SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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PARAMETRIC TECHNOLOGY CORP

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended: April 3, 2004

Commission File Number: 0-18059

Parametric Technology Corporation

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2866152**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

140 Kendrick Street, Needham, MA 02494
(Address of principal executive offices, including zip code)

(781) 370-5000
(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 ☒ NO ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). YES ☒ NO ☐

There were 268,073,578 shares of our common stock outstanding on May 7, 2004 and 268,030,621 shares of our common stock outstanding on April 3, 2004.

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PART I–FINANCIAL INFORMATION

PARAMETRIC TECHNOLOGY CORPORATION

CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)
(unaudited)

	April 3, 2004	September 30, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$221,665	$ 205,312
Accounts receivable, net of allowance for doubtful accounts of $6,541 and $6,845, respectively	154,827	140,151
Prepaid expenses	28,781	29,616
Other current assets	54,397	41,007
Total current assets	459,670	416,086
Property and equipment, net	62,541	73,563
Goodwill (Note 5)	38,301	37,404
Other intangible assets, net (Note 5)	11,537	14,447
Other assets	33,623	36,190
Total assets	$605,672	$ 577,690
LIABILITIES AND STOCKHOLDERS' EQUITY		

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Current liabilities:		
Accounts payable	$17,949	$ 20,569
Accrued expenses and other current liabilities	49,350	48,296
Accrued compensation and severance	53,481	55,620
Deferred revenue	214,082	173,015
Total current liabilities	334,862	297,500
Other liabilities	91,505	85,032
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000 shares authorized; none issued	–	–
Common stock, $0.01 par value; 500,000 shares authorized; 268,031 and 266,383 shares issued, respectively	2,680	2,664
Additional paid-in capital	1,657,277	1,652,303
Accumulated deficit	(1,445,329)	(1,421,963)
Accumulated other comprehensive loss	(35,323)	(37,846)
Total stockholders' equity	179,305	195,158
Total liabilities and stockholders' equity	$605,672	$ 577,690

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

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PARAMETRIC TECHNOLOGY CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Revenue:				
License	$50,971	$55,284	$94,488	$106,761
Service	113,737	115,742	227,030	236,232
Total revenue	164,708	171,026	321,518	342,993
Costs and expenses:				
Cost of license revenue	1,914	1,978	4,041	4,623
Cost of service revenue	38,656	50,694	88,676	99,324
Sales and marketing	57,132	77,629	115,317	159,072
Research and development	26,780	31,942	56,359	63,842
General and administrative	14,364	16,654	29,324	32,177
Amortization of intangible assets (Note 5)	1,336	1,460	2,745	2,941
Restructuring and other charges (Note 2)	16,680	–	38,300	–

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Total costs and expenses	156,862	180,357	334,762	361,979
Operating income (loss)	7,846	(9,331)	(13,244)	(18,986)
Other income (expense), net	177	(887)	(313)	(1,452)
Income (loss) before income taxes	8,023	(10,218)	(13,557)	(20,438)
Provision for income taxes	4,852	4,951	9,809	6,121
Net income (loss)	$3,171	$(15,169)	$(23,366)	$(26,559)
Earnings (loss) per share−Basic and Diluted (Note 4):	$0.01	$(0.06)	$(0.09)	$(0.10)
Weighted average shares outstanding−Basic	267,515	263,796	266,895	263,193
Weighted average shares outstanding−Diluted	273,601	263,796	266,895	263,193

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

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PARAMETRIC TECHNOLOGY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six months ended	
	April 3, 2004	March 29, 2003
Cash flows from operating activities:		
Net loss	$(23,366)	$(26,559)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation and amortization	18,742	21,235
Other non-cash costs and expenses	3,375	974
Changes in operating assets and liabilities that provided (used) cash:		
Accounts receivable	(7,053)	184
Accounts payable and accrued expenses	(8,196)	401
Accrued compensation and severance	(4,005)	(7,600)
Deferred revenue	34,624	(3,594)
Income taxes	5,545	51,546
Other current assets and prepaid expenses	(8,416)	(22,057)
Other noncurrent assets and liabilities	3,922	(11,436)

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Net cash provided by operating activities	15,172	3,094
Cash flows from investing activities:		
Additions to property and equipment	(4,500)	(11,305)
Additions to other intangible assets	(1,192)	(1,980)
Purchases of investments	–	(10,417)
Proceeds from sales and maturities of investments	–	10,400
Net cash used by investing activities	(5,692)	(13,302)
Cash flows from financing activities:		
Proceeds from issuance of common stock	4,771	3,905
Net cash provided by financing activities	4,771	3,905
Effect of exchange rate changes on cash and cash equivalents	2,102	1,441
Net increase (decrease) in cash and cash equivalents	16,353	(4,862)
Cash and cash equivalents, beginning of period	205,312	178,825
Cash and cash equivalents, end of period	$221,665	$173,963

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

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PARAMETRIC TECHNOLOGY CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Net income (loss)	$3,171	$(15,169)	$(23,366)	$(26,559)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment, net of tax of $0 for all periods	855	(1,346)	2,045	(509)
Net unrealized gain (loss) on securities, net of tax of $0 for all periods	724	(215)	478	(232)
Other comprehensive income (loss)	1,579	(1,561)	2,523	(741)
Comprehensive income (loss)	$4,750	$(16,730)	$(20,843)	$(27,300)

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

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Parametric Technology Corporation and its wholly owned subsidiaries and have been prepared by management in accordance with generally accepted accounting principles. Unless otherwise indicated, all references to a year reflect our fiscal year, which ends on September 30. The year-end consolidated balance sheet was derived from our audited financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of our financial position, results of operations and cash flows at the dates and for the periods indicated. While we believe that the disclosures presented are adequate to make the information not misleading, these unaudited quarterly financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2003.

Deferred revenue primarily relates to software maintenance agreements billed to customers for which the services have not yet been provided. The liability associated with performing these services is included in deferred revenue and, if not yet paid, the related customer receivable is included in other current assets. This maintenance-related customer receivable included in other current assets at April 3, 2004 and September 30, 2003 was $50.4 million and $37.0 million, respectively.

The results of operations for the three and six months ended April 3, 2004 are not necessarily indicative of the results expected for the remainder of the fiscal year. Certain reclassifications have been made for a consistent presentation.

2. Restructuring and Other Charges

In 2003, we announced and began implementing cost reduction initiatives designed to significantly reduce our operating cost structure. As a continuation of these cost reduction initiatives, in the second quarter and first six months of 2004 we recorded total restructuring and other charges of $16.7 million and $38.3 million, respectively. The charges include costs for severance and termination benefits related to 136 employees and 274 employees terminated during the second and first quarters, respectively, and excess facilities and other costs. The charges for excess facilities are primarily related to gross lease commitments in excess of estimated sublease income for excess facilities. Of the total restructuring and other charges, $0.7 million and $1.6 million for the second quarter and first six months of 2004, respectively, were non-cash for the write-off of leasehold improvements related to the excess facilities.

Over the remainder of 2004, we expect to incur restructuring and other charges aggregating approximately $5 million in conjunction with the continuation of the cost reduction initiatives begun in 2003. These expected restructuring and other charges are incremental to the charges recorded in the first six months of 2004 and will be primarily related to employee severance and termination benefits and excess facilities.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

The following table summarizes restructuring accrual activity for the three and six months ended April 3, 2004:

	Three months ended April 3, 2004			Six months ended April 3, 2004		
	Employee Severance and Related Benefits	Facility Closures and Other Costs	Total	Employee Severance and Related Benefits	Facility Closures and Other Costs	Total
Beginning balance	$ 6,104	$ 43,640	$49,744	$ 4,843	$ 38,106	$42,949
Charges to operations	6,951	9,729	16,680	19,216	19,084	38,300
Cash disbursements	(9,175)	(5,661)	(14,836)	(20,179)	(8,554)	(28,733)
Non-cash utilization	−	(663)	(663)	−	(1,591)	(1,591)
Balance, April 3, 2004	$ 3,880	$ 47,045	$50,925	$ 3,880	$ 47,045	$50,925

The accrual for facility closures and related costs is included in current liabilities (accrued expenses and other current liabilities) and long-term liabilities (other liabilities) in the consolidated balance sheets, and the accrual for employee severance and related benefits is included in accrued compensation and severance. We expect to make cash disbursements related to these accrued restructuring and other charges of approximately $17 million within the next twelve months. The remaining payments of approximately $34 million primarily relate to excess facilities and are expected to be paid out through 2013.

3. Valuation of Employee Stock Plans

We offer an employee stock purchase plan (ESPP) for all eligible employees. Under the current plan, which qualifies as an “employee stock purchase plan” under Section 423 of the Internal Revenue Code, shares of our common stock can be purchased at 85% of the lower of the fair market value of the stock on the first or the last day of each six-month offering period, with certain limitations. In addition, we have stock option plans for employees, directors, officers and consultants that provide for issuance of nonqualified and incentive stock options as well as restricted stock awards and stock appreciation rights. The option exercise price is typically the fair market value at the date of grant. These options generally vest over four years and expire ten years from the date of grant, although other vesting terms are permitted. These stock plans are described more fully in Note J to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2003.

We account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Under APB No. 25, no compensation cost is recognized when the option exercise price is equal to the market price of the underlying stock on the date of grant. An alternative method of accounting is provided

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by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation−Transition and Disclosure.* Under SFAS No. 123, employee stock options are valued at the grant date using an option pricing model, and compensation cost is recognized ratably over the vesting period.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

As permitted by APB No. 25, we generally have not recognized compensation expense in connection with stock option grants to employees, directors and officers under our plans. The following table illustrates the effect on net income (loss) and earnings (loss) per share if we had applied the fair value recognition provisions of SFAS No. 123 to all stock-based awards to employees.

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Net income (loss), as reported	$ 3,171	$ (15,169)	$(23,366)	$ (26,559)
Stock-based employee compensation cost included in reported net income (loss), net of tax of $0 for all periods	109	109	218	219
Stock-based employee compensation expense determined under fair value based method, net of tax of $0 for all periods	(8,841)	(14,075)	(18,149)	(28,961)
Pro forma net loss	$ (5,561)	$ (29,135)	$(41,297)	$ (55,301)
Earnings (loss) per share:				
Basic and diluted-as reported	$ 0.01	$ (0.06)	$(0.09)	$ (0.10)
Basic and diluted-pro forma	$ (0.02)	$ (0.11)	$(0.15)	$ (0.21)

The illustrative disclosures above include the amortization of the fair value of all options over their vesting schedules. The pro forma net loss for all periods includes an income tax valuation allowance fully offsetting any income tax benefit related to the stock-based employee compensation expense for those periods. The effects indicated above of applying SFAS No. 123 are not necessarily representative of the effects on similar illustrative disclosures in future years.

The fair value of options granted has been estimated at the date of grant using the Black-Scholes option-pricing model assuming the following weighted-average assumptions:

	2004	2003
Expected life of options (years)	4.0	4.0

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Expected life of ESPP shares (months)	6.0	6.0
Risk-free interest rates for options	3.0-3.4%	2.9-3.2%
Risk-free interest rates for ESPP shares	1.2-3.3%	2.4-3.0%
Volatility	75 %	75 %
Dividend yield	–	–

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and that are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Our options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

4. Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS) is calculated by dividing net income (loss) by the weighted average number of shares outstanding during the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of shares outstanding plus the dilutive effect, if any, of outstanding stock options using the "treasury stock" method.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

Stock options to purchase 47.4 million and 68.6 million shares for the second quarter of 2004 and 2003, respectively, and 47.9 million and 70.3 million shares for the first six months of 2004 and 2003, respectively, had exercise prices per share that were greater than the average market price of our common stock for those periods. These shares were excluded from the computation of diluted EPS as the effect would have been anti-dilutive. Due to the net losses generated in the second quarter of 2003 and the first six months of 2004 and 2003, the effect of outstanding stock options for the purchase of an additional 2.8 million, 19.9 million and 1.6 million shares, respectively, was excluded from the computation of diluted EPS as the effect would have been anti-dilutive.

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Net income (loss)	$ 3,171	$ (15,169)	$(23,366)	$ (26,559)
Weighted average shares outstanding	267,515	263,796	266,895	263,193
Dilutive effect of employee stock options	6,086	−	−	−
Diluted shares outstanding	273,601	263,796	266,895	263,193
Basic earnings (loss) per share	$ 0.01	$ (0.06)	$(0.09)	$ (0.10)
Diluted earnings (loss) per share	$ 0.01	$ (0.06)	$(0.09)	$ (0.10)

5. Goodwill and Other Intangible Assets

We currently operate within a single industry segment−computer software and related services. Within this single industry segment, we have two reporting segments: our software products operating segment and services operating segment (see Note 7, Segment Information, for further discussion). All of our goodwill and other intangible assets are associated with our software products operating segment. Goodwill and other indefinite lived intangible assets are tested for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the operating segment below its carrying value. We plan to conduct our annual impairment test as of the end of the third quarter of each year. Other intangible assets with finite lives are tested for impairment if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the operating segment below its carrying value.

The following goodwill and other intangible assets are included in the accompanying consolidated balance sheets:

	April 3, 2004	September 30, 2003

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	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Goodwill and intangible assets with indefinite lives (not amortized):						
Goodwill	$143,614	$ 105,313	$ 38,301	$140,310	$ 102,906	$ 37,404
Trademarks	10,197	6,099	4,098	9,925	5,939	3,986
Sub-total	153,811	111,412	42,399	150,235	108,845	41,390
Intangible assets with finite lives (amortized):						
Purchased software	28,842	26,842	2,000	28,482	24,482	4,000
Capitalized software	22,547	17,114	5,433	21,354	15,636	5,718
Customer lists	8,901	8,901	–	8,631	7,946	685
Other	316	310	6	316	258	58
Sub-total	60,606	53,167	7,439	58,783	48,322	10,461
Total goodwill and other intangible assets	$214,417	$ 164,579	$ 49,838	$209,018	$ 157,167	$ 51,851

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

The change in the carrying amounts of goodwill and other intangible assets for the six months ended April 3, 2004 is affected by foreign currency translation adjustments related to those asset balances that are recorded in non-U.S. currencies.

The aggregate amortization expense for intangible assets with finite lives recorded for the three and six months ended April 3, 2004 was $2.2 million and $4.2 million, respectively, and for the three and six months ended March 29, 2003 was $2.0 million and $4.1 million, respectively. Of those amounts, $1.3 million and $2.7 million for the three and six months ended April 3, 2004, respectively, and $1.5 million and $2.9 million for the three and six months ended March 29, 2003, respectively, was recorded as amortization of other intangible assets and $0.9 million and $1.5 million for the three and six months ended April 3, 2004 and $0.5 million and $1.2 million for the three and six months ended March 29, 2003, respectively, was recorded as cost of license revenue. The estimated aggregate future amortization expense for intangible assets with finite lives remaining as of April 3, 2004 is $3.9 million for the remainder of 2004, $1.6 million for 2005, $1.5 million for 2006 and $0.4 million for 2007.

6. Recent Accounting Pronouncements

Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board (FASB) issued FIN No. 46, *Consolidation of Variable Interest Entities* and, in December 2003, issued a revision to that interpretation (FIN No. 46R). FIN No. 46R replaces FIN No. 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as (a) an ownership, contractual or monetary interest in an entity where the ability to influence financial decisions is not proportional to the investment interest, or (b) an entity lacking the invested capital sufficient to fund future activities without the support of a third party. FIN No. 46R establishes standards for determining under what circumstances VIE’ s should be consolidated with their primary beneficiary, including those to which the usual condition for consolidation does not apply. FIN No. 46R requires that if an entity has a controlling financial interest in a VIE, the assets, liabilities and results of activities of the VIE should be included in the consolidated financial statements of the entity. The provisions of FIN No. 46R were effective immediately for all arrangements entered into after January 31, 2003 and in the second quarter of fiscal 2004 for those arrangements entered into prior to January 31, 2003. The adoption of FIN No. 46R did not have a material impact on our financial position or results of operations.

Pension Plan Disclosures

In December 2003, the FASB issued a revision to SFAS No. 132, *Employers’ Disclosures about Pensions and Other Postretirement Benefits* (SFAS No. 132R), relating to financial statement disclosures for defined benefit plans. The change replaces existing FASB disclosure requirements for pensions. SFAS No. 132R requires that companies provide more details about their plan assets, benefit obligations, cash flows, benefit costs and other relevant information. SFAS No. 132R will require companies to disclose plan assets by category, such as equity, debt, and real estate and a description of investment policies and strategies and target allocation percentages, or target ranges, for those asset categories. Projections of future benefit payments and an estimate of contributions to be made in the next year to fund pension and other post employment benefit plans also will be required. The guidance for the annual disclosure requirements is effective for fiscal years ending after December 15, 2003.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

The following amounts of net periodic pension cost have been recorded in the accompanying consolidated statements of operations:

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Interest cost of projected benefit obligation	$ 1,815	$ 2,200	$ 3,582	$ 4,887
Expected return on plan assets	(1,431)	(1,700)	(2,835)	(3,745)
Amortization of prior service cost	5	2	9	10
Recognized actuarial loss	500	554	988	1,210
Net periodic pension cost	$ 889	$ 1,056	$ 1,744	$ 2,362

We have made employer contributions to our pension plans totaling $0.8 million for the first six months of 2004 and expect to make additional contributions of approximately $3.9 million in 2004.

7. Segment Information

We operate within a single industry segment−computer software and related services. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-making group is our executive officers. We have two operating segments: (1) software products, which includes license and maintenance revenue (including new releases and technical support); and (2) services, which includes consulting, implementation, education and other support revenue. For external reporting purposes (as shown in our consolidated statements of operations), maintenance revenue is included in Service Revenue. We do not allocate certain sales, marketing or administrative expenses to our operating segments, as these activities are managed separately. Within our software products operating segment, we have two software product categories: (1) our computer aided design, manufacturing and engineering software (design solutions), including our flagship Pro/ENGINEER® design software, which provide engineering solutions to our customers, and (2) our collaboration and data management technologies (collaboration and control solutions), including our Windchill® software suite, which provide information management solutions to our customers.

In the second quarter of 2003, with the launch of Pro/ENGINEER Wildfire™, we began selling a product development system package called “Flex 3C” for Create, Collaborate and Control. This package is configured to meet the needs of the high-end design engineer working in a process-oriented environment. It includes Pro/ENGINEER Wildfire with advanced engineering modules, Windchill ProjectLink™ and Windchill PDMLink™ as a data management option. Because the package includes both design solutions and collaboration and control

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solutions, for purposes of reporting revenues by product categories, we developed a revenue allocation methodology in conjunction with Pro/ENGINEER Wildfire pricing and packaging. New Flex 3C revenue is allocated 90% to our design solutions and 10% to our collaboration and control solutions. Revenue from upgrades to the Flex 3C package is allocated 50% to our design solutions and 50% to our collaboration and control solutions. As we continue to offer packages that include both design solutions products and collaboration and control solutions products, the delineation between the two product lines may become less meaningful and, accordingly, we may revise our product categories.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

The revenue and operating income (loss) attributable to these operating segments are summarized as follows:

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Revenue:				
Software Products Segment:				
License:				
Design solutions	$38,026	$40,102	$67,822	$75,820
Collaboration and control solutions	12,945	15,182	26,666	30,941
Total software products license revenue	50,971	55,284	94,488	106,761
Maintenance: (1)				
Design solutions	68,616	68,092	136,151	141,023
Collaboration and control solutions	10,991	7,944	21,831	15,584
Total software products maintenance revenue	79,607	76,036	157,982	156,607
Total software products revenue	130,578	131,320	252,470	263,368
Services Segment:				

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Design solutions	16,319	20,280	32,851	39,986
Collaboration and control solutions	17,811	19,426	36,197	39,639
Total services revenue	34,130	39,706	69,048	79,625
Total Revenue:				
Design solutions	122,961	128,474	236,824	256,829
Collaboration and control solutions	41,747	42,552	84,694	86,164
Total revenue	$164,708	$171,026	$321,518	$342,993
Operating income (loss): (2)(3)				
Software products segment	$90,659	$84,088	$161,637	$168,915
Services segment	(3,938)	864	(11,318)	3,348
Distribution expenses (4)	(62,369)	(77,629)	(130,060)	(159,072)
Unallocated expenses (5)	(16,506)	(16,654)	(33,503)	(32,177)
Total operating income (loss)	$7,846	$(9,331)	$(13,244)	$(18,986)

(1) Maintenance revenue is included in Service Revenue in the consolidated statements of operations.

(2) The operating income (loss) reported does not represent the total operating results for each operating segment as it does not contain an allocation of sales, marketing, corporate and general administrative expenses incurred in support of the operating segments.

(3) In the second quarter and first six months of 2004, software products included $3.6 million and $8.5 million, services included $5.7 million and $10.9 million, distribution expenses included $5.2 million and $14.7 million and unallocated expenses included $2.2 million and $4.2 million, respectively, of the $16.7 million and $38.3 million of restructuring and other charges recorded in those periods.

(4) Distribution expenses represent all sales and marketing expenses, including the related portion of restructuring and other charges.

(5) Unallocated expenses represent all corporate and general and administrative expenses, including the related portion of restructuring and other charges.

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PARAMETRIC TECHNOLOGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS−(Continued)

Data for the geographic regions in which we operate is presented below:

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Revenue:				
North America	$54,921	$67,762	$111,752	$136,254
Europe (1)	61,481	57,605	120,644	117,381
Asia/Pacific (2)	48,306	45,659	89,122	89,358
Total revenue	$164,708	$171,026	$321,518	$342,993

(1) Includes revenue in Germany totaling $18.8 million and $15.8 million for the three months ended April 3, 2004 and March 29, 2003, respectively, and $38.2 million and $34.3 million for the six months ended April 3, 2004 and March 29, 2003, respectively.
(2) Includes revenue in Japan totaling $32.4 million and $23.3 million for the three months ended April 3, 2004 and March 29, 2003, respectively, and $54.0 million and $46.7 million for the six months ended April 3, 2004 and March 29, 2003, respectively.

Total long-lived assets by geographic region have not changed significantly from September 30, 2003.

8. Commitments and Contingencies

Legal Proceedings

We are currently defending a class action lawsuit claiming violations of the federal securities laws based on alleged misrepresentations regarding our reported financial results for the fiscal years 1999, 2000 and 2001 and revisions to our announced results for 2002. The case is pending in the U.S. District Court for the District of Massachusetts. The consolidated amended complaint was filed on September 15, 2003 and seeks unspecified damages. We have filed a motion to dismiss the consolidated action and the court held a hearing on our motion on April 28, 2004. The motion currently is under consideration by the court. We believe the claims are without merit, and we intend to defend them vigorously. We cannot predict the ultimate resolution of this action at this time, and there can be no assurance that this action will not have a material adverse impact on our financial condition or results of operations.

On May 30, 2003, a lawsuit was filed against us in the U.S. District Court for the District of Massachusetts by Rand A Technology Corporation and Rand Technologies Limited (collectively “Rand”). Rand historically had been our largest distributor. The complaint alleges various breaches of a revised distribution agreement entered into in December 2002, as well as other agreements between Rand and us, and also asserts certain non-contract claims. The complaint, as amended, seeks equitable relief and substantial damages. On November 24, 2003,

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we filed our substantive response to Rand' s complaint and asserted counterclaims against Rand including, among other things, that Rand' s action in filing the lawsuit constituted a breach of the December 2002 agreement, which established certain dispute resolution procedures and which, we believe, discharged any and all claims arising prior to that date. We believe Rand' s claims are without merit and will continue to contest them vigorously. We also intend diligently to prosecute our counterclaims. We cannot predict the ultimate resolution of this action at this time, and there can be no assurance that this action will not have a material adverse impact on our financial condition or results of operations.

We also are subject to various legal proceedings and claims that arise in the ordinary course of business. We currently believe that resolving these other matters will not have a material adverse impact on our financial condition or results of operations.

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Guarantees and Indemnification Obligations

We enter into standard indemnification agreements in our ordinary course of business. Pursuant to these agreements, we indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally our business partners or customers, in connection with patent, copyright or other intellectual property infringement claims by any third party with respect to our current products, as well as claims relating to property damage or personal injury resulting from the performance of services by us or our subcontractors. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. Historically, our costs to defend lawsuits or settle claims relating to such indemnity agreements have been minimal and we accordingly believe the estimated fair value of these agreements is immaterial.

We warrant that our software products will perform in all material respects in accordance with our standard published specifications in effect at the time of delivery of the licensed products for a specified period of time (generally 90 to 180 days). Additionally, we generally warrant that our consulting services will be performed consistent with generally accepted industry standards. In most cases, liability for these warranties is capped. If necessary, we would provide for the estimated cost of product and service warranties based on specific warranty claims and claim history; however, we have never incurred significant cost under our product or services warranties. As a result, we believe the estimated fair value of these agreements is immaterial.

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

Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q about our anticipated financial results and growth, as well as about the development of our products and markets, are forward looking statements that are based on our current plans and assumptions. Important information about the bases for these plans and assumptions and certain factors that may cause our actual results to differ materially from these statements is contained below and in *"Important Factors That May Affect Future Results"* beginning on page 33.

Executive Overview

Over the last several years, we have been transforming Parametric Technology Corporation (PTC) from a one-product company in a mature mechanical computer-aided design, manufacturing and engineering (CAD/CAM/CAE) market to a multi-product company in the emerging product lifecycle management (PLM) market. Our core business focus has been to provide design solutions to customers through our flagship Pro/ENGINEER® design software. Revenue associated with our design solutions continues to comprise a majority of our revenue today. Although, as discussed below, revenue associated with our design solutions improved sequentially in the second quarter of 2004, the discrete market for computer-aided design solutions has been declining, and our revenue in this market also has declined. The decline in our design solutions revenue is attributable to several factors, including customers' unwillingness to invest in this market during difficult economic conditions, the relative saturation and increased competitiveness of the North American and European markets for design solutions, as well as the relative difficulty of displacing incumbent software vendors within this finite market.

Although the discrete market for computer-aided design solutions has declined, we believe that there is opportunity for growth in the adjacent collaboration and control solutions market and we have seen these two markets converge into a broader PLM opportunity. The PLM market encompasses the CAD/CAM/CAE markets as well as many previously isolated markets that address various phases of the product lifecycle. These include product data management (PDM), component and supplier management, visualization and digital mockup, enterprise application integration, program and project management, after market service and portfolio management, requirements management, customer needs management, and manufacturing planning.

To position our company to capitalize on the opportunity presented by the emerging PLM market, we have, among other things, significantly remodeled our product lines, overhauled our distribution infrastructure, and created marketing and sales tools aimed at educating our customers on the benefits of our offerings. Much of this investment occurred during the recent economic downturn, which in turn put pressure on our revenue performance and operating profitability. Nevertheless, using cash built up during the 1990s when we experienced sustained growth with our design solutions, as well as using cash generated from our ongoing operations, we were able to proceed with these strategic investments. We believe that our investment in this strategy will contribute to our success over the long term. We recently have introduced award winning products that allow our customers to implement a scalable product development system that meets their requirements for both functionality and return on investment, two critical variables in today' s economic environment. With a good portion of this business transformation investment behind us, beginning in 2003 and continuing during 2004 we embarked on cost cutting initiatives in an effort to improve profitability. Although these reductions may impact overall revenue growth, we expect these cost reductions will improve our overall profitability and provide operating leverage.

Looking forward, our overall performance will depend on, among other factors: (i) improved economic conditions and the strengthening of technology spending in the global manufacturing sector; (ii) our ability to elevate PLM expenditures over other technology spending as a budgetary priority among our customers; (iii) our ability to successfully execute our product strategy to provide an integrated, easy to use and rapidly deployable

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suite of PLM software solutions that customers can deploy to create a product development system that meets their evolving requirements; and (iv) our ability to differentiate our products and services from those of our competitors, including larger companies with established enterprise relationships with our customers. Our enhanced suite of PLM software solutions provides the foundation for our future growth, as these solutions expand upon traditional high-end design products (for which the market has declined) and allow us to offer our customers a comprehensive product development system. We must accordingly focus on enhancing and marketing our product and service offerings so that our customers are able to recognize clearly and understand their advantages.

Our performance also will depend on our ability to undertake our strategic initiatives while at the same time executing our current expense control initiatives. Specifically, in 2003, we began implementing cost cutting initiatives (discussed further below) designed to reduce our quarterly operating cost structure to approximately $150 million, excluding restructuring charges, by the end of fiscal 2004. As of the end of the second quarter of 2004, those cost reductions have reduced our quarterly operating cost structure, excluding restructuring charges, to under $150 million. In connection with these reductions, we incurred $38.3 million of restructuring charges in the first six months of 2004 and we expect to incur restructuring charges of approximately $5 million during the remainder of 2004. Our ability to implement these measures while minimizing disruption to our organization will be an important determinant of our future success.

Finally, our success also will depend on other factors, including: (i) our ability to optimize our sales and services coverage and productivity through, among other means, effective utilization and management of our resellers and other strategic partners as well as our own sales force; (ii) our ability to further improve customer satisfaction and to build customer references; (iii) our effective management of our development resources; (iv) our success at penetrating strategic emerging markets; and (v) our ability to migrate our customers to a more robust PLM product development system. We believe that we have made progress on these initiatives; however, spending in our sector of the economy has been weak and prospects remain uncertain. Although recent economic indicators suggest that technology spending is expected to increase modestly in calendar 2004, technology spending in the manufacturing sector is expected to lag behind overall increases in technology spending. In addition, although we likely would benefit from renewed economic growth and improvements in technology spending in the manufacturing sector, any revenue improvement is likely to lag any such growth and increased spending by six to nine months due to the length of our sales cycles.

Additional factors affecting our revenues and operating results are identified under *“Important Factors That May Affect Future Results”* below.

Our Business

The following overview of PTC’ s business may be helpful in understanding the detailed analysis of our results of operations and financial condition that follows.

PTC, founded in 1985 and headquartered in Needham, MA, develops, markets and supports PLM software solutions and related services that help manufacturers improve the competitiveness of their products and product development processes. Our solutions, which include a suite of mechanical computer-aided design tools (our design solutions) and a range of collaboration and data management technologies (our collaboration and control solutions), enable manufacturing companies to create virtual computer-based products (digital products), collaborate on designs within the enterprise and throughout the extended supply chain, and control the digital product information throughout the product lifecycle. This results in streamlined engineering processes, improved product quality, optimized product information management and reduced cost and time-to-market cycles. Our PLM software solutions are complemented by our experienced services and technical support organizations, as well as resellers, systems integrators, and other strategic partners, who provide training, consulting, ancillary product offerings, implementation and support to customers worldwide.

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With our suite of PLM software solutions, we see an opportunity to address several of the key challenges that manufacturing companies face in their product development processes: more frequent change, heterogeneity of systems, and increased communication inside and outside the manufacturing enterprise to support growing outsourcing and increasingly transparent supply chains. Accordingly, we have devoted significant resources into our collaboration and control solutions and their integration with our design software. With our PLM software suite, we can provide our customers a product development system that permits individuals−regardless of their roles in the commercialization of a product, the computer-based tools they use, or their location geographically or in the supply chain−to participate in and impact the product development process across the digital product value chain. We believe that as we continue to implement our strategy for our products to become more tightly integrated and easier to deploy, we can create significant added value for our customers.

Our design solutions and our collaboration and control solutions are aligned under a unified product strategy. The strategy allows us to capitalize on existing product synergies and offer fully leveraged product development solutions that enable the creation, collaboration and control of digital product information across the extended design chain. Our efforts have resulted in the creation of a new offering, the product development system, which is comprised of a suite of integrated products and services offerings. The goal of our product development system approach is to reduce complexity for our customers by ensuring that our solutions, which support core product development processes, work together in a cohesive system. The system delivers a comprehensive footprint that offers the capabilities necessary to improve our customers' product development processes. These processes involve the entire enterprise and are further extended to include supplier, partner, and customer participants.

DESIGN SOLUTIONS

Our family of engineering design software encompasses a broad spectrum of engineering disciplines essential to the development of virtually all manufactured products, ranging from consumer products to jet aircraft. Our software tools offer high-performance product design solutions for the creation of digital products that improve product quality and reduce time to market by enabling end-users easily to evaluate multiple design alternatives and to share data with bi-directional associativity. The cornerstone of our design solutions software is Pro/ENGINEER®, a mechanical design automation technology based on a robust, parametric, feature-based solid modeler, enabling changes made during the design process to be associatively updated throughout the design. Pro/ENGINEER is complemented by functional options and extensions as well as other products for conceptual design, simulation, routed systems design, and manufacturing production. These features allow companies to create more innovative, differentiated and functional products quickly and easily.

In 2003, we commenced shipment of Pro/ENGINEER Wildfire™, the most recent release of our Pro/ENGINEER design solution and in May 2004 we released version 2.0 of this product. Pro/ENGINEER Wildfire is designed to offer design engineers enhanced ease-of-use and the ability to integrate design tools with our collaboration and control solutions. The product' s new user interface makes it more competitive with lower end modeling tools on the market that are known for ease-of-use, while maintaining the powerful functionality of Pro/ENGINEER. Additionally, Pro/ENGINEER Wildfire is the first CAD system with an embedded web browser and native support for web services. The combination of Pro/ENGINEER and Windchill® on an integral, Internet-based, interoperable architecture enables us to offer customers a product development system that supports a multi-user, distributed environment and complex product development processes. Pro/ENGINEER Wildfire also offers optional peer-to-peer design conferencing from within the application, enabling enhanced real-time collaboration with a distributed design team.

COLLABORATION AND CONTROL SOLUTIONS

Since their introduction in 1998, our collaboration and control solutions have evolved to address expanding customer needs. The cornerstone of our collaboration and control solutions is our suite of Windchill® based products. Windchill is currently sold in two forms based on the common Windchill infrastructure: our Windchill Link solutions and configurable Windchill Modules for enterprise-level PLM.

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Our Windchill Link solutions consist of pre-configured, integrated products that utilize the web-based Windchill architecture, as well as components of our design solutions and our Windchill enterprise-level application modules. These point solutions are designed to address specific business-critical manufacturing functions and can be implemented with little configuration in as few as several weeks in accordance with a predefined implementation methodology. These solutions include Windchill PDMLink™, Windchill ProjectLink™, Windchill DynamicDesignLink™ and Windchill PartsLink™.

We also offer Windchill capabilities in a modular form to support customer-specific configurations that address unique needs within customers' complex PLM processes. The Windchill Modules architecture and toolsets enable manufacturers to extend the data models and user interface to support unique business processes, such as legacy system replacement and consolidation, complex workflow and document management, and integration and rationalization of diverse systems following merger or acquisition. Unlike other product information management applications based on proprietary architectures and toolsets that discourage tailored configurations, the Windchill Modules architecture and toolsets explicitly enable manufacturers to extend the data models, functionality, and user interface as they see fit.

The Windchill Modules consist principally of the following: a vault for data management to store and retrieve product files; workflow applications for sequencing the flow of product information and change management processes; visualization software for enabling the customer to see a three-dimensional view of product data; and, when desired, data adaptors for connecting to standard computer aided design (CAD) software or standard enterprise resource planning (ERP) systems via standard application interfaces. The Windchill Modules have standard features and functions with capabilities that include product and process management, collaboration, and product planning. The predefined templates (e.g., document folders and workflows) may be used as is or may be configured to the customer's business environment. For example, the workflow template may be changed to reflect the customer's organizational approval preferences.

Because all Windchill-based products are built on the same core technology, our customers are able to combine configured Windchill Modules with the Windchill Link solutions. As a result of this flexibility, our customers are not forced to make tradeoffs between competitive differentiation and operational efficiency−both can be realized with Windchill, maximizing competitive advantage.

In late December 2003, we introduced Windchill 7.0, our most recent Windchill release. With Windchill 7.0, we have provided our customers with a seamless user and data environment across Windchill PDMLink and Windchill ProjectLink, thus furthering the integral product development system by combining flexible and streamlined collaborative capabilities with formal control of information and processes. Both capabilities share a common pure Internet architecture to enable communication of information throughout the value chain, as well as a turnkey enterprise application interoperability module that connects to other enterprise systems such as SAP. Windchill 7.0 also includes a number of product-specific enhancements that improve usability and performance, including enhanced distributed product administration, support for product teams and templates, extended support for structured documents, streamlined Microsoft® Office integration, and advanced audit reporting.

Subsequent to the second quarter of 2004, we announced the acquisition of OHIO Design Automation, Inc., a maker of collaboration solutions for electronics design. This acquisition will allow us to better serve the high technology and electronics industries by enabling the dynamic management of design information from electronics design automation vendors. We have begun to integrate OHIO Design Automation's technology into the Windchill product line and expect to provide integrated product functionality within six to nine months. In addition, we will continue to offer the technology on a stand-alone basis. Although this is a strategic investment to augment our Windchill solutions, OHIO Design Automation's revenues on a historic stand-alone basis were not significant.

These design and collaboration and control solutions are part of our overall strategy to provide a portfolio of PLM solutions that address specific business challenges that occur at various points in the product lifecycle.

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They are designed to enable manufacturers to implement a product development system appropriate for their particular requirements, allowing them to deliver new products to market faster and manage the complexities of product development throughout an evolving supply chain.

SERVICES

We offer maintenance support plans for our software products. Customers who participate in our maintenance support plans receive periodic software updates and new releases. Active maintenance plan customers also are provided self-service support tools and have direct access to our global technical support team of certified engineers and thus benefit from the knowledge, experience and responsiveness of this ISO 9001 accredited organization, resulting in timely and accurate issue resolution.

Our software solutions and maintenance support offerings are complemented by additional service offerings from our services organization, as well as from resellers, systems integrators and other strategic partners. Our services organization focuses on: Implementation Services (providing a range of technology installation, configuration, and migration services, from pre-packaged "quick start" deployments to full system integration); Process and Technology Adoption Services (designed to help ensure widespread acceptance and utilization of our solutions); and Education Services (providing an extensive role-based curriculum to accelerate adoption of the product development system and realize value across the entire enterprise).

SALES AND DISTRIBUTION

All of our software solutions continue to be distributed primarily through our direct sales force. In tandem with our direct sales force, we utilize an indirect distribution channel. Our indirect distribution channel has been broadened over the last three years through resellers, alliances with systems integrators and other strategic partners. The resellers provide greater geographic and small-account coverage, primarily for our design solutions. Systems integrator partners work with our direct sales force to locate and target potential PLM opportunities.

Results of Operations

The following is an overview of our results of operations for the second quarter and first six months of 2004. A detailed discussion regarding these results follows the table below.

Total revenue was $164.7 million for the second quarter of 2004, compared to $171.0 million for the second quarter of 2003. Total revenue was $321.5 million for the first six months of 2004 compared to $343.0 for the first six months of 2003.

Our year-over-year second quarter revenue declined 4%, reflecting an 8% decrease in software license revenue and a 2% decrease in service revenue. Our year-over-year six-month revenue declined 6%, reflecting an 11% decrease in software license revenue and a 4% decrease in service revenue.

Our year-over-year collaboration and control solutions revenue decreased 2% to $41.7 million for the second quarter of 2004 from $42.5 million for the second quarter of 2003. Our year-over-year collaboration and control solutions revenue decreased 2% to $84.7 million for the first six months of 2004 from $86.2 million for the first six months of 2003.

Our year-over-year design solutions revenue decreased 4% to $123.0 million for the second quarter of 2004 from $128.5 million for the second quarter of 2003. Our year-over-year design solutions revenue decreased 8% to $236.8 million for the first six months of 2004 compared to $256.8 million for the first six months of 2003.

On a sequential basis from the previous quarter, our collaboration and control solutions revenue for the second quarter of 2004 decreased 3% and our design solutions revenue increased 8%.

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Total costs and expenses decreased 13% to $156.9 million, including $16.7 million of restructuring and other charges for the second quarter of 2004 and a one-time benefit to cost of service revenue of $5 million, from $180.4 million for the second quarter of 2003. Total costs and expenses decreased 8% to $334.8 million, including $38.3 million of restructuring and other charges for the first six months of 2004, from $362.0 million for the first six months of 2003. There were no restructuring and other charges in the first six months of 2003.

For the second quarter of 2004, we had net income of $3.2 million, compared to a net loss of $15.2 million for the second quarter of 2003. For the first six months of 2004, we incurred a net loss of $23.4 million, compared to a net loss of $26.6 million for the first six months of 2003.

The following table shows certain consolidated financial data as a percentage of our total revenue for the second quarter and first six months of 2004 and 2003:

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
Revenue:				
License	31 %	32 %	29 %	31 %
Service	69	68	71	69
Total revenue	100	100	100	100
Costs and expenses:				
Cost of license revenue	1	1	1	1
Cost of service revenue	23	29	28	29
Sales and marketing	35	45	36	46
Research and development	16	19	17	19
General and administrative	9	10	9	9

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Amortization of intangible assets	1	1	1	1
Restructuring and other charges	10	–	12	–
Total costs and expenses	95	105	104	105
Operating income (loss)	5	(5)	(4)	(5)
Other income (expense), net	–	(1)	–	(1)
Income (loss) before income taxes	5	(6)	(4)	(6)
Provision for income taxes	3	3	3	2
Net income (loss)	2%	(9)%	(7)%	(8)%

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Revenue

Total Revenue

Our revenue consists of software license revenue and service revenue, which includes software maintenance as well as consulting, implementation, education and other technical support revenue. We presently report our revenue in two product categories: (1) our collaboration and data management technologies (collaboration and control solutions), including our Windchill web-based software, and (2) our computer aided design, manufacturing and engineering software (design solutions), including our flagship Pro/ENGINEER design software. The following table illustrates trends from the second quarter and first six months of 2003 to the second quarter and first six months of 2004 in our software license revenue and in our service revenue, as well as in our two product categories:

	Three months ended			Six months ended		
	April 3, 2004	March 29, 2003	Percent Change	April 3, 2004	March 29, 2003	Percent Change
	(Dollar amounts in millions)					
License revenue	$51.0	$ 55.3	(8)%	$94.5	$ 106.8	(11)%
Service revenue:						
Maintenance revenue	79.6	76.0	5 %	158.0	156.6	1 %
Other service revenue	34.1	39.7	(14)%	69.0	79.6	(13)%
Total service revenue	113.7	115.7	(2)%	227.0	236.2	(4)%
Total revenue	$164.7	$ 171.0	(4)%*	$321.5	$ 343.0	(6)%*
Revenue by product category:						
Collaboration and control solutions revenue	$41.7	$ 42.5	(2)%	$84.7	$ 86.2	(2)%
Design solutions revenue	$123.0	$ 128.5	(4)%	$236.8	$ 256.8	(8)%

* On a consistent foreign currency basis from the prior period, total revenue decreased 11% and 7% in the second quarter and first six months of 2004, respectively, compared to the second quarter and first six months of 2003.

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While total revenue in the second quarter of 2004 increased slightly from the first quarter of 2004, revenue in the second quarter of 2004 continued to be adversely affected by ongoing weakness in technology spending in the global manufacturing economy, continued reluctance of our customers to consummate large, enterprise-wide software purchases, the relative saturation and increased competitiveness of the North American and European markets for design solutions and the relative infancy of the PLM market. We derived 67% and 60% of our total revenue from sales to customers outside of North America in the second quarter of 2004 and 2003, respectively, and 65% and 60% for the first six months of 2004 and 2003, respectively. North American revenues were 19% and 18% lower in the second quarter and first six months of 2004 than in the second quarter and first six months of 2003, while sales in Europe were up 7% and 3% (down 9% and 11% on a consistent foreign currency basis) for the second quarter and first six months of 2004, respectively, and sales in Asia-Pacific were up 6% (down 2% on a consistent foreign currency basis) in the second quarter of 2004 over the same period in 2003 and were flat for the first six months of 2004 compared to the first six months of 2003. On a consistent foreign currency basis, Asia-Pacific revenue grew 16 percent sequentially from the first quarter of 2004. This growth was primarily attributable to several larger deals in Japan, where we completed five of our ten largest transactions during the quarter.

License revenue accounted for 31% and 32% of total revenue in the second quarter of 2004 and 2003, respectively, and 29% and 31% of total revenue in the first six months of 2004 and 2003, respectively. Service revenue, which has a lower gross profit margin than license revenue, accounted for 69% and 68% of total revenue in the second quarter of 2004 and 2003, respectively, and 71% and 69% of total revenue in the first six months of 2004 and 2003, respectively. Maintenance revenue for the second quarter of 2004 was up 5% over the second quarter of 2003 (down 4% on a consistent foreign currency basis) and up 2% sequentially while other

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service revenue for the second quarter of 2004 was down 14% over the second quarter of 2003 and down 2% sequentially. Although the decrease in service revenue for both the second quarter and first six months of 2004, as compared to 2003, were less than those in license revenue, service revenue has been, and may continue to be, adversely affected by lower license sales in current and prior periods. Our other service revenue (consulting, implementation, education and other support revenue) also has been adversely affected by the removal of a portion of our services delivery headcount in connection with our cost reductions.

In the second quarter of 2003, with the launch of Pro/ENGINEER Wildfire, we began selling a product development system package called "Flex 3C" for Create, Collaborate and Control. This package is configured to meet the needs of the high-end design engineer working in a process-oriented environment. It includes Pro/ENGINEER Wildfire with advanced engineering modules, Windchill ProjectLink, and Windchill PDMLink as a data management option. Because the package includes both design solutions and collaboration and control solutions, for purposes of reporting revenues by product categories, we allocate revenue from sales of the Flex 3C package among our two product categories. Revenue from sales of new Flex 3C licenses is allocated 90% to our design solutions and 10% to our collaboration and control solutions. Revenue from upgrades to the Flex 3C package is allocated 50% to our design solutions and 50% to our collaboration and control solutions. In line with customer demand for a complete product development system, we foresee that we will continue to offer packages that include both design solutions products and collaboration and control solutions products. As such, the delineation between the two product lines may become less meaningful and, accordingly, we may revise our product categories.

We have been building and diversifying our reseller channel to become less dependent on a small number of distributors and to provide the resources necessary for more effective distribution of our products. Although we typically receive lower revenue per seat for an indirect sale versus a direct sale, we believe that utilizing diverse and geographically dispersed distributors that focus on smaller businesses will provide an efficient and cost effective means to reach these customers, while allowing our direct sales force to focus on higher dollar sales opportunities. License sales from our reseller channel, which are primarily for design solutions, were $14.2 million and $14.0 million in the second quarter of 2004 and 2003, respectively, and $27.6 million and $27.0 million in the first six months of 2004 and 2003, respectively. In 2003, our new major European distributor, Mensch und Maschine, began selling our design solutions and we aligned almost all of our existing European resellers under this new structure. Mensch und Maschine is responsible for building and managing a network of PTC resellers and has devoted resources to training and marketing throughout Europe to help make these resellers successful. While we expect that, over the long-term, this relationship will expand our coverage of the European market, we do not expect that this new relationship will have a material impact on our near-term operating results.

Our largest distributor historically had been Rand A Technology Corporation. Rand' s distribution rights for certain territories expired on December 31, 2003 and, for the remaining territories, expired at the end of March 2004. Rand retains certain rights to provide training and consulting to customers through calendar year 2004, with an option to renew through calendar year 2005. We do not expect that the expiration of Rand' s distribution rights will have a material effect on our operating results, as the customers formerly serviced by Rand may now be serviced by PTC directly or by other PTC resellers. We are also currently involved in a lawsuit with Rand, as described in Part II, Item 1, *"Legal Proceedings"*. We are uncertain how this lawsuit will impact our future financial results.

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Collaboration and Control Solutions Revenue

The following table illustrates trends from the second quarter and first six months of 2003 to the second quarter and first six months of 2004 in our collaboration and control solutions software license revenue and service revenue:

	Three months ended			Six months ended		
	April 3, 2004	March 29, 2003	Percent Change	April 3, 2004	March 29, 2003	Percent Change
	(Dollar amounts in millions)					
Collaboration and control solutions:						
License revenue	$ 12.9	$ 15.2	(15)%	$ 26.7	$ 31.0	(14)%
Service revenue:						
Maintenance revenue	11.0	7.9	38 %	21.8	15.6	40 %
Other service revenue	17.8	19.4	(8)%	36.2	39.6	(9)%
Total service revenue	28.8	27.3	5 %	58.0	55.2	5 %
Total revenue	$ 41.7	$ 42.5	(2)%	$ 84.7	$ 86.2	(2)%

Total revenue from our collaboration and control solutions software and related services was 25% of our total revenue in both the second quarter of 2004 and 2003, and 26% and 25% of our total revenue in the first six months of 2004 and 2003, respectively.

Total collaboration and control solutions revenue declined 2% year over year and 3% sequentially, the result of decreased license and consulting service revenue partially offset by growth in maintenance revenue. Collaboration and control license revenue in the second quarter of 2004 declined 15% year-over-year and 6% sequentially. The declines in our collaboration and control solutions license revenue are attributable in part to a decrease in the number of large license transactions, which reflects a continued shift by customers toward purchasing PLM solutions in incremental fashion. We are addressing this buying preference with our Windchill Link solutions (described below), as well as with our Product Development System adoption roadmap, which provides customers with a suggested approach for purchasing and implementing our solutions in stages.

The increase in maintenance revenue for all periods presented is attributable to a growing user base of our Windchill solutions and the introduction of our Flex 3C package in 2003. The decrease in other service revenue reflects lower consulting and training revenues primarily resulting from prior period decreases in license revenue. Other service revenues have been also adversely affected by the removal of a portion of our delivery capacity in connection with our cost reductions.

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As indicated above, to improve our ability to provide PLM solutions to a broader range of customers and to complement our enterprise offerings, we have introduced Windchill-based point solutions targeted at specific business-critical PLM processes (our Windchill Link solutions). Our Windchill Link solutions license revenue as a percent of our total collaboration and control solutions license revenue was 56% and 62% for the second quarters of 2004 and 2003, respectively. Although the percent of our Windchill Link solutions license revenue as a percent of our total collaboration and control solutions license revenue is down in the second quarter of 2004 from the second quarter of 2003, it is up from 40% in the first quarter of 2004. We believe our Windchill Link solutions address a growing customer demand for better return on investment as they can be implemented easily and quickly. As the requirements of our customers and the general market change, we plan periodically to evaluate the need for additional solutions.

We recently have offered a limited number of qualified resellers the ability to sell our Windchill Link solutions. We also have business relationships with leading systems integrators and other strategic partners to expand the coverage of our distribution and services efforts. While these initiatives may limit some opportunities for service revenue growth within enterprise-level implementations, we believe that these relationships are important to help expand coverage for our collaboration and control software solutions, generate additional license and maintenance revenue, and provide expertise for implementation and support.

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Design Solutions Revenue

The following table illustrates trends from the second quarter and first six months of 2003 to the second quarter and first six months of 2004 in our design solutions software license revenue and service revenue:

	Three months ended			Six months ended		
	April 3, 2004	March 29, 2003	Percent Change	April 3, 2004	March 29, 2003	Percent Change
	(Dollar amounts in millions)					
Design solutions:						
License revenue	$ 38.1	$ 40.1	(5)%	$ 67.8	$ 75.8	(11)%
Service revenue:						
Maintenance revenue	68.6	68.1	1 %	136.2	141.0	(3)%
Other service revenue	16.3	20.3	(20)%	32.8	40.0	(18)%
Total service revenue	84.9	88.4	(4)%	169.0	181.0	(7)%
Total revenue	$ 123.0	$ 128.5	(4)%	$ 236.8	$ 256.8	(8)%

Total revenue from our design solutions software and related services was 75% of our total revenue in the second quarter of both 2004 and 2003 and 74% and 75% of our total revenue for the first six months of 2004 and 2003, respectively. Design solutions license revenue of $38.1 million, although representing a 5% quarterly decline year-over-year, represented an improvement of 28% sequentially from the first quarter of 2004. Compared to the second quarter of 2003, design solutions license revenue in the second quarter of 2004 reflects a decrease in the average price per seat of 24%. The decrease in the average price per seat is attributable, in part, to a higher mix of lower-end software packages being sold due to growing acceptance of Pro/ENGINEER Wildfire in the low-end of the MCAD market as well as to an increased mix of sales completed by resellers, for which we receive lower revenue. Sequentially, the average price per seat was up 12%, and the total number of new seats added during the second quarter of 2004 was up both sequentially−14% higher than new seats added during the first quarter of 2004, and year-over-year−25% higher than new seats added in the second quarter of 2003. The decrease in design solutions service revenue is due in large part to the lag effect of license revenue declines in prior periods and has been also adversely affected by the removal of a portion of our delivery capacity in connection with our cost reductions.

Design solutions revenue continues to be adversely affected by: (i) weakness in technology spending in the global manufacturing economy, which has led to a decline in large-dollar license transactions; (ii) increased competition and price pressure from products offering more

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limited functionality at lower cost; (iii) the relative maturity and saturation of the North American and European markets; and (iv) the difficulty associated with displacing incumbent product design systems in the discrete market for computer-aided design solutions.

To address the decline in our design solutions revenue, we have introduced design solutions packages that have price points, functionality and ease-of-use features that appeal to a broader spectrum of design solution users. Pro/ENGINEER Wildfire, released in February 2003 and updated with Pro/ENGINEER Wildfire 2.0 in May 2004, supports web interfaces and Windchill-based interfaces and provides customers with the opportunity to integrate more readily traditional design solutions with collaboration and control solutions. The product' s user interface makes it more competitive with lower-end modeling tools on the market that are known for ease-of-use, while maintaining the powerful functionality of Pro/ENGINEER. The new web interface, which is unique to Pro/ENGINEER, offers a differentiated design solution to manufacturing companies looking for a complete product development system. All Pro/ENGINEER customers on an active maintenance plan receive Pro/ENGINEER Wildfire as a maintenance release consistent with their current configurations. We also offer various technology and service upgrade packages, allowing customers to upgrade from their existing product configuration to the full suite of Pro/ENGINEER Wildfire functionality.

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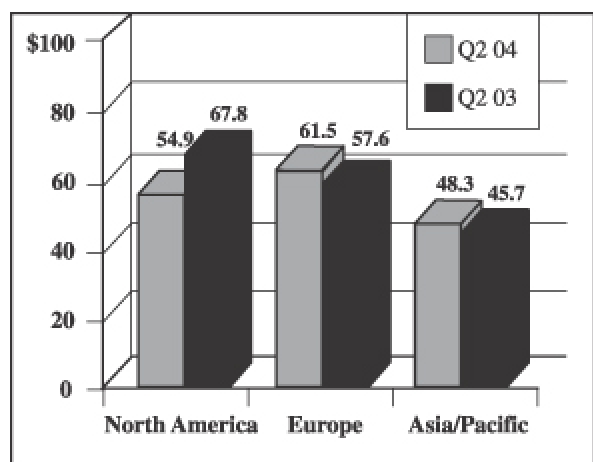

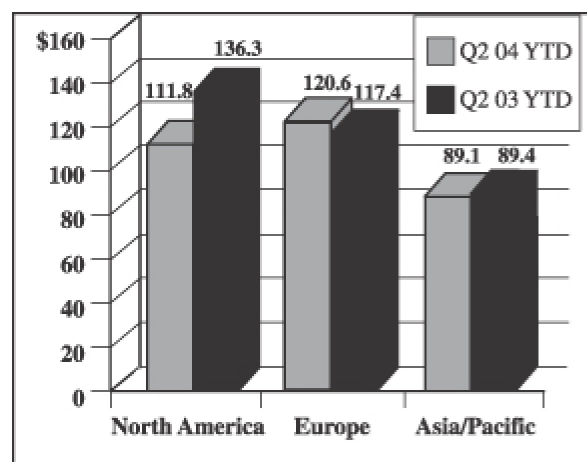

Revenue By Geography (in millions)

Costs and Expenses

Total costs and expenses decreased 13% to $156.9 million in the second quarter of 2004, compared to $180.4 million in the second quarter of 2003, and decreased 7% to $334.8 million in the first six months of 2004, compared to $362.0 million in the first six months of 2003. The decrease in the second quarter and first six months of 2004 is due primarily to lower costs related to headcount reductions, partially offset by $16.7 million and $38.3 million in restructuring and other charges in the second quarter and first six months of 2004, respectively. There were no restructuring charges in the second quarter and first six months of 2003. On a consistent foreign currency basis from the comparable prior period, total costs and expenses decreased 17% and 11% in the second quarter and first six months of 2004, respectively, compared to the second quarter and first six months of 2003.

In support of our focus on improving profitability, we announced in 2003 that we would be implementing cost reductions designed to reduce our operating cost structure by the end of fiscal 2004 to approximately $150 million per quarter, excluding restructuring and other charges. Over the past several years, we have made significant investments needed to transform our business from providing a single line of technical software with a direct distribution model to providing a family of enterprise solutions with an expanded channel and partner-involved distribution model. We undertook to reduce our cost structure after completing a significant portion of this transformation and we believe we will be able to maintain product quality and customer satisfaction, even with our reduced cost structure. In conjunction with the continuation of the cost reduction initiatives begun in 2003, we recorded restructuring and other charges of $16.7 million and $38.3 million in the second quarter and first six months of 2004, respectively, primarily as a result of headcount reductions and excess facility costs. We expect to incur incremental restructuring and other charges during the remainder of 2004 of approximately $5 million. These expected charges are primarily related to employee severance and termination benefits and excess facilities and are incremental to the charges recorded in prior periods (see "*Restructuring and Other Charges*" below and Note 2 of "Notes to Consolidated Financial Statements").

As a result of these initiatives, our headcount has decreased to 3,028 at the end of the second quarter of 2004 from 3,500 as of September 30, 2003, and 3,787 as of the end of the second quarter of 2003.

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Cost of License Revenue

Our cost of license revenue consists of fixed and variable costs associated with reproducing and distributing software and documentation as well as royalties owed to third parties for technology embedded in or licensed with our software products. Cost of license revenue was $1.9 million and $2.0 million in the second quarter of 2004 and 2003, respectively, and $4.0 million and $4.6 million for the first six months of 2004 and 2003, respectively. Cost of license revenue as a percentage of license revenue was 4% for the second quarter and first six months of both 2004 and 2003. Cost of license revenue as a percent of license revenue can vary depending on product mix sold and the effect of fixed and variable royalties in relation to the level of license revenue. The decrease in cost of license revenue in the second quarter and first six months of 2004 compared to the second quarter and first six months of 2003 was primarily due to lower royalty costs of approximately $0.3 million and $0.8 million, respectively.

Cost of Service Revenue

Our cost of service revenue includes costs associated with training, customer support and consulting personnel, such as salaries and related costs, third-party subcontractor fees, the release of maintenance updates, including related royalty costs, and facility costs. Cost of service revenue as a percentage of service revenue was 34% in the second quarter of 2004 and 44% in the second quarter of 2003, and was 39% in the first six months of 2004 and 42% in the first six months of 2003. Cost of service revenue decreased $12.0 million to $38.7 million in the second quarter of 2004 from $50.7 million in the second quarter of 2003 and decreased $10.6 million to $88.7 million in the first six months of 2004 from $99.3 million in the first six months of 2003. These cost decreases were due primarily to headcount reductions, reduced compensation and benefit costs, and lower travel costs, which in the aggregate, decreased by approximately $4.0 million and $4.5 million during the second quarter and first six months of 2004, respectively, compared to the same periods in 2003. In addition, in the second quarter of 2004, as a result of a contract renegotiation finalized in the quarter, we realized a one-time benefit of $5.0 million from the reversal of an accrual established in the fourth quarter of fiscal 2003 for obligations related to our services business. Total service related employee headcount decreased 18% at the end of the second quarter of 2004 compared to the end of the second quarter of 2003.

Sales and Marketing

Our sales and marketing expenses primarily include salaries and benefits, sales commissions, advertising and marketing programs, travel and facility costs. Sales and marketing expenses as a percentage of total revenue were 35% and 45% for the second quarters of 2004 and 2003, respectively, and 36% and 46% for the first six months of 2004 and 2003, respectively. Total sales and marketing employee headcount decreased 28% at the end of the second quarter of 2004 compared to the end of the second quarter of 2003, and total sales and marketing expenses decreased 26% and 28% in the second quarter and first six months of 2004, respectively, as compared to the same periods in 2003. As a result of reduced headcount and lower revenues, compensation and benefit costs, sales commissions and travel expenses were lower by an aggregate of approximately $13.5 million and $28.6 million in the second quarter and first six months of 2004, respectively, compared to the second quarter and first six months of 2003. Additionally, our marketing communications and program costs decreased in the second quarter and first six months of 2004 by approximately $3.0 million and $5.9 million, respectively, compared to the second quarter and first six months of 2003.

Research and Development

Our research and development expenses consist principally of salaries and benefits, costs of computer equipment and facility expenses. Research and development expenses as a percentage of total revenue were 16% and 19% in the second quarter of 2004 and the second quarter of 2003, respectively, and 17% and 19% in the first six months of 2004 and 2003, respectively. Total research and development employee headcount decreased 14% at the end of the second quarter of 2004 compared to the end of the second quarter of 2003, and total research and development expenses decreased 16% and 12% in the second quarter and first six months of 2004, respectively,

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as compared to the same periods in 2003. The decreases are due primarily to headcount reductions, shifting certain development activities to lower cost locations, and to lower depreciation and telecommunication costs.

General and Administrative

Our general and administrative expenses include the costs of our corporate, finance, information technology, human resources and administrative functions as well as bad debt expense. General and administrative expenses as a percentage of total revenue were 9% and 10% in the second quarter of 2004 and 2003, respectively, and 9% for the first six months of both 2004 and 2003. Compared to the prior year, these costs decreased 14% and 9% in the second quarter and first six months of 2004. The decrease is primarily related to lower headcount and, as a result, lower salaries and benefits expense. General and administrative headcount was 16% lower at the end of the second quarter of 2004 compared to the end of the second quarter of 2003.

Amortization of Intangible Assets

These costs represent the amortization of acquired intangible assets. Amortization of intangible assets was $1.3 million and $1.5 million in the second quarter of 2004 and 2003, respectively, and $2.7 million and $2.9 million in the first six months of 2004 and 2003, respectively. For a further discussion, see Critical Accounting Estimates−*Valuation of Goodwill and Other Intangible Assets* below and Note 5 of "Notes to Consolidated Financial Statements."

Restructuring and Other Charges

In 2003, we announced and began implementing cost reduction initiatives designed to significantly reduce our operating cost structure. As a continuation of these cost reduction initiatives, in the second quarter and first six months of 2004 we recorded total restructuring and other charges of $16.7 million and $38.3 million, respectively. The charges include costs for severance and termination benefits related to 136 employees and 274 employees terminated during the second and first quarters, respectively, and excess facilities and other costs. The charges for excess facilities are primarily related to gross lease commitments in excess of estimated sublease income for excess facilities. Of the total restructuring and other charges, $0.7 million and $1.6 million for the second quarter and first six months of 2004, respectively, were non-cash for the write-off of leasehold improvements related to the excess facilities.

Over the remainder of 2004, we expect to incur restructuring and other charges aggregating approximately $5 million in conjunction with the continuation of the cost reduction initiatives begun in 2003. These expected restructuring and other charges are incremental to the charges recorded in the first six months of 2004 and will be primarily related to employee severance and termination benefits and excess facilities.

Cash disbursements related to restructuring and other charges totaled $28.7 million and $5.4 million in the first six months of 2004 and 2003, respectively. Amounts accrued and not yet paid at April 3, 2004 related to the current quarter and all prior period restructuring initiatives totaled $50.9 million. We expect to make cash disbursements related to these accrued restructuring and other charges of approximately $17 million within the next twelve months. The remaining accruals of approximately $34 million primarily relate to excess facilities and are expected to be paid out through 2013.

Other Income (Expense), net

Other income (expense), net includes interest income, costs of hedging contracts, certain realized and unrealized foreign currency transaction gains or losses, charges incurred in connection with financing customer contracts and exchange gains or losses resulting from the required period-end currency remeasurement of the financial statements of our subsidiaries that use the U.S. dollar as their functional currency. A large portion of our revenue and expenses is transacted in foreign currencies. To reduce our exposure to fluctuations in foreign exchange

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rates, we routinely engage in hedging transactions involving the use of foreign currency forward contracts and, from time-to-time, foreign currency option contracts, primarily in the Euro and in Asian currencies. Other income (expense), net was $0.2 million and $(0.9) million in the second quarter of 2004 and 2003, respectively, and $(0.3) million and $(1.5) million in the first six months of 2004 and 2003, respectively. Other income, net was higher in 2004 compared to 2003 primarily due to lower charges in connection with financing customer contracts, which were $1.3 million in the first six months of 2004 compared to $2.4 million in the first six months of 2003.

Income Taxes

Our effective tax rate was 60% on pre-tax income of $8.0 million in the second quarter of 2004 compared to 49% on a pre-tax loss of $10.2 million in the second quarter of 2003 and was 72% on a pre-tax loss of $13.6 million in the first six months of 2004 and 30% on a pre-tax loss of $20.4 million in the first six months of 2003. The difference between the statutory federal income tax rate benefit of 35% and the effective tax rate provisions is due primarily to U.S. operating losses that could not be benefited and to income taxes payable in certain foreign jurisdictions. Due to the uncertainty regarding the realizability of deferred tax assets, we recorded in 2002 a full valuation allowance to completely offset our deferred tax assets (that are primarily related to operating loss carryforwards generated in recent years). The full valuation allowance was still recorded in the second quarters and first six months of 2004 and 2003.

In the normal course of business, PTC and its subsidiaries are examined by various taxing authorities, including the Internal Revenue Service (IRS) in the United States. In fiscal 2004, the IRS concluded its field examination of our income tax returns for fiscal years 1998 through 2000. Our case is currently undergoing a review by the Joint Committee on Taxation. Although the outcome of this review cannot be presently determined, we expect that it may reach a favorable conclusion within the next three to nine months. A favorable resolution would result in a reduction to our tax provision in the quarter of resolution and would result in a tax refund to us above amounts that are already anticipated. We do not expect that an unfavorable outcome would affect our tax provision or result in any reduction in refund amounts we have recorded as receivable.

At April 3, 2004, accrued income taxes of $11.3 million includes and is reflected net of expected refunds of U.S. federal income taxes and related interest of approximately $23 million.

Employees

The number of worldwide employees was 3,028 at April 3, 2004, compared to 3,787 at March 29, 2003. The decrease over the prior year is primarily a result of terminations associated with the reductions in workforce described above.

Critical Accounting Estimates

We have prepared our consolidated financial statements in accordance with accounting principles generally accepted in the United States. In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our reported revenues, results from operations, and net income (loss), as well as on the value of certain assets and liabilities on our balance sheet. These estimates, assumptions and judgments about future events and their effects on our results cannot be determined with certainty, and are made based on our historical experience and on other assumptions that are believed to be reasonable under the circumstances. These estimates may change as new events occur or additional information is obtained, and we may periodically be faced with uncertainties, the outcomes of which are not within our control and may not be known for a prolonged period of time. While there are a number of accounting policies, methods and estimates affecting our financial statements, described in Note A to the Consolidated Financial Statements included in our Form 10-K for the year ended September 30, 2003, the areas that are our most important critical accounting policies include revenue recognition, valuation of goodwill and intangible assets, accounting for income taxes, allowance for accounts and other receivables, transfers of financial assets and restructuring charges. These areas

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are described below. A critical accounting policy is one that is both material to the presentation of our financial statements and requires us to make difficult, subjective or complex judgments that could have a material effect on our financial condition and results of operations. They may require us to make assumptions about matters that are highly uncertain at the time of the estimate, and different estimates that we could have used, or changes in the estimate that are reasonably likely to occur, may have a material impact on our financial condition or results of operations. Because the use of estimates is inherent in the financial reporting process, actual results could differ from those estimates.

Revenue Recognition

We exercise judgment and use estimates in connection with the determination of the amounts of software license and services revenues to be recognized in each accounting period. Our primary judgments involve the following:

determining whether collection is probable;

assessing whether the fee is fixed or determinable;

determining whether service arrangements, including modifications and customizations of the underlying software, are not essential to the functionality of the licensed software and thus would qualify as “service transactions” under SOP 97-2, resulting in the revenue for license and service elements of an agreement to be recorded separately; and

determining the fair value of services and maintenance elements included in multiple element arrangements, which is the basis for allocating and deferring revenue for such services and maintenance.

We derive revenues from three primary sources: (1) software licenses, (2) maintenance services and (3) other services, which include consulting and education services. Revenue by type for the second quarter and first six months of 2004 and 2003 are as follows:

	Three months ended		Six months ended	
	April 3, 2004	March 29, 2003	April 3, 2004	March 29, 2003
	(in thousands)			
License revenue	$50,971	$55,284	$94,488	$106,761
Maintenance services revenue	79,607	76,036	157,982	156,607
Other services revenue	34,130	39,706	69,048	79,625
Total revenue	$164,708	$171,026	$321,518	$342,993

For software license arrangements that do not require significant modification or customization of the underlying software, we recognize revenue when: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred (generally, FOB shipping point or electronic distribution), (3) the fee is deemed fixed or determinable, and (4) collection is probable. Substantially all of our license revenues are recognized in this manner.

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At the time of each sale transaction, we must make an assessment of the collectibility of the amount due from the customer. Revenue is only recognized at that time if management deems that collection is probable. In making this assessment, we consider customer credit-worthiness and historical payment experience. At that same time, we assess whether fees are fixed or determinable and free of contingencies or significant uncertainties. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction and our collection experience in similar transactions without making concessions, among other factors. Our software license arrangements generally do not include customer acceptance provisions. However, if an arrangement includes an acceptance provision, we record revenue only upon the earlier of (1) receipt of a written acceptance or (2) expiration of the acceptance period.

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Our software arrangements often include implementation and consulting services that are sold separately under consulting engagement contracts or as part of the software license arrangement. When we determine that such services are not essential to the functionality of the licensed software and qualify as "service transactions" under SOP 97-2, we record revenue separately for the license and service elements of these arrangements. Generally, we consider that a service is not essential to the functionality of the software when the services may be provided by independent third parties experienced in providing such consulting and implementation in coordination with dedicated customer personnel. If an arrangement does not qualify for separate accounting of the license and service elements, then license revenue is recognized together with the consulting services using either the percentage-of-completion or completed-contract method of contract accounting. Contract accounting is also applied to any software arrangements that include customer-specific acceptance criteria or where the license payment is tied to the performance of consulting services. Under the percentage-of-completion method, we estimate the stage of completion of contracts with fixed or "not to exceed" fees based on hours or costs incurred to date as compared with estimated total project hours or costs at completion. If we do not have a sufficient basis to measure progress towards completion, revenue is recognized upon completion of the contract. When total cost estimates exceed revenues, we accrue for the estimated losses immediately. The use of the percentage-of-completion method of accounting requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the project, the nature and complexity of the work to be performed, and anticipated changes in salaries and other costs. When adjustments in estimated contract costs are determined, such revisions may have the effect of adjusting, in the current period, the earnings applicable to performance in prior periods.

We generally use the residual method to recognize revenues from arrangements that include one or more elements to be delivered at a future date, when evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements (e.g., maintenance, consulting and education services) based on vendor-specific objective evidence (VSOE) is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements (i.e., software license). If evidence of the fair value of one or more of the undelivered services does not exist, all revenues are deferred and recognized when delivery of all of those services has occurred or when fair values can be established. We determine VSOE of the fair value of services revenues based upon our recent pricing for those services when sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume, maintenance term and customer location. We review services revenues sold separately and maintenance renewal rates on a periodic basis and update, when appropriate, our VSOE of fair value for such services to ensure that it reflects our recent pricing experience.

Valuation of Goodwill and Other Intangible Assets

Our net goodwill and other intangible assets totaled $49.8 million and $51.9 million as of April 3, 2004 and September 30, 2003, respectively. We assess the impairment of goodwill and other identifiable indefinite lived intangible assets on at least an annual basis and whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Factors we consider important that could trigger an impairment review include significant underperformance relative to historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, a significant decline in our stock price for a sustained period, or a reduction of our market capitalization relative to net book value.

We adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* effective October 1, 2002 and, as a result, we no longer amortize goodwill and certain intangible assets with indefinite useful lives. The goodwill impairment test prescribed by SFAS No. 142 requires us to identify reporting units and to determine estimates of the fair values of our reporting units as of the date we test for impairment. We have two reporting units−our software products operating segment and our services operating segment−as described in Note 7 of "Notes to Consolidated Financial Statements." All goodwill is attributable to

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our software products operating segment. To conduct these tests of goodwill, the fair value of the reporting unit is compared to its carrying value. If the reporting unit' s carrying value exceeds its fair value, we record an impairment loss to the extent that the carrying value of goodwill exceeds its fair value. We estimate the fair values of our reporting units using discounted cash flow valuation models. Those models require estimates of future revenues, profits, capital expenditures and working capital for each unit. We estimate these amounts by evaluating historical trends, current budgets, operating plans and industry data. We completed the initial impairment review as of the beginning of fiscal 2003 and our annual impairment review as of the end of the third quarter of 2003 and concluded that, as of October 1, 2002 and June 28, 2003, no impairment charge was required. We plan to conduct our annual impairment test of goodwill and indefinite lived assets as of the end of the third quarter of each fiscal year. There can be no assurance that at the time subsequent impairment reviews are completed an impairment charge will not be recorded in light of the factors described above. If a charge were deemed necessary in the future, it would directly affect net income (loss) for the period in which the charge was taken.

For long-lived assets and identifiable intangible assets, other than goodwill and indefinite-lived intangible assets, we reassess the recoverability of the asset based on projected undiscounted future cash flows over the asset' s remaining life if an event occurs or circumstances change that would, more likely than not, reduce the fair value of the operating segment below its carrying value. When the carrying value of the asset exceeds its undiscounted cash flows, we record an impairment loss equal to the excess of the carrying value over the fair value of the asset. Determining the fair value of individual assets and goodwill includes significant judgment by management. Different judgments could yield different results.

Accounting for Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to calculate our income tax expense based on taxable income by jurisdiction. There are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of revenue-sharing and cost-reimbursement arrangements among related entities and the differing tax treatment of revenue and cost items across various jurisdictions.

The income tax accounting process also involves estimating our actual current tax liability, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that it is more likely than not that all or a portion of deferred tax assets will not be realized, we must establish a valuation allowance as a charge to income tax expense. As of April 3, 2004 and September 30, 2003, we have fully reserved for deferred tax assets, primarily related to net operating loss carryforwards. The decision to record the valuation allowance required significant management judgment. Had we not recorded this valuation allowance, we would have reported materially different results. If the realization of deferred tax assets in the future is considered more likely than not, a reduction in the valuation allowance would increase net income in the period such determination is made. Net deferred tax liabilities at April 3, 2004 were $0.5 million, comprised of deferred tax assets of $152.4 million, a valuation allowance of $131.5 million and deferred tax liabilities of $21.4 million. Our deferred tax assets consist primarily of net operating loss carryforwards.

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Allowance for Accounts and Other Receivables

Management judgment is required in assessing the collectability of customer accounts and other receivables, for which we generally do not require collateral. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. In determining the adequacy of the allowance for doubtful accounts, management specifically analyzes individual accounts receivable, historical bad debts, customer concentrations, customer credit-worthiness, current economic and accounts receivable aging trends and changes in our customer payment terms. The following table summarizes our accounts receivable and related reserve balances as of April 3, 2004 and September 30, 2003:

	April 3, 2004	September 30, 2003
	(in thousands)	
Gross accounts receivable	$161,368	$ 146,996
Allowance for doubtful accounts	(6,541)	(6,845)
Net accounts receivable	$154,827	$ 140,151
Accounts receivable reserves as a percentage of gross accounts receivable	4.1 %	4.7 %

If the financial condition of our customers were to deteriorate, additional allowances might be required, resulting in future operating expenses that are not included in the allowance for doubtful accounts. Concentration of credit risk with respect to trade receivables is not significant.

Transfers of Financial Assets

We offer our customers the option to purchase software and services through payment plans. In general, we transfer future payments under certain of these contracts to third-party financing institutions on a non-recourse basis. We record such transfers as sales of the related accounts receivable when we surrender control of such receivables under the provisions of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

Restructuring Charges

We periodically record restructuring charges resulting from restructuring our operations (including consolidations and/or relocations of operations), changes in our strategic plan, or managerial responses to declines in demand, increasing costs, or other environmental factors. The determination of restructuring charges requires management judgment and may include costs related to employee benefits, such as costs of severance and termination benefits, and costs for future lease commitments on excess facilities, net of estimated future sublease income. In determining the amount of the facilities charge, we are required to estimate such factors as future vacancy rates, the time required to sublet properties and sublease rates. These estimates will be reviewed and potentially revised quarterly based on known real estate market conditions and the credit worthiness of subtenants, and may result in revisions to established facility reserves. We have accrued $45.7 million as of April 3, 2004 related to excess facilities representing gross lease commitments, with agreements expiring at various dates through November 2012, of approximately $83.8 million, net of committed and estimated sublease income of approximately $36.2 million and $1.9 million of present value factor. We have entered into signed sublease arrangements for approximately $22.3 million, with the remaining $13.9 million based on

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future estimated sublease arrangements, including $11.4 million for space currently available for sublease. If our sublease assumptions prove to be inaccurate, we may need to make changes in these estimates that would affect our results of operations and potentially our financial condition.

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Accounting Changes

Accounting policies, guidelines and interpretations related to our Critical Accounting Policies are generally subject to numerous sources of authoritative guidance and are often reexamined by accounting standards rule makers and regulators. These rule makers and/or regulators may promulgate interpretations, guidance or regulations that may result in changes to our accounting policies, which could result in a material impact on our financial position and results of operations.

Liquidity and Capital Resources

	April 3, 2004	March 29, 2003
	(in thousands)	
Cash and cash equivalents	$221,665	$173,963
Investments	–	31,574
Total cash and investments	$221,665	$205,537
Amounts below are for the six months ended:		
Cash provided by operating activities	15,172	3,094
Cash used by investing activities	(5,692)	(13,302)
Cash provided by financing activities	4,771	3,905
Cash disbursements for restructuring and other charges	(28,733)	(5,388)

Our operating activities, the proceeds from our issuance of stock under stock plans and existing cash and investments provided sufficient resources to fund our employee base, capital asset needs, acquisitions and financing needs, in all periods presented.

As of April 3, 2004, cash and cash equivalents totaled $221.7 million, up from $205.3 million at September 30, 2003. We invest our cash with highly rated financial institutions and in diversified domestic and international money market mutual funds. The portfolio is primarily invested in short maturity investments to minimize interest rate risk and to ensure cash is available to meet requirements as needed. The increase in cash and cash equivalents during the first six months of 2004 consisted primarily of $15.2 million provided by operations (including payments toward restructuring and other charges) and $4.8 million provided by financing activities.

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Cash provided by operations was $15.2 million in the first six months of 2004, compared to $3.1 million in the first six months of 2003. Cash provided by operations in the first six months of 2003 included the receipt of a U.S. federal income tax refund of $48.2 million partially offset by the disbursement of $10.6 million for a cash contribution to a U.S. defined benefit pension plan. Cash provided by operations in the first six months of 2004 was primarily affected by improved operating performance and improved cash collections of seasonal annual customer maintenance contract renewals, partially offset by higher cash expenditures for restructuring and other charges in 2004 ($28.7 million, compared to $5.4 million in 2003).

Cash used by investing activities was $5.7 million in the first six months of 2004, compared to $13.3 million in the first six months of 2003, and was primarily for the acquisition of property and equipment and other intangible assets. Our expenditures for property and equipment consist primarily of computer equipment, software, office equipment and facility improvements. Financing activities provided cash of $4.8 million in the first six months of 2004 and $3.9 million in the first six months of 2003 from the issuance of common stock under our employee stock option plans. Through April 3, 2004, we had repurchased, at a cost of $366.8 million, a total of 31.2 million shares of the 40.0 million shares authorized by the Board of Directors to be repurchased under our repurchase program. There were no repurchases during the first six months of 2004 and 2003.

We lease office facilities and certain equipment under operating leases that expire at various dates through 2014, including an operating lease agreement related to our headquarters office in Needham, Massachusetts entered

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into in 2000, which expires in 2013, subject to certain renewal rights. These leases qualify for operating lease accounting treatment and, as such, are not included on our balance sheet. At September 30, 2003, our total contractual obligations, which include future minimum lease payments, net of sublease income, under noncancellable operating leases, pension obligations, and other purchase obligations was $286.3 million (less than one year, $60.0 million; one to three years, $76.6 million; three to five years, $54.3 million; and thereafter $95.4 million). Total contractual obligations have not changed significantly from September 30, 2003. For further information on these obligations, refer to Contractual Obligations on page 26 of our Form 10-K for the year ended September 30, 2003.

In April 2004, we acquired OHIO Design Automation, Inc., a provider of electronic design verification, visualization and collaboration solutions. The all-cash transaction closed on April 7, 2004 and was valued at approximately $12 million, $9.8 million of which was paid at the closing.

We believe that existing cash and cash equivalents, together with cash generated from operations, an expected refund of U.S. federal income taxes within the next three to nine months, and the issuance of common stock under our stock plans, will be sufficient to meet our working capital, financing and capital expenditure requirements through at least the next twelve months. Over the next four quarters, we expect to incur cash disbursements estimated at $17 million for restructuring and other charges incurred in the current and prior periods. Capital expenditures for 2004 are currently anticipated to continue at lower levels than fiscal 2003. Although we were profitable in the second quarter of 2004 after several quarters of operating losses, our cash position could be adversely affected if we are unable to sustain operating profitability.

New Accounting Pronouncements

In accordance with recently issued accounting pronouncements, we will be required to comply with certain changes in accounting rules and regulations. See Note 6 of "Notes to Consolidated Financial Statements" included herein.

Important Factors That May Affect Future Results

The following are some of the factors that could affect our future results. They should be considered in connection with evaluating forward-looking statements contained in this Quarterly Report on Form 10-Q and otherwise made by us or on our behalf, because these factors are among those that could cause actual results and conditions to differ materially from those projected in forward-looking statements.

I. Operational Considerations

Our operating results fluctuate within each quarter and from quarter-to-quarter making our future revenues and operating results difficult to predict

While our sales cycle varies substantially from customer to customer, we usually realize a high percentage of our revenue in the third month of each fiscal quarter, and this revenue tends to be concentrated in the later part of that month. Our orders early in a quarter will not generally occur at a rate which, if sustained throughout the quarter, would be sufficient to assure that we will meet our revenue targets for any particular quarter. Moreover, our transition from a one-product company to a multi-product company, our increased utilization of indirect distribution channels through alliances with resellers, systems integrators, and other strategic partners and our shift in business emphasis to a more solutions-oriented sales process have resulted in more unpredictable and often longer sales cycles for products and services. Accordingly, our quarterly results may be difficult to predict prior to the end of the quarter. Any inability to obtain large orders or orders in large volumes or to make shipments or perform services in the period immediately preceding the end of any particular quarter may cause

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the results for that quarter to fall short of our revenue targets. In addition, our operating expenses are based on expected future revenue and are largely fixed for the short term. As a result, a revenue shortfall in any quarter could cause our earnings for that quarter to fall below expectations as well. Any failure to meet our quarterly revenue or earnings targets could adversely impact the market price of our stock.

Other factors that may cause quarter-to-quarter revenue and earnings fluctuations or that may affect our ability to make quarter end shipments include the following:

our sales incentive structure is weighted more heavily toward the end of the fiscal year, and the revenue for the first quarter historically has been lower and more difficult to predict than that for the fourth quarter of the immediately preceding fiscal year;

variability in the levels of professional service revenues and the mix of our license and service revenues;

declines in license sales may adversely affect the size of our installed base and our level of service revenue;

our increased utilization of third parties, such as resellers, systems integrators, and other strategic partners, as distribution and delivery mechanisms for our software products and related services, which may lessen the control we have over revenue and earnings during any particular quarter;

the outsourcing of our software distribution operations to third party vendors may lesson our ability to undertake corrective measures or alternative operations in the event shipping systems or processes are interrupted or are hampered due to conditions beyond our or our vendor' s control at the end of any particular quarter; and

a significant portion of our revenue is in foreign currency and major shifts in foreign currency exchange rates could impact our reported revenue.

In addition, the levels of quarterly or annual software or service revenue in general, or for particular geographic areas, may not be comparable to those achieved in previous periods.

General economic and political conditions may impact our results

Our revenue growth and profitability depends on the overall demand for software and related services. This demand can be adversely affected by unfavorable economic conditions, as customers reduce or defer spending on information technology improvements. We may be especially prone to this as a result of the relatively large license transactions we have historically relied upon. Accordingly, general economic and business conditions may affect our future operating results. A softening demand for software caused by a prolonged slowdown of the economy would result in decreased revenue or lower revenue growth rates. If the recent unfavorable economic conditions continue, the economic slowdown has the potential to continue to materially and adversely affect us.

Political/social events in recent years, including the outbreak of Severe Acute Respiratory Syndrome and concerns regarding terrorism, continue to put further pressure on economic conditions both domestically and internationally. The potential turmoil that may result from such events contributes to the uncertainty of the economic climate, further reducing predictability and our ability to develop and implement long-term strategic plans. In light of the foregoing, the impact of these or future similar conditions may have a materially adverse impact on our business, operating results, and financial position.

Moreover, the uncertain economic conditions have hampered our ability to make measured predictions as to our business, reducing our ability to develop and implement long-term business strategies and models.

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We utilize third parties, such as resellers, systems integrators, and other strategic partners for the distribution and implementation of our software solutions, which makes it more difficult to manage the sales process

We have entered into relationships with groups of geographically dispersed resellers and systems integrators to promote, sell and implement our products, which can result in a reduction in our control over the sales process and the delivery of services to our customers. The successful utilization of third parties will depend on:

- our ability to enter into agreements with appropriate third parties that can deliver our products in appropriate markets;
- the third party' s ability to learn, promote and implement our products; and
- our ability to efficiently manage our sales channels, by effectively coordinating and managing joint activities (including sales, marketing, implementation, support and customer service).

We may not be able to implement new initiatives successfully

Part of our success in the past has resulted from our ability to implement new initiatives. Our future operating results will continue to depend upon:

- our successful implementation of a unified PLM product strategy, including the realignment of internal functions, the management of multiple development and distribution processes and effective mitigation of disruption that may result from organizational change;
- our ability to deliver an integrated and comprehensive suite of solutions and to capitalize on existing synergies by offering a comprehensive product development system;
- our ability to appropriately allocate and implement cost cutting measures, including transferring activities to lower cost regions, that increase profitability while maintaining adequate resources for effective and coordinated organizational performance;
- the success of our sales coverage reorganization and optimization initiatives, including:
  - the effectiveness of our organizational sales model,
  - the ability of our sales representatives to learn and sell our products, and
  - our ability to broaden and effectively utilize indirect distribution channels through alliances with resellers, systems integrators, and other strategic partners;
- our ability to anticipate and meet evolving customer requirements for PLM solutions and successfully deliver products and services at an enterprise level;
- our ability to develop rapidly implementable point solutions that adequately address specific business challenges;
- our ability to identify and penetrate additional industry sectors that represent growth opportunities; and
- our ability to execute on customer satisfaction initiatives and programs in order to retain our customer base and to develop customer references upon which we can expand that base.

We are dependent on key personnel whose loss could cause delays in our product development and sales efforts

Our success depends upon our ability to attract and retain highly skilled technical, managerial and sales personnel. Competition for such personnel in the high technology industry is intense. We assume that we will continue to be able to attract and retain such personnel. The failure to do so, however, could have a material adverse effect on our business.

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We must continually modify and enhance our products to keep pace with changing technology, and we may experience delays in developing and debugging our software

We must continually modify and enhance our products to keep pace with changes in computer software, hardware and database technology, as well as emerging Internet standards. We must also continually expend efforts to review and fix errors ("bugs") found in our current and upcoming software releases. Our ability to remain competitive will depend on our ability to:

enhance our current offerings and develop new products and services that keep pace with technological developments, and effectively undertake "debugging" efforts, through:

- internal research and development and quality assurance programs,
- acquisition of technology, and
- strategic partnerships;

meet evolving customer requirements, especially ease-of-use;

provide adequate funding for development efforts in the face of a challenging economic climate; and

license appropriate technology from third parties for inclusion in our products.

Also, as is common in the computer software industry, we may from time to time experience delays in our product development and "debugging" efforts. Our performance could be hurt by significant delays in developing, completing or shipping new or enhanced products. Moreover, if significant bugs were found in our software products, we may be impacted by negative customer reaction and could experience delays in our new product development efforts, as development resources may need to be shifted toward our debugging efforts. Among other things, such delays could cause us to incorrectly predict the fiscal quarter in which we will realize revenue from the shipment of the new or enhanced products and give our competitors a greater opportunity to market competing products.

We may be unable to price our products competitively or distribute them effectively

Our success is tied to our ability to price our products and services competitively and to deliver them efficiently, including our ability to:

provide a range of products with functionality that our customers want at prices they can afford;

build appropriate direct distribution channels;

utilize the Internet for distribution; and

build appropriate indirect distribution channels.

We may be adversely affected by a decline in demand for PLM solutions

We currently derive our license and service revenues from a group of related PLM software products and services and we expect this to continue into the future. As a result, factors affecting the demand for PLM software solutions or pricing pressures on this single category could have a material adverse effect on our financial condition and results of operations.

We depend on sales within the discrete manufacturing market

A large amount of our revenues are related to sales to customers in the discrete manufacturing sector. A decline in spending in this sector could have a material adverse effect on our financial condition and results of operations.

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We depend on sales from outside the United States that could be adversely affected by changes in the international markets

A significant portion of our business comes from outside the United States. Accordingly, our performance could be adversely affected by economic downturns in Europe or the Asia/Pacific region. Another consequence of significant international business is that a large percentage of our revenues and expenses are denominated in foreign currencies that fluctuate in value. Although we may enter into foreign exchange forward contracts and foreign exchange option contracts to offset a portion of the foreign exchange fluctuations, unanticipated events may have a material impact on our results. Other risks associated with international business include:

changes in regulatory practices and tariffs;

staffing and managing foreign operations, including the difficulties in providing cost-effective, equity based compensation to attract skilled workers;

longer collection cycles in certain areas;

potential changes in tax and other laws;

greater difficulty in protecting intellectual property rights; and

general economic and political conditions.

We may not be able to obtain copyright or patent protection for the software products we develop or our other trademarks

Our software products and our other trademarks, including our company names, product names and logos, are proprietary. We protect our intellectual property rights in these items by relying on copyrights, trademarks, patents and common law safeguards, including trade secret protection, as well as restrictions on disclosures and transferability contained in our agreements with other parties. Despite these measures, there can be no assurance that the laws of all relevant jurisdictions will afford adequate protection to our products and other intellectual property. The software industry is characterized by frequent litigation regarding copyright, patent and other intellectual property rights. While we have not, to date, had any significant claims of this type asserted against us, there can be no assurance that someone will not assert such claims against us with respect to existing or future products or other intellectual property or that, if asserted, we would prevail in such claims. In the event a lawsuit of this type is filed, it could result in significant expense to us and divert the efforts of our technical and management personnel, whether or not we ultimately prevail. Certain of our products also contain technology developed and licensed from third parties. We may likewise be susceptible to infringement claims with respect to these third party technologies.

II. Design Solutions Related Considerations

Increasing competition in the computer aided design marketplace may reduce our revenues

There are an increasing number of competitive design products. Some competitive products have reached a level of functionality whereby product differentiation is less likely, in and of itself, to dislodge incumbent design systems, given the training, data conversion, and other startup costs associated with system replacement. We recently have introduced the next major release of our design solutions, Pro/ENGINEER Wildfire, which focuses on PLM interoperability and ease-of-use. Although Pro/ENGINEER Wildfire and other initiatives are designed to address these competitive pressures, increased competition and further market acceptance of competitive products could have a negative effect on pricing and revenue for our products, which could have a material adverse affect on our results.

In addition, our design software is capable of performing on a variety of platforms. Several of our competitors focus on single platform applications, particularly Windows-based platforms. There can be no assurance that we will have a competitive advantage with multiple platform applications.

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We continue to enhance our existing product line by releasing updates as well as new products/modules. Our competitive position and operating results could suffer if:

- we fail to anticipate or to respond adequately to customer requirements or to technological developments, particularly those of our competitors;
- we delay the development, production, testing, marketing or availability of new or enhanced products or services;
- customers fail to accept such new or enhanced products or services; or
- we fail to execute our integrated product strategy initiative.

Growth in the computer aided design solutions industry has slowed

Growth in certain segments of the computer aided design solutions industry has slowed and, coupled with decreased functional differentiation among flexible engineering tools, may adversely affect our ability to penetrate the market for new customers and recapture our market share. Over the long term, we believe our emphasis on PLM solutions will allow us to differentiate our design solutions from the competition and stabilize sales of our design solutions products while we seek to increase sales of our collaboration and control solutions. However, the strategy may not be successful or may take longer than we plan. There could be a material adverse affect on our operating results in any quarter if these assumptions prove to be incorrect.

III. Collaboration and Control Solutions and Overall PLM Related Considerations

We are attempting to capitalize on a market opportunity known as Product Lifecycle Management (PLM). It may be that our assumptions about this market opportunity are wrong, which could adversely affect our results

We have identified PLM as a new market opportunity for us, and have devoted significant resources toward capitalizing on that opportunity. Our collaboration and control solutions, together with our design solutions, allow us to offer a suite of PLM solutions and related services targeted at this market. This suite includes software and services that utilize Internet technologies to permit our customers' employees, suppliers and customers to collaboratively develop, build, distribute and manage products throughout their entire lifecycle. Because the market for software products that allow companies to collaborate on product information on an enterprise-wide level is newly emerging and because companies have not traditionally linked customers and suppliers in this process directly, we cannot be certain as to the size of this market, whether it will grow, or whether companies will elect to utilize our products rather than attempt to develop applications internally, acquire them from other sources or to forego PLM initiatives altogether.

In addition, companies that have already invested substantial resources in other methods of sharing product information in the design-through-manufacture process may be reluctant to adopt a new approach that may replace, limit or compete with their existing systems or methods. We expect that we will continue to need to educate prospective customers about the uses and benefits of our products. Demand for and market acceptance of our products will be affected by the success of those efforts.

Our Windchill technology, which is central to our PLM strategy, is not yet well established in the marketplace

The success of our PLM strategy will depend in large part on the ability of our Windchill-based solutions to meet customer expectations, especially with respect to:

- measuring and understanding the benefits of our Windchill solutions, including return on investment and value creation;
- ease and rapidity of installation;
- ease of use;

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- full capability, functionality and performance;
- ability to support a large, diverse and geographically dispersed user base; and
- quality and efficiency of the services we and our partners perform relating to implementation and configuration.

The software is still relatively new. If our customers cannot successfully deploy large-scale implementation projects or if they determine that we or our partners are unable to accommodate large-scale deployments, our operating results may be affected.

Our PLM point solutions strategy is developing

We are pursuing a strategy to provide a series of easily deployable PLM solutions that address specific business challenges that arise at points along the product lifecycle timeline (our Windchill Link solutions). These Windchill Link solutions utilize our web-based Windchill architecture as well as components of our design solutions. By offering pre-configured, fully integrated applications that can be implemented quickly, our strategy is designed both to solve customers' problems relating to costly, large-scale implementation projects and to provide customers with the ability to deploy a product development system that meets their evolving requirements. If we are unable to provide these solutions or are unable to meet customer expectations, our overall revenue may be adversely affected.

Our Windchill Link point solutions, as well as our utilization of third party service providers, may crowd out service revenue

Our introduction of our Windchill Link point solutions, which provide customers more autonomy over solving their problems, and our partnerships with third party service providers that provide implementation services directly to customers, may have an adverse affect on our service revenue. We believe that entering into these relationships and offering these solutions will best serve to expand the coverage of our PLM software solutions, generate additional license revenue and provide the necessary expertise for their implementation and support. If these assumptions prove to be inaccurate or if projected additional license revenue and/or broader market coverage does not materialize, our revenues may be adversely affected.

PLM software solutions must meet our customers' expectations for integration with existing systems to generate references for new accounts

Our PLM software must integrate with our customers' and their partners' existing computer systems and software programs. Ours is one of the first PLM solutions, and thus many customers will be facing these integration issues for the first time, particularly in the context of collaborating with customers, supply chain partners and other members of the extended enterprise. Our customers could become dissatisfied with our products or services if systems integration proves to be difficult, costly or time consuming, and thus our operating results may be adversely affected. Moreover, due to the emerging nature of the industry and technology, the sales process relies in large part on customer references. Accordingly, if our customers become dissatisfied, future business and revenues may be adversely affected.

Competition may increase, which may reduce our profits and limit or reduce our market share

The market for our PLM software solutions is new, highly fragmented, rapidly changing and increasingly competitive. We expect competition to intensify, which could result in price reductions for our products and services, reduced gross margins and loss of market share. Our primary competition comes from:

- larger, more well-known enterprise software providers who may seek to extend the functionality of their products to encompass PLM or who may develop and/or purchase PLM technology; and
- other vendors of engineering information management software.

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In addition, our services organization may face increasing competition for follow-on consulting, implementation and education services from other third-party consultants and service providers, including those of larger, better known consulting firms that exert considerable influence within portions of our customer base.

To overcome the influence of larger enterprise software and consulting firms within our customer base, we must successfully demonstrate the technological superiority of our offerings as well as customer return on investment.

If the Internet does not continue to develop or reliably support the demands placed on it by electronic commerce, we may experience a loss of sales

Our success depends upon continued growth in the use of the Internet as a medium of collaboration and commerce. The use of the Internet for collaboration and commerce is still relatively new. As a result, a sufficiently broad base of companies and their supply chain may not adopt or continue to use the Internet as a medium of exchanging product information. Our PLM strategy would be seriously harmed if:

- the infrastructure for the Internet does not efficiently support enterprises and their supply chain partners; or
- concerns over the secure transmission of confidential information over public networks inhibit the growth of the Internet as a means of collaborating across enterprises and/or conducting commercial transactions.

Our PLM strategy will also be seriously harmed if the Internet infrastructure is not able to support the demands placed on it by increased usage or the limited capacity of networks to transmit large amounts of data, or if delays in the development or adoption of new equipment standards or protocols required to handle increased levels of Internet activity, or increased governmental regulation, cause the Internet to lose its viability as a means of communication between manufacturers and their customers and supply chain partners.

IV. Other Considerations

Our stock price has been highly volatile; this may make it harder to resell your shares at the time and at a price that is favorable to you

Market prices for securities of software companies have generally been volatile. In particular, the market price of these stocks has been and may continue to be subject to significant fluctuations unrelated or disproportionate to the operating performance of these companies. The trading prices and valuations of these stocks, and of ours, may not be predictable. Negative changes in the public’ s perception of the prospects of software companies, or of PTC, could depress our stock price regardless of our results.

Also, traditionally, a large percentage of our common stock has been held by institutional investors. Purchases and sales of our common stock by certain of these institutional investors could have a significant impact on the market price of the stock. For more information, please see our proxy statement with respect to our most recent annual meeting of stockholders and Schedules 13D and 13G filed with the SEC with respect to our common stock.

Short-term liquidity

Although we were profitable in the second quarter of 2004 after several quarters of operating losses, our liquidity position may be adversely affected if we are unable to sustain operating profitability, which may lead to a diminished ability to implement strategic initiatives and/or make investments in our operational infrastructure.

We are currently defending two lawsuits in which we could be liable for damages

We are currently defending two lawsuits as described in Part II, Item 1: “Legal Proceedings.” We believe the claims in each of these matters are without merit, and we intend to defend them vigorously. We cannot predict the ultimate resolution of these actions at this time, and there can be no assurance that these actions will not have a material adverse impact on our financial condition or results of operations.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Other than as disclosed in this report on Form 10-Q, there have been no significant changes in our market risk exposure as described in Item 7A: "Quantitative and Qualitative Disclosures About Market Risk" to our 2003 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures*. Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report. Based on this evaluation, our principal executive officer and principal financial officer concluded that these disclosure controls and procedures are effective and designed to ensure that the information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the requisite time periods.

(b) *Changes in Internal Control Over Financial Reporting.* There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the evaluation of our internal control that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II–OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are currently defending a class action lawsuit claiming violations of the federal securities laws based on alleged misrepresentations regarding our reported financial results for the fiscal years 1999, 2000 and 2001 and revisions to our announced results for 2002. The case is pending in the U.S. District Court for the District of Massachusetts. The consolidated amended complaint was filed on September 15, 2003 and seeks unspecified damages. We have filed a motion to dismiss the consolidated action and the court held a hearing on our motion on April 28, 2004. The motion currently is under consideration by the court. We believe the claims are without merit, and we intend to defend them vigorously. We cannot predict the ultimate resolution of this action at this time, and there can be no assurance that this action will not have a material adverse impact on our financial condition or results of operations.

On May 30, 2003, a lawsuit was filed against us in the U.S. District Court for the District of Massachusetts by Rand A Technology Corporation and Rand Technologies Limited (collectively "Rand"). Rand historically had been our largest distributor. The complaint alleges various breaches of a revised distribution agreement entered into in December 2002, as well as other agreements between Rand and us, and also asserts certain non-contract claims. The complaint, as amended, seeks equitable relief and substantial damages. On November 24, 2003, we filed our substantive response to Rand' s complaint and asserted counterclaims against Rand including, among other things, that Rand' s action in filing the lawsuit constituted a breach of the December 2002 agreement, which established certain dispute resolution procedures and which, we believe, discharged any and all claims arising prior to that date. We believe Rand' s claims are without merit and will continue to contest them vigorously. We also intend diligently to prosecute our counterclaims. We cannot predict the ultimate resolution of this action at this time, and there can be no assurance that this action will not have a material adverse impact on our financial condition or results of operations.

We also are subject to various legal proceedings and claims that arise in the ordinary course of business. We currently believe that resolving these other matters will not have a material adverse impact on our financial condition or results of operations.

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

At the Annual Meeting of Stockholders of the Company held on March 3, 2004, the stockholders of the Company:

(i) elected Noel G. Posternak and Michael E. Porter as Class II directors of the Company to hold office until the 2007 Annual Meeting (subject to the election and qualification of their successors and to their earlier death, resignation or removal); (ii) approved an increase in the number of shares of our common stock issuable under our 2000 Employee Stock Purchase Plan ("2000 ESPP"); and (iii) confirmed the selection by the Board of Directors of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ended September 30, 2004. The votes were as follows:

	Votes For	Votes Withheld or Opposed
Election of Directors:		
Michael E. Porter	220,459,945	12,834,046
Noel G. Posternak	201,689,769	31,604,222

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	Votes For	Votes Against	Votes Abstaining
Approve an increase in the number of shares issuable under the 2000 ESPP by 8,000,000 shares:	173,281,096	14,585,206	1,481,850

	Votes For	Votes Against	Votes Abstaining
Confirmation of independent auditors:			
PricewaterhouseCoopers	196,685,446	22,301,856	14,306,688

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1*	Form of Executive Agreement with certain Executive Officers, together with schedule identifying each executive officer.
31.1	Certification of the Chief Executive Officer Pursuant to Exchange Act Rules 13(a)-14(a) and 15d-14(a).
31.2	Certification of the Chief Financial Officer Pursuant to Exchange Act Rules 13(a)-14(a) and 15d-14(a).
32 **	Certification of Periodic Financial Report Pursuant to 18 U.S.C. Section 1350.

* Identifies a management contract or compensatory plan or arrangement in which an executive officer or director of PTC participates.

** Indicates that the exhibit is being furnished with this report and is not filed as a part of it.

(b) Reports on Form 8-K

Report Date	Description of Matters Disclosed in Form 8-K
January 21, 2004**	Form 8-K furnishing to the SEC, under Item 12, our press release issued on January 21, 2004 announcing results for the fiscal quarter ended January 3, 2004.
January 29, 2004	Form 8-K disclosing that two executive officers had entered into Securities and Exchange Commission Rule 10b5-1 Trading Plans.

** The inclusion in this Quarterly Report on Form 10-Q of the description of the above Form 8-K, by which we furnished a certain press release to the SEC, is for informational purposes only. Accordingly, such press release shall not be deemed "filed" for the purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section.

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SIGNATURE

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 hereunto duly authorized.

PARAMETRIC TECHNOLOGY CORPORATION

By:

/s/ CORNELIUS F. MOSES, III

Cornelius F. Moses, III
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: May 18, 2004

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EXHIBIT 10.1

FORM OF EXECUTIVE AGREEMENT

The following Executive Agreement has been entered into with the following officers effective as of the dates indicated opposite their name:

Executive Officer	Effective Date	Expiration Date
Barry F. Cohen Executive Vice President, Strategic Services and partners	January 21, 2003	February 25, 2006
Paul J. Cunningham Executive Vice President, Worldwide Sales	January 21, 2003	February 25, 2006
Anthony DiBona Executive Vice President, Maintenance	March 3, 2004	March 3, 2007
James E. Heppelmann Executive Vice President and Chief Product Officer	January 21, 2003	February 25, 2006
Cornelius F. Moses Executive Vice president and Chief Financial Officer	June 24, 2003	February 25, 2006
Aaron C. von Staats Senior Vice President, General Counsel & Clerk	March 3, 2004	March 3, 2007

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EXECUTIVE AGREEMENT

This Agreement is entered into as of the day of , between Parametric Technology Corporation, a Massachusetts corporation (the "Company"), and [Executive], [Address] (the "Executive").

WHEREAS, the Executive is the [Executive Title] of the Company; and

WHEREAS, to provide incentive for the Executive to remain with the Company, the Company desires to make the following arrangements with the Executive concerning certain payments and benefits to be provided to the Executive in the event of the termination of his employment without cause or in the event of certain other events specified herein;

NOW, THEREFORE, the Company and the Executive hereby agree as follows:

1. *Termination Notice*. The Company agrees that it may not terminate the employment of the Executive unless (i) it does so for Cause (as defined below) or (ii) the Company has delivered to the Executive a written notice of such termination of employment (the "Termination Notice") at least twelve (12) months in advance of the effective date thereof. The duties of the Executive during the period from the date of delivery of a Termination Notice until the termination of his employment shall be as determined by the Board of Directors.

2. *Salary and Benefits.*

(a) During the period from the date of delivery of a Termination Notice (the "Notice Date") until the earlier of (i) the date twelve (12) months after the Notice Date, or (ii) the date the Executive commences employment with another company or organization, it being agreed that the Executive shall immediately notify the Company of such event (the "Severance Period"), and so long as the Executive is in compliance with the terms of this Agreement and any material provision of any other written agreement with the Company, the Company shall (A) pay to the Executive, per normal payroll practice, a salary (the "Severance Period Salary") at a rate equal, on an annualized basis, to the highest annual salary (excluding any bonuses) in effect with respect to the Executive during the six month period immediately preceding the Termination Notice and (B) provide the Executive with employee benefits, including health insurance, dental insurance, life insurance, participation in the Company' s 401(k) plan and Employee Stock Purchase Plan and short-term and long-term disability coverage, pursuant to the same terms and conditions under which the Company makes such benefits available to employees generally, all subject to the terms and conditions of the respective plans and applicable law (collectively, the "Severance Period Benefits").

(b) In the event that (i) there is a Change in Control (as defined below) of the Company and (ii) within twelve (12) months thereafter, a Change in Status (as defined below) of the Executive occurs, and so long as the Executive is in compliance with the terms of this Agreement and any material provision of any other written agreement with the Company, the Company shall pay the Severance Period Salary and provide the Severance Period Benefits to the Executive during the period from the effective date of the Change in Status until the earlier of (i) the date twelve (12) months after such date or (ii) the date the Executive commences employment with another company or organization, it being agreed that the Executive shall immediately notify the Company of such event. Such compensation and benefits, and those provided under Section 3, shall be in lieu of any other compensation and benefits to the Executive with respect to any continuing employment during such period, and the Company shall have no obligation to make any payments or provide any benefits to the Executive under Section 2(a) above.

3. *Stock Options and Other Equity Awards*. Effective upon a Change in Control, (i) all outstanding stock options and stock appreciation rights ("SARs") granted under any Stock Plan (as defined below) held by Executive shall immediately become exercisable in full, (ii) all restrictions applicable to restricted stock held by Executive under any Stock Plan shall immediately lapse, and (iii) all other criteria for vesting of any award granted under any Stock Plan and held by Executive shall be deemed to have been met, notwithstanding any

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vesting schedule or other provisions to the contrary in the agreements evidencing such stock options, SARs, restricted stock or other award. The Company and Executive hereby agree that such agreements are hereby and will be deemed amended to give effect to this provision.

4. *Definitions.*

(a) The Company shall be deemed to have terminated the Executive' s employment for "Cause" if it does so (i) for the Executive' s willful and continued failure to substantially perform his duties to the Company (other than any such failure resulting from the Employee' s incapacity due to physical or mental illness or any such actual or anticipated failure after a Change in Status of the Executive), provided that the Company has delivered a written demand for substantial performance to the Executive specifically identifying the manner in which the Company believes that the Executive has not substantially performed his duties, and that the Executive has not cured such failure within 30 days after such demand, (ii) for willful conduct by the Executive which is demonstrably and materially injurious to the Company, (iii) because the Executive has been convicted of, or has pled guilty or nolo contendere to, a felony or (iv) for the Executive' s willful violation of any material provision of any confidentiality, nondisclosure, assignment of invention, noncompetition or similar agreement entered into by the Executive in connection with his employment by the Company. For purposes of this paragraph, no act or failure to act on the Executive' s part shall be deemed "willful" unless done or omitted to be done by the Executive not in good faith and without reasonable belief that his action or omission was in the best interests of the Company.

(b) A "Change in Control" of the Company shall mean the occurrence of any of the following events: (i) any "person", as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") (other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportion as their ownership of stock in the Company) is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 50% or more of the combined voting power of the Company' s then outstanding securities (other than as a result of acquisitions of such securities from the Company); (ii) individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company' s stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board (other than an election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of the Company) shall be, for purposes of this Agreement, considered to be a member of the Incumbent Board; (iii) the consummation of a merger, share exchange or consolidation of the Company or any subsidiary of the Company with any other corporation (each a "Business Combination"), other than (A) a Business Combination that would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of another entity) beneficial ownership, directly or indirectly, of a majority of the combined voting power of the Company or the surviving entity (including any person that, as a result of such transaction, owns all or substantially all of the Company' s assets either directly or through one or more subsidiaries) outstanding immediately after such Business Combination or (B) a merger, share exchange or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no "person" (as defined above) is or becomes the beneficial owner of 50% or more of the combined voting power of the Company' s then outstanding securities; or (iv) the stockholders of the Company approve (A) a plan of complete liquidation of the Company; or (B) an agreement for the sale or disposition by the Company of all or substantially all of the Company' s assets but excluding a sale or spin-off of a product line, business unit or line of business of the Company if the remaining business is significant as determined by the Company' s board of directors in its sole discretion.

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(c) A “Change in Status” of the Executive shall mean the occurrence, without the Executive’ s written consent and without Cause, of any of the following circumstances (unless such circumstances constitute an isolated, insubstantial and inadvertent action not taken in bad faith and are fully remedied by the Company within 30 days after receipt of notice thereof by the Executive): (i) any diminution or change in a manner adverse to the Executive of (A) his title, office or position with the Company, (B) his salary or other benefits (other than diminutions that are made generally with respect to substantially all executives of similar rank), or (C) his duties, responsibilities or employment condition, (ii) the Company’ s requiring the Executive (without his consent) to be based at any office or location more than fifty (50) miles from the location of his principal office on the date of this Agreement, or (iii) the failure by the Company to pay to the Executive any portion of his compensation within ninety (90) days after such compensation is due.

(d) A “Stock Plan” of the Company shall mean any stock option or equity compensation plan of the Company in effect at any time, including without limitation the 1987 Incentive Stock Option Plan, the 1997 Incentive Stock Option Plan, the 1997 Nonqualified Stock Option Plan and the 2000 Equity Incentive Plan.

5. *Taxes*.

(a) *Withholding*. All payments to be made to the Executive under this Agreement will be subject to any required withholding of federal, state and local income and employment taxes.

(b) *Payment Limitation*. Notwithstanding anything in this Agreement to the contrary, if the Company determines, based on the opinion of its independent accountants serving as such immediately prior to the Change in Control (the “Accounting Firm”), that any of the payments provided for in this Agreement, together with any other payments that must be included in such determination, would constitute an “Excess Parachute Payment” (as defined in Section 280G (or any successor provision thereof) of the Internal Revenue Code of 1986, as amended (the “Code”), and proposed and final regulations thereunder), the payments pursuant to this Agreement shall be reduced to the maximum amount that would permit a determination that the Executive has not received an Excess Parachute Payment (the “Maximum Amount”) unless the after-tax amount payable to the Executive hereunder without regard to the foregoing limitation (“Uncapped After-Tax Amount,” as defined below) exceeds the after-tax amount payable to the Executive with regard to such limitation (“Capped After-Tax Amount,” as defined below) by 10% or more. Any such determination or reduction in amounts payable pursuant to this Agreement shall be made in accordance with the following provisions.

(i) For purposes of determining whether the amounts payable to the Executive pursuant to this Agreement shall be reduced to the Maximum Amount, the following terms shall have the meaning indicated.

(A) The “Uncapped After-Tax Amount” shall be equal to the sum of the amounts payable pursuant to this Agreement (without regard to this paragraph 5(b)) and pursuant to all benefit and compensation plans and arrangements that must, pursuant to the Code, be included in determining whether an Excess Parachute Payment has been made, less the Income Tax Amount on such sum and the 20% excise tax under Section 4999 of the Code that would be due on all Excess Parachute Payments.

(B) The “Capped After-Tax Amount” shall be equal to the sum of the Maximum Amount and all amounts payable pursuant to all benefit and compensation plans and arrangements that must, pursuant to the Code, be included in determining whether an Excess Parachute Payment has been made, less the Income Tax Amount on such sum.

(C) The “Income Tax Amount” shall be equal to the amount of federal, state and local income taxes and the Executive’ s share of Federal Insurance Contributions Act taxes that would be due on a payment (after taking into account the deductibility of state and local income taxes for federal income tax purposes) if the highest marginal federal, state and local income tax rate in effect at the time of the Change in Control were imposed on the value of the payments, assuming

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that the amounts payable pursuant to this Agreement and all benefit and compensation plans and arrangements shall be treated as paid in full on the date of the Change in Control.

(ii) If the Accounting Firm determines that payments pursuant to this Agreement should be reduced to the Maximum Amount, the Company shall promptly give the Executive notice to that effect and a copy of the detailed calculation thereof, and the Executive may then elect, in his sole discretion, which and how much of the payments shall be eliminated or reduced (as long as, after such election, the present value of the aggregate payments equals the Maximum Amount), and shall advise the Company in writing of his election within 10 days of his receipt of notice. If no such election is made by the Executive within such period, the Company may elect which and how much of the payments shall be eliminated or reduced (as long as, after such election, the present value of the aggregate payments equals the Maximum Amount) and shall notify the Executive promptly of such election. All determinations made by the Accounting Firm under this paragraph 5 shall be (i) based upon Sections 280G and 4999 of the Code (or successor provisions thereof) and on proposed or final regulations for applying those Code sections, or on substantial authority within the meaning of Section 6662 of the Code, (ii) binding upon the Company and the Executive and (iii) made within 60 days of the Notice Date. As promptly as practicable following such determination, the Company shall pay to or distribute for the Executive' s benefit such payments as are then due to the Executive under this Agreement and shall promptly pay to or distribute for the Executive' s benefit in the future such payments as become due to the Executive under this Agreement.

(iii) As a result of possible uncertainty in the application of Section 280G of the Code at the time of the determinations by the Accounting Firm hereunder, amounts may be paid that should not be paid ("Overpayment"), or additional amounts may not be paid that could be paid ("Underpayment"), in each case, consistent with the calculations required to be made hereunder. In the event that the Internal Revenue Service asserts a deficiency against the Executive or the Company in such a case and the Accounting Firm determines that an Overpayment has been made, the Executive shall reimburse the Company the amount of such Overpayment together with interest at the applicable federal rate under Section 7872(f)(2)(B) of the Code within 60 days (or such shorter period as may be required by law) after receipt by the Executive of written notice of such determination by the Accounting Firm, including the amount of the Overpayment and interest calculation; provided, however that no such amount shall be payable by the Executive to the Company if and to the extent such reimbursement is prohibited by applicable law or would not eliminate either the excise tax under Section 4999 of the Code or the disallowance of the deduction under Section 280G(a) of the Code, for the amounts previously paid to the Executive. In the event that the Accounting Firm determines that an Underpayment has been made, the Company shall promptly pay such Underpayment to the Executive, together with interest at the applicable federal rate provided for in Section 7872(f)(2)(B) of the Code.

6. *Term*. This Agreement shall continue in effect until , unless extended by the mutual written consent of the Company and the Executive.

7. *Successor*.

(a) This Agreement is personal to the Executive and without the prior written consent of the Company shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used in this Agreement, "Company" shall mean the Company as defined above and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement.

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8. *Miscellaneous.*

(a) This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Massachusetts, without reference to principles of conflict of laws.

(b) This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives.

(c) This Agreement constitutes the entire understanding and agreement between the parties hereto with regard to the compensation and benefits payable to the Executive in the circumstances described herein, superseding all prior understandings and agreements, whether oral or written.

(d) The Company agrees to pay as incurred and within 20 days after submission of supporting documentation, to the full extent permitted by law, all legal fees and expenses the Executive may reasonably incur as a result of any contest (regardless of the outcome thereof) by the Company, the Executive or others of the validity or enforceability of, or liability under, any provision of this Agreement (including as a result of any contest by the Executive about the amount of any payment pursuant to this Agreement), but not more than an aggregate of $50,000, in the event the Company prevails thereon plus in each case interest on any delayed payment at the applicable Federal rate provided for in Section 7872(f)(2)(A) of the Code.

(e) All notices and other communications hereunder shall be delivered by hand delivery, by a reputable overnight courier service, or by registered or certified mail, return receipt requested, postage prepaid, in each case addressed as follows:

If to the Company:

Parametric Technology Corporation

140 Kendrick Street

Needham, MA 02494

Attention: General Counsel

If to the Executive:

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Any notice or communication shall be deemed to be delivered upon the date of hand delivery, one day following delivery to an overnight courier service, or three days following mailing by registered or certified mail.

EXECUTED as of the date first written above.

PARAMETRIC TECHNOLOGY CORPORATION

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By: ______________________________

Title:

____

Name:

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EXHIBIT 31.1

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, C. Richard Harrison, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Parametric Technology Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: May 18, 2004

/s/ C. RICHARD HARRISON

C. Richard Harrison
Chief Executive Officer

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CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Cornelius F. Moses, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Parametric Technology Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: May 18, 2004

/s/ CORNELIUS F. MOSES, III

Cornelius F. Moses, III
Executive Vice President and Chief Financial Officer

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EXHIBIT 32

Parametric Technology Corporation

Certification of Periodic Financial Report
Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Parametric Technology Corporation (the "Company") certifies that, to his knowledge, the Quarterly Report on Form 10-Q of the Company for the quarter ended April 3, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in that Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 18, 2004

/s/ C. RICHARD HARRISON

C. Richard Harrison
Chief Executive Officer

Date: May 18, 2004

/s/ CORNELIUS F. MOSES, III

Cornelius F. Moses, III
Executive Vice President and Chief Financial Officer

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