001, the Emerging Issues Task Force of the Financial Accounting Standards Board issued EITF Issue No. 00-25 ("EITF 00-25"), "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." EITF 00-25 addresses whether consideration from a vendor to a reseller of the vendor's products is an adjustment to the selling prices of the

vendor's products and, therefore, should be deducted from revenue when recognized in the vendor's results of operations, or, a cost incurred by the vendor for assets or services received from the reseller and, therefore, should be included as a cost of expense when recognized in the vendor's results of operations. EITF 00-25 is effective for the Company's fiscal quarters beginning on January 1, 2002; early adoption is encouraged. Upon adoption of EITF 00-25, financial statements for prior periods presented for comparative purposes should be reclassified to comply with EITF 00-25. The Company is currently assessing the impact of adopting EITF 00-25 on its financial position and results of operations.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company's business operates in an intensely competitive environment and operations are subject to risks and uncertainties. Such risks and uncertainties include, but are not limited to (1) the loss of, or a significant curtailment of, purchases by any one or more principal customers; (2) the cyclicality of the retail software industry; (3) inability to protect the Company's proprietary technology and intellectual property; (4) the inability to attract or retain skilled employees; (5) technological obsolescence of current products and the inability to develop new products; (6) the inability to respond to competitive technology and competitive pricing pressures; (7) the ability to sustain product revenues upon the introduction of new products; (8) quarterly operating results that fluctuate and differ materially from one quarter to the next which could have an impact on the Company's stock price.

There can be no assurance that cash generated by operations will be sufficient to satisfy our liquidity requirements, and we may be required to sell additional equity or debt securities, or increase or obtain additional lines of credit. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders. It may be difficult to sell additional equity or obtain debt financing, and this could result in significant constraints on the Company's ongoing investments to grow revenue and develop new products.

For further discussion regarding these and other risks, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2000 filed with the Securities and Exchange Commission on April 2, 2001.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We develop our products in the United States and Hungary. We sell our products globally, primarily through an indirect reseller channel. As a result, our financial results are affected by factors such as changes in foreign currency exchange rates and weak economic conditions in foreign markets.

We collect a portion of our revenue and pay a portion of our operating expenses in foreign currencies. As a result, changes in currency exchange rates from time to time may affect our operating results. Currently, we do not engage in hedging transactions to reduce our exposure to changes in currency exchange rates, although we may do so in the future.

PART II. OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 27, 2001, the Company held its Annual Meeting of Stockholders. At such meeting the following actions were voted upon:

(a) To elect a Board of seven (7) directors to hold office until the next annual meeting of stockholders or until their respective successors have been elected and qualified:

DIRECTOR	VOTES FOR	WITHHELD
Michael K. Tivnan	42,683,866	1,360,439
Paul A. Ricci	43,402,746	641,559
Mark B. Myers	43,346,875	697,430
Katharine A. Martin	43,373,759	670,546
Robert G. Teresi	42,903,439	1,140,866
Robert J. Frankenberg	43,371,228	673,077
Herve Gallaire	43,338,622	705,683

(b) To approve an amendment to the 1995 Director's Stock Option Plan to (a) increase the number of shares that may be issued under the Plan, (b) to increase the number of shares in the initial and subsequent annual grants to directors, and (c) to grant to persons who were outside directors on January 23, 2001 an additional grant of 40,000 shares.

VOTES FOR	VOTES AGAINST	ABSTAINED	BROKER NON-VOTES
36,473,392	7,381,278	189,635	0

(c) To ratify the appointment of PricewaterhouseCoopers LLP as independent public accountants for the period ending December 31, 2001:

VOTES FOR	VOTES AGAINST	ABSTAINED
43,566,951	368,093	109,261

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The exhibits listed on the Exhibit Index hereto are filed or incorporated by reference (as stated therein) as part of this report on Form 10-Q.

(b) Reports on Form 8-K

May 30, 2001, Form 8-K/A Item 7, update to exhibits and exhibit index to report of Form 8-K dated March 13, 2000.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the Registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Peabody, State of Massachusetts, on August 3, 2001.

SCANSOFT, INC.

By: /s/ GERALD C. KENT JR.

Gerald C. Kent, Jr.
Chief Accounting Officer
And Corporate Controller

EXHIBIT INDEX

Exhibits (numbered in accordance with Item 601 of Regulation S-K)

EXHIBIT NO.	DESCRIPTION OF EXHIBITS
2.1(1)	Agreement and Plan of Merger dated December2, 1998, between Visioneer, Inc., a Delaware corporation, and ScanSoft, Inc., a Delaware corporation.
2.2(2)	Agreement and Plan of Reorganization, dated January 15, 2000, by and among ScanSoft, Inc., a Delaware corporation, Scorpion Acquisitions Corporation, a Delaware corporation and a wholly-owned subsidiary of ScanSoft, and Caere Corporation, a Delaware corporation.
3.1(3)	Bylaws of Registrant.
3.2(6)	Amended and Restated Certificate of Incorporation of Registrant.
4.1(4)	Specimen Common Stock Certificate.
4.2(5)	Preferred Shares Rights Agreement, dated as of October 23, 1996, between the Registrant and U.S. Stock Transfer Corporation, including the Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock, the form of Rights Certificate and Summary of Rights attached thereto as Exhibits A, B and C, respectively.
4.3(1)	Common Stock Purchase Warrant.
4.4(1)	Registration Rights Agreement, dated March 2, 1999, between the Registrant and Xerox Corporation.

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(1) Incorporated by reference from the Registrant's Registration Statement on Form S-4 (No. 333-70603) filed with the Commission on January 14, 1999.

(2) Incorporated by reference from the Registrant's Registration Statement on Form S-4 (No. 333-96487) filed with the Commission on February 9, 2000.

(3) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (No. 333-98356) filed with the Commission on October 19, 1995.

(4) Incorporated by reference from the Registrant's Registration Statement on Form S-1 (No. 33-98356) filed with the Commission on October 19, 1995.

(5) Incorporated by reference from the Registrant's current Report on Form 8-K dated October 31, 1996.

(6) Incorporated by reference from the Registrants current Report on Form 10Q dated May 11, 2001.